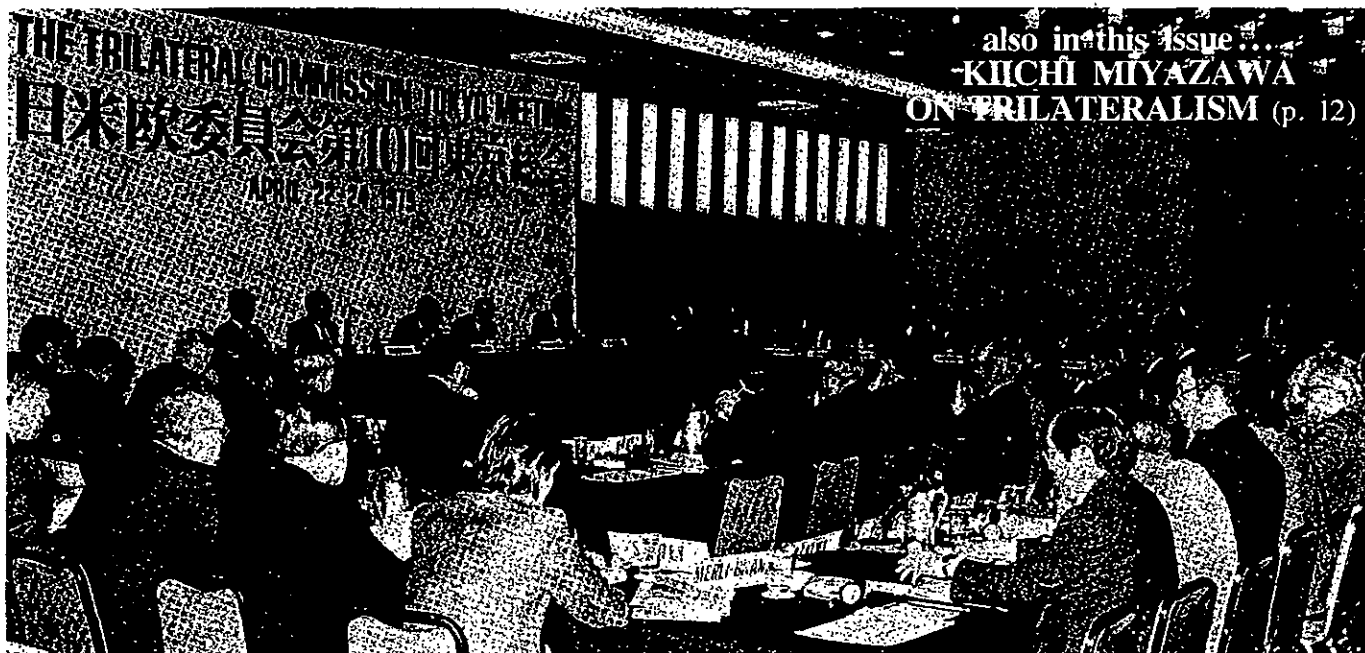


Trialogue

10th TRILATERAL MEETING

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Trilateral Commission's 10th plenary conference opens in Tokyo under the chairmanship of Takeshi Watanabe, the Commission's Japanese Chairman.

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I

PAYMENTS IMBALANCES AND INTERNATIONAL FINANCIAL STABILITY

The draft report presented in Tokyo by the Trilateral Task Force on Payments Imbalances analyzes the extreme payments imbalances which have marked the world economy throughout the 1970s and offers a series of broad policy recommendations for the trilateral countries to reduce payments imbalances and maintain the stability of the international financial system. The report was prepared by Masao Fujioka, Executive Director of the Export-Import Bank of Japan; Alexandre Lamfalussy, Economic Adviser and Head of the Monetary and Economic Department of the Bank for International Settlements; and Bruce K. MacLaury, President and Chief Executive Officer of the Brookings Institution.*

Outlining in their introductory remarks the principal sections of the report, the authors noted in particular that:

- With regard to industrial country imbalances, diverse policy reactions to the oil shock and the protracted recession that ensued are an important part of the background to current imbalances, and the conventional adjustment processes—exchange rate changes and demand management policies—have achieved only mixed success. The floating exchange rate system, which appeared in the early 1970s, has not acted as well as expected to correct persistent imbalances and avoid payments crises. The authors welcomed the potential contribution of the European Monetary System as an important political commitment to promote orderly exchange markets, while stressing the importance of a wider international regime for “orderly change” in exchange rates.

- The OPEC surplus, after a decline from the 1974 peak, is unlikely to climb back beyond half the 1974 level in the next few years, and its projected 1979 size of around \$20 billion is, in the words of one of the authors, “entirely manageable from a financial perspective.” Yet, the sharp decline of the current account surplus through 1978 does not eliminate the fact that a substantial *stock* of external financial assets remains concentrated in a few hands—a potential element of destabilization of the international financial system, particularly since the surplus is beginning to rise again.

- The LDCs have survived the oil shock and the recession with less of a “growth rate trauma” than was previously feared. However, the authors stressed that aggregate

numbers hide widely divergent developments in individual countries, whose growth rates often remain inadequate. Among the factors which have cushioned the impact of the oil shock on these countries, the authors mentioned in particular some good agricultural results (particularly in South Asia), the sustained strength of export earnings (particularly of manufactured exports), and the continued availability of financing. In this respect, they urged the trilateral countries to sustain the growth of their own domestic markets and to keep these markets open.



A. Lamfalussy, M. Fujioka, B. MacLaury

Inflation and the Economic Outlook

The two major themes in the authors' remarks and in the discussion which followed were the international resurgence of inflation, and the question of reserve assets for the world economy.

After greeting the measures taken by the U.S. and other monetary authorities to bring the crisis of the dollar under control as “the best news in the past six months,” one of the authors underlined the current resurgence of inflation as a central immediate problem for the stability of the international economic system. The increase in oil prices and the boom of raw material prices, he noted, are now accompanied by notable increases of domestic prices in countries like the Federal Republic of Germany, Switzerland and Japan, which had been extremely successful at controlling inflation—an indication that their past successes had to be

(Continued on p. 5)

*The reader should bear in mind that the three authors' presentations and the subsequent discussion took place in April, 1979.

PRIME MINISTER MASAYOSHI OHIRA



On the occasion of the Tokyo plenary meeting of the Commission, the Prime Minister of Japan, Masayoshi Ohira, received all the participants at his official residence on April 24, 1979. We reproduce below in extenso the text of his address to the Commission, which he delivered in English before informally answering a few questions from Commissioners-

... I am delighted to be with you for this 10th plenary meeting of the Trilateral Commission. I feel quite at home among so many familiar faces. Some of you, I am sure, were surprised at my election as Prime Minister towards the end of last year. So was I! But this happy accident must not alter our relationship. I hope you will continue to extend to me your friendship, counsel and encouragement.

May I first of all applaud the Commission's decision to continue its activities for another three years. The value as well as the prestige of the Commission have grown steadily year by year. I hope the Commission's activities during the coming three years will be even more useful.

Today is the 139th day since I assumed the premiership of Japan. Apparently, it has been reported abroad that the new Prime Minister of Japan is decisively domestic-oriented. However, this is contrary to my own recognition and my own experience, having served twice as Foreign Minister.

Let me take this opportunity to narrow the gap of this image of me and to express briefly my own views

on Japan's future directions, looking to the 1980s with respect to Japan's role in the world.

No nation today can survive in isolation from the international community. Japan in particular can survive only in a harmonious relationship with the rest of the world. As the second largest economy in the free world, Japan depends on imports for 75 percent of its total energy resources.

As Japan's sheer weight in the world economy has vastly increased, so have Japan's international responsibilities. Clearly, Japan must seek its future direction in full recognition that we are dependent on the international community, and with the determination to fulfill our growing responsibilities and to play a larger role commensurate with our economic power and our position in international politics.

Naturally, the recognition of interdependence and responsibilities applies to others as well, and especially to North America and Western Europe, whose weight in the world economy is also great. If either of these giants were to turn to protectionism as an easy way out of present predicaments, the result could be world economic chaos and hardship for all.

During the more than 30 years since the end of the war, we Japanese have diligently—and with remarkable success—pursued economic affluence. However, the time has come for us to give more serious consideration to the harmony between man and nature, to the balance between liberty and responsibility, and to the spiritual meaning of being and the quality of our lives.

Today we Japanese are on the threshold of a new age, aiming at the enrichment of our cultural environment and deeper respect for human qualities as we move beyond the pursuit of material affluence. In light of these new priorities, I intend that respect for culture and the fuller development of human qualities shall serve as the guiding philosophy behind all my policies. I shall strive for the creation of a humane and just society conforming to our special needs and character, providing greater dignity for the individual through such means as enhancement of the value of the family

and home, and promotion of the concept of the garden-city. I also believe in the benefits of greater leisure, and I shall therefore encourage wider acceptance of the five-day week.

Turning to our external relations, we find that the burning issues of the day are those of sorting out economic frictions between Japan, on the one hand, and on the other, the United States and the European Community. Japan cannot afford to disregard our economic problems either with the United States or with Western Europe, particularly the European Community, which is the world's largest trading bloc. Nor do we underestimate the seriousness of our problems with Europe. In readjusting our external economic relations, I believe we have to take appropriate measures, not just for the short term, but also from a medium- and long-term perspective.

Specifically, we are determined to open further our domestic market and, over the longer term, to manage and restructure our economy so that Japan will be able to contribute to a more harmonious functioning of the international economy, of which it is an important part.

In pursuing both the domestic and external policy directions I have indicated, I intend to make every effort to strengthen the common foundations on which Japan, North America and Europe stand together, while preserving Japan's own traditions and values. Just as each person cherishes his own individuality, so each nation values its own traditions, life style, and patterns of behavior. Just as there are cultural distinctions between America and Europe—and even among European countries—it is only natural to find, between Japan and both North America and Europe, differences which derive from our separate historical backgrounds and geographical conditions.

Unfortunately, however, ignorance of Japan's culture and society has led to misunderstanding and to distortion of Japan's image abroad. Japan, as a highly industrialized society, is in many respects like the United States and the nations of Western Europe. Indeed, when Japan embarked on its modernization process more than a century ago, European institutions served as our principal model. We Japanese do share with you North Americans and Europeans the same basic values. We, like you, work to ensure the freedom and dignity of the individual. We, too, are deeply committed to parliamentary democracy, and we abide by the principles of the market economy and free trade. As an advanced industrialized society, we are faced with similar problems and troubled by similar difficulties, as are you North Americans and Europeans. It is precisely on this common ground that Japanese, North Americans and Europeans have regularly consulted each other at the summit talks on such shared concerns and responsibilities as economic growth, energy and currencies.

It is my fervent hope that North Americans and Europeans will come to appreciate the fact that we share the same aspirations, and that we are treading the same paths, even though our cultural and social backgrounds are different. Toward this end, I believe there are things we can do to improve our understanding and appreciation of each other. I think, for example, it would be of real value, to work out a joint studies scheme—first, to examine the causes of our frictions and misunderstandings and determine how we can best prevent or eliminate such problems in the future. Second, we could study together and seek remedies for problems which are peculiar to all highly industrialized societies—problems such as the increase in crime, overpopulation in cities, underdevelopment of agricultural and remote areas, decline in work morale, and the erosion of social cohesion in modern life.

As I have said, Japan, North America and Europe stand on common ground as advanced industrial societies, while each retains its respective individuality. We therefore have the obligation to establish a creative relationship, based on our interdependence and expressed in closer cooperation. We three are called upon to join our distinctive qualities and values in the search for common approaches, which will enable us together to cope, not only with our problems as advanced industrial nations, but also with our common global concerns, such as North-South relations, East-West relations, and the like. Such a relationship will surely contribute to world peace and the greater prosperity of all mankind.

Saint-Exupéry, the French aviator and writer, once said: "To love each other is not for the two to look at each other, but for the two to look in the same direction." I believe that if Japan, North America and Europe can walk hand in hand, looking in the same direction, true friendship will grow from this, and a brighter future will open up for all mankind. This indeed is our common mission. ■



(Continued from p. 2)

attributed to a considerable extent to the steady appreciation of their currencies' exchange rates. Now that this appreciation has stopped, international inflation transfers itself directly to their domestic economies. For instance, for an open economy such as Germany's, a 30 percent increase within one year in the dollar prices of raw materials while the Deutsche Mark began to depreciate against the dollar has had an *immediate* effect on domestic prices. The combination of the commodity boom with this depreciation of the DM is, in this author's words, "potentially explosive."

In the light of this new phenomenon, the author outlined two possible scenarios for the immediate future: In the first—the "optimistic" scenario—the U.S. boom dies gently, causing a reduction in both the demand for oil and speculative commodity purchases; consequently, countries such as Germany and Japan feel less of a need to enforce strong fiscal and monetary restriction, and the result is a generalized "soft landing" for the world economy with a continued improvement of payments imbalances among the trilateral countries. In the second scenario—where the U.S. boom continues unabated—the commodity boom persists and the price of oil rises still further, leading to strongly restrictive domestic economic measures in trilateral surplus countries to protect against excessive inflation. The overall result—the first signs of which are already noticeable in Germany and Japan—would be a pronounced widening of payments imbalances.

The Dollar Overhang and the Reserve Asset Question

A British participant envisaged the case where the death—"probably violent"—of the U.S. boom, leading into a serious recession, would create a constant inhibition on expansionary policies in the United States because of the considerable amount of dollar balances abroad. This dollar overhang remains even if the U.S. current account situation is in balance; it raises fundamental questions as to the future of an international economic system based so much on the dollar and it points to the need for international action to fund this dollar overhang.

Some underlined the crucial importance of a healthy U.S. current account as a fundamental prerequisite without which the confidence in the dollar would collapse; and it is only on the basis of such a healthy pattern that one can start to deal with the problem of the overhang.

A number of other participants went beyond this to argue that more attention should be devoted to the nature of the underlying reserve asset—and several Europeans evoked the creation of the European Monetary System as a dramatic development which may be the prelude to a new monetary unit providing an "alternative reserve asset" alongside the dollar. In this respect, the authors and other experts warned against the difficulties inherent in the operation of multiple reserve currency systems because of inevitable shifts between the various assets and the need to cushion the ensuing disruption. The ECU (the European monetary unit) repre-

sents at the present time a claim on the European Monetary Cooperation Fund; for it to become a viable international reserve asset, some observed, central banks (including the IMF) outside the European system would have to be allowed to acquire such claims, through ECUs being issued to cover a European deficit, or through the creation of a substitution account—neither of which is yet in sight. The second means of transforming ECUs into a reserve asset would be for non-European central banks to make deposits in ECUs with commercial banks, which presupposes that some people wish to borrow in ECUs—a development which is unlikely to occur in the immediate future. Reflecting upon the difficulties of cushioning the shifts among the various assets of a multiple reserve currency system, a speaker pictured such a system as one which, in theory, creates symmetrical constraints on each reserve currency, thereby forcing cooperation between the three or four reserve centers. He contrasted this with today's situation, where the unavailability of real alternative reserve assets inevitably creates asymmetrical constraints on currencies.

Current Account vs. Basic Balance

Turning to other aspects of the report, some participants suggested that more importance be given to the basic balance—an indicator which puts the current account into a broader perspective. In this respect, an American Commissioner drew attention to the rough equilibrium of Japan's basic balance, where the net deficit of long-term capital flows practically "cancels out" the current account surplus. Others, looking at the world economy as a whole, recalled that for a few countries to run current account surpluses implies that other countries carry a corresponding deficit: It used to be assumed that the LDCs, because of their need for imported capital and technology, were the natural bearers of this deficit, the sustainability of which is determined by the availability of capital financing. Noting that the combination of the OPEC surplus with surpluses in some trilateral countries made it necessary until now for the United States to carry the corresponding excess deficit, a speaker emphasized that, beyond a certain limit, too large a surplus situation, instead of generating capital outflows, leads to undesired inflows.

Structural and Political Factors

Finally, a number of Commissioners insisted on the long-term, structural factors behind current imbalances, and on the need to take into account the broader political aspects of the payments problem. Some—especially from Japan and Europe—emphasized the need for *structural* policies to reduce the existing disparities among our countries over the long run, and to fight inflation successfully in the United States. Others joined the authors in expressing their skepticism that structural changes within or among the trilateral countries could be expected to take place very quickly. On the *political* front, most participants agreed that one of the most serious concerns for future stability relates to the politi-

cal evolution of OPEC countries—particularly Iran and Saudi Arabia, the biggest oil exporters in recent decades. A few Commissioners stressed that extreme doomsday scenarios (i.e., an upheaval in Saudi Arabia, or a withdrawal of Saudi holdings in the U.S. and a spectacular hike of oil prices as a result of Saudi disenchantment with America's Middle East and economic policies) could no longer be ruled out. Others, reflecting further upon the latest developments in the Middle East, emphasized that the absence of proper action by other trilateral countries to help support the financial burden of the Israeli-Egyptian peace treaty could have serious consequences for the dollar and the world economy. ■



At a dinner for the participants in the Tokyo plenary meeting on April 23, 1979, Henry Kissinger spoke informally and answered a few "off-the-record" questions from Commissioners. Earlier that day, the participants had been the guests at a reception hosted by Japanese Foreign Minister Sonoda at Japan's Foreign Ministry.

Foreign Minister Sonoda greets Henry Kissinger and David Rockefeller.



On April 23, the participants in the Tokyo meeting gathered for a working luncheon with the three authors of the 1978 task force report, *Energy: Managing the Transition*—John C. Sawhill, President of New York University and former Administrator of the U.S. Federal Energy Administration; Hanns W. Maull, the outgoing European Secretary of the Trilateral Commission; and Keichi Oshima, Professor of Nuclear Engineering at the University of Tokyo. The introductory remarks of the three authors and the subsequent discussion attempted to review the overall energy situation in light of the developments since the report was presented to the Commission in June 1978. To this end, the authors and participants dwelt in particular on the evolution of the Middle East in the wake of the Iranian revolution, on the implications of the Three Mile Island nuclear accident, and on the impact of Mexican oil reserves; and, last but not least, they discussed at length the major components of the Carter Administration's energy policy.

• *A New Situation in the Middle East*

Recent developments in Iran, it was noted, have highlighted dramatically the security issue and the increased possibility of shortages and supply disruptions in the immediate future. They have also tended to reaffirm the strength of the OPEC cartel: The OPEC countries, as a number of participants observed, have not only made a new commitment to higher prices, but for the first time they have been able to reach an agreement on the allocation of production cutbacks among them, thus showing their readiness to curtail supplies in order to achieve the price increases they are determined to bring about. Finally, Iran has led to a reappraisal of Saudi capacities: Observing that the often-mentioned figure of 12 million barrels per day appears to be "on the high side" and represents the maximum Saudi Arabia can physically produce at the present time, the authors noted that "tightness" on the supply side, which their report had forecast for the late 1980s, could well occur earlier.

Reviewing the overall situation in the Middle East in the wake of Iran's upheaval, a number of participants stressed that political factors there have now become *the* driving force in the energy crisis. In the view of many, the recent deterioration in U.S.-Saudi relations has made it no longer possible to rely on the "special relationship" mentioned in the earlier Trilateral report to obtain increases in production. In addition, the current polarization in the Arab world, encouraged further by the Israeli-Egyptian peace treaty, has increased the Saudis' insecurity in the region, which makes it unlikely, in the opinion of a number of participants, that Saudi Arabia will again enjoy the position it used to occupy within OPEC.

THE ENERGY REPORT REVISITED



However, it was the feeling of the three authors that moderation on the part of OPEC was not unlikely and should indeed be further encouraged. In this respect, they emphasized again both the crucial need for solidarity on the part of the trilateral countries vis-à-vis OPEC, and the particular importance at this stage of promoting further the dialogue between producers and consumers.

• *Delays in Nuclear Programs*

A great number of participants noted that the Three Mile Island nuclear accident has inevitably raised very serious questions on the future of nuclear energy—in the United States itself, but also in most other trilateral countries. Consequently, it will be more difficult for these countries to pursue vigorous nuclear programs. Some North American participants expressed their alarm at what they viewed as a “meltdown” of the credibility of our experts in the wake of the accident. Others suggested that this accident should be seen as a useful warning and as a positive development, since neither a break in the reactor shield nor a big radioactivity release occurred.

On the other hand, several Europeans and Japanese, noting the delays which are likely to affect their countries' efforts to develop nuclear power, emphasized that Japan and Europe have “no other option” than moving ahead with their nuclear programs. Stressing the need for a common strategy in this area on the part of the trilateral countries, and the political courage which it will take for our leaders to shift the debate from the safety issue to the energy supply issue, some of these participants insisted that our countries “stop interfering with each other's policies” in the nuclear area, and urged that a strong pronouncement to this effect be made at the June 1979 Tokyo Summit meeting.

• *Mexican Oil*

Regarding recent oil discoveries in Mexico, the authors stressed that these reserves, in general, had been considerably overestimated. They noted that it would be “ridiculous to compare these reserves”—now at a proved level of about 30 billion barrels—to the Saudi reserves, and that, in addition, they were unlikely to yield enough to make much of a difference before 1985. However, authors and participants pointed to the need for the United States to develop a solid and coherent oil policy towards both Mexico and Canada.

• *The Carter Policy Reappraised*

Turning finally to the current policy of the United States, the authors and a number of participants welcomed the Administration's decision to decontrol domestic oil prices; but they warned that little result is to be expected in 1979, the major price increases towards world levels being likely to occur only in 1980 and 1981. In addition, the authors expressed “three disappointments” with respect to the supply side of the U.S. program: They saw the proposed windfall profits tax as likely to impair vigorous development of new supplies; they deplored the fact that no improvement of the 1978 Gas Bill was made, thereby prompting a decline of drilling in the United States; and they regretted that so little had been done on existing environmental regulations to make it easier to reach decisions on trade-offs between environmental and energy considerations.

In conclusion, the authors observed that in their current form, both the Gas Act and the plan to decontrol oil prices meet some of their report's major recommendations. Furthermore, stockpiling continues, “although too slowly.” On the international front, they took note of the fact that steps have been taken or are being considered (especially by the World Bank) vis-à-vis the non-oil LDCs; and they welcomed the commitment by the members of the International Energy Agency to reduce their oil consumption by 5 percent. On the negative side, they strongly underlined the lack of sufficient efforts on the part of the trilateral countries to reduce their oil imports, and the lack of appropriate initiatives in the field of research and development. They expressed their hope that energy would be high on the agenda of the coming Tokyo Summit meeting, noting that by and large “the problem has not yet been addressed in a meaningful manner by our countries.” ■

II

INDUSTRIAL POLICY AND THE INTERNATIONAL ECONOMY

The draft report presented in Tokyo by the Trilateral Task Force on Industrial Policy, based on an analysis of the experience of Japan, North America, and Western Europe, reviews the desirable aims and criteria of trilateral industrial policies and their international implications. The report was prepared by John Pinder, Director of the Policy Studies Institute (PSI) in London; Takashi Hosomi, Advisor to the Industrial Bank of Japan and Chairman of IBJ International Limited; and William Diebold, Senior Research Fellow of the Council on Foreign Relations in New York. The authors were assisted by two special consultants—Eisuke Sakakibara, Associate Professor of Economics at the Institute for Policy Science, Saitama University; and Wolfgang Hager, Senior Fellow at the Research Institute of the German Society for Foreign Policy in Bonn. The authors worked closely while drafting their report, and benefited from extensive consultations with over 120 experts in North America, Europe, and Japan.

Presenting their draft to the participants in the Tokyo meeting, all three authors stressed at the outset the current dilemma of our countries which have to contend with an international economy combined with national politics. The social, cultural, historical and political diversity of our countries, they indicated, creates different industrial structures and inevitably generates widely divergent approaches in the field of industrial policy. They characterized their draft report as essentially an attempt to clarify some of the complex issues involved in the intertwining of national industrial strategies.

Pointing to "the challenge of structural change" in our countries, the authors described industrial policy as an increasingly important element in responding to the profound structural difficulties in the modern economy. These are difficulties which, in their words, imply reallocations of resources in our economies—a process which becomes increasingly costly and time-consuming for three reasons: Because of the growing capital and skill-intensity of our economies, necessary changes in the patterns of production imply writing off ever more expensive investments in both equipment and human resources; in addition, in our highly developed societies, the resistance of social and political forces to industrial change has become strong; and the above difficulties are aggravated further by the slow growth of our economies in the 1970s. These factors, the authors noted, have made it necessary for our countries to devise policies, in the words of the Secretary-General of the OECD, that can facilitate the needed structural changes and adjustments "at a socially acceptable pace."

Emphasizing the somewhat narrower focus of their report on industrial policies per se—i.e., adjustment policies whose aim is to affect directly the structure of industries in the trilateral countries—the authors underlined fundamental principles which had guided them in the drafting of their report. They insisted first that industrial policy should complement and help market mechanisms, rather than work against the underlying forces of the market. Second, they stressed the need in our countries for "positive" industrial policies—i.e., policies which stimulate *viable* activities and help move resources into them. They recognized that such policies often had to be combined with more "defensive" measures to secure the "socially acceptable pace" of the required adjustments; yet, they noted that our nations' policies tended often to be too exclusively "defensive," thereby failing to meet the need for truly adaptive strategies and exacerbating international frictions.

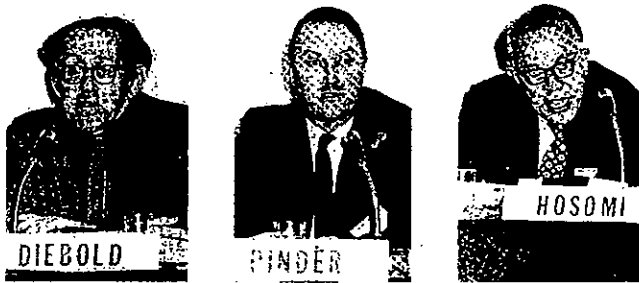
The authors also observed that national differences in approach compounded the complexity of dealing with the *international implications* of our various industrial policies. Reflecting upon the recent completion of the Tokyo Round of trade negotiations, they pointed to the codes on subsidies and government procurement, as well as the postponed question of safeguards and selectivity, as "going some distance towards providing an international framework to look at and possibly agree upon industrial policy measures." They stressed, however, that uniformity and even harmonization of industrial policies were highly unlikely and probably impractical; and that our aim at the international level should be to engage in an empirical, "trial-and-error" process allowing us to accommodate the diversity of national situations.

In this respect, the authors strongly underlined the importance of the role of the OECD. They singled out their report's recommendation that an OECD Working Party be created to coordinate further the international discussion of industrial and other structural policies, in order to tackle better the often conflicting international implications of divergent national approaches; and they stressed their proposal for the creation of a distinct institute, sponsored by both government and industry, to further this process of international consultation. One of the main purposes of such an institute, in their view, would be to gather data in a systematic manner and provide a sound statistical basis for this international discussion, thus enhancing the much desired transparency of our nations' policies. Particular emphasis was put in this respect on the need for annual, comprehensive national reports on subsidies.

Market Forces and Social Objectives

The participants in the discussion which followed the authors' presentations generally appeared to recognize what the report identifies as "the challenge of structural change." There was general acceptance of the utility of positive industrial policy in seeing us through these changes, even among those Commissioners skeptical about the prospects for success.

Striking a theme which was to receive considerable attention during much of the ensuing discussion, a European trade union leader took the authors to task for overlooking some basic social factors "without which . . . no positive industrial policy can function." Noting that progress which does not provide for social security and evolution "cannot be called progress," he insisted in particular that the "social management of structural processes and of technological progress must be given priority." This, he added, is also in the best interests of the economy since "there can be no economic and technological progress without its social equivalent."



Also expressing surprise that "the report seems much more ready to accept protectionist measures against imports from Eastern Europe than from developing countries," this speaker observed that the exploitation of the social imbalances between industrial countries and the Third World distorts the market no less than the arbitrary price-fixing methods of the centrally planned economies. Underlining the efforts of the international trade union movements to contribute to the industrial development of the Third World in practical terms and to promote the application of fair labor standards to economic relations with the developing countries, he emphasized as a golden rule of industrial development that such development should above all benefit the majority of the population.

Echoing this speaker's insistence that social policy be viewed as an integral part of structural policy, a number of Commissioners drew attention to the importance and value of trade union involvement in the formulation of industrial policy. A Japanese participant referred to the benefits of the joint consultation system between labor and management in Japan, observing that, as a consequence, "the introduction of technology was made fairly smoothly, and the technology itself was assimilated in a short period of time." In his view, the involvement of the unions had facilitated necessary structural adjustments and brought about a rapid in-

crease in productivity. Others argued that to give "economic efficiency" highest priority as an aim or a value above broader considerations of public interest and social welfare is not acceptable in modern democracies. For some, who emphasized further that industrial policy must be "adjusted to social needs and evolution," the main problem remains unemployment and the necessity to provide better employment for the labor force. More generally speaking, a few participants also disputed what they viewed as the report's "absolute confidence in market forces and entrepreneurship," with a European Commissioner observing in particular that, "in Europe at least, a large proportion of the labor force works for the government, and many citizens have mixed feelings about private enterprise and economic efficiency."

The Government as Industrial Policymaker

Noting that the development of "a framework of thinking based on the major private wants and the great public problems that will arise in the 1980s and 1990s" is not the function of the enterprise sector but that of the government, a European Commissioner emphasized the importance of our governments' role and of cooperation between government and industry, as best exemplified in France and Japan. Along the same lines, a Japanese pointed to the inability of the private sector on its own to take care of workers in the midst of change out of declining sectors and emphasized the role of the government as the "forerunner" for the people in smoothing structural changes. On the other hand, some deplored the considerable increase in the role of the government and its frequent "arbitrariness"—particularly in not respecting the sanctity of contractual relationships, or in generating a proliferation of laws in the field of product liability, for instance. Others also pointed to "a serious conflict" between "freedom," one of the aims and values the authors advance as important, and the report's stress on the "inevitability" of industrial policy nationally and the need to coordinate such policies internationally to some extent.

By and large, however, the views of a great number of participants were reflected in a European Commissioner's statement that "whether we like it or not, government will take an increasingly active role in the economy when faced with difficult economic problems." Proceeding to review specific aspects of our countries' industrial policies, the discussion focused in particular on:

- *The overlay between regional and sectoral policy.* In a European's words, the "explosion" of regional development aids, uncoordinated sectorally, is probably "the most significant single development in industrial policy." Citing as an example the Ford plant now being peddled around Europe for competitive bids, he noted that the volume of investment influenced in this way is "increasing by leaps and bounds"; since there is no discrimination by sector in these regional and national inducements to investment, the implications for certain sectors worldwide are considerable. The authors

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Otto Graf Lambsdorff



Otto Graf Lambsdorff, Minister of Economics of the Federal Republic of Germany (left), with Japanese Trade Representative Nobuhiko Ushiba and SONY Chairman Akio Morita, during Tokyo plenary meeting. We reproduce below in extenso the text of Graf Lambsdorff's special address to the participants.

It is a special pleasure for me to be speaking about closed or open-shop policies in international economics here in Tokyo, considering that the name of this city has been attached to the round of negotiations within GATT whose substantial phase has just ended. Indeed, this country itself owes much of its present prosperity to free international trade.

Let me begin with a brief look back at the past. In the decades following the Second World War, world output and world trade grew at a pronounced rate. If we leave aside cyclical fluctuations, production averaged about 5 percent per year while trade expanded almost twice as fast.

International specialization and the inter-linking of national economies reached a level never seen before. The breadth of present integration and the prosperity that goes with it would certainly not have been possible without the strong political will over a long period to dismantle restrictions. I am thinking in particular of the OECD's liberalization program and the six GATT tariff rounds so far completed.

At the start of the 1970s there were considerable changes in some of the background conditions in the world economy which none of us could overlook. I need only mention the drastic increases in prices for energy and raw materials, radical shifts in currency relations and growing competition from developing country exports. The consequences were painful for nearly all economies: rapidly rising prices, high payments deficits caused by the cost of oil, a slowdown in growth ending in a recession of a severity not seen since the war. We cannot regard the problems that have arisen as in any way solved. We are still faced with major employment difficulties in most industrial nations with too high a level of underlying inflation.

In this phase of low growth and high unemployment, the pressing need for structural adjustment is naturally being felt as especially burdensome. We are all under growing pressure at home to relieve difficulties in our domestic economies by external economic measures—and this in spite of the fact that no one doubts nowadays that interventionism and protectionism are damaging. General awareness that such practices are self-defeating goes back at least to the experience with worldwide protectionism in the 1930s.

Fortunately, we are still a long way from a 1930s situation. But a philosophy of justifying each isolated case on its merits has its dangers. Even small doses of protectionism can start a chain reaction on the snowball pattern. They can become ammunition in the hands of other industries downstream or elsewhere in the economy, claiming similar treatment, and above all they reduce the chances of integrating the developing nations into the world economy.

But the shift to new forms of protectionism seems to me just as significant a threat to our liberal economic order. The classical restrictions—such as quota systems or higher tariffs under GATT—are being leavened with more hidden distortions of competition. Think for example of the use of administrative and technical regulations to hamper competitive imports, or the spreading trend to carve up world trade by self-restraint agreements, or the maze of often ingenious subsidies, as well as intervention at the production end to prop up outdated structures. It is this slow poison of concealed restriction and intervention which I consider especially worrisome. It is less obvious, less easy to detect, and thus harder to fight against internationally.

Theorists and politicians largely agree that all these measures are damaging in the long run. Their apparent immediate success, say in employment terms, turns quickly into an almost insurmountable barrier to a rational division of labor between countries and so to higher standards of living. A less efficient world economy, less monetary stability, less growth and in the final analysis less prosperity all around are the result. The choice between a closed or an open-shop policy virtually settles itself. Anyone who wants to see more prosperity for all can only be for an open-shop policy. It follows from this that one of the most vital tasks for policymakers today is to maintain and increase freedom of movement in international economic relations.

The current tensions, the current threats to the world economy, are without doubt due in large part to the slow pace of growth in the Western industrialized nations. Nonetheless, prospects for growth worldwide in 1979 are generally better now, allowing a cautious optimism. We ought not to overlook the differences from region to region, however.

Western Europe and Japan are likely to see accelerated expansion in the first half, while the United States must expect a marked flattening out of its growth rate. The gaps between the various national growth rates will narrow and help towards balance-of-payments equilibrium. Yet expectations here should not be set too high; inflation in many of these countries is still too strong. Caution is all the more necessary because the latest oil price rise will put renewed pressure on payments balances and prices generally.

In spite of the unmistakable slowdown of activity in the United States, the increased growth in Western Europe and Japan will mean that growth in the OECD area as a whole in 1979 ought to be around 3 percent. World trade, too, will expand again—as last year—at about 5 to 6 percent. This is also encouraging, and is attributable above all to the high international integration of the faster growing economies in Europe. The labor market situation, however, will continue to cause problems in spite of a slight trend to recovery. Overall, there is not likely to be any sustained improvement in West European countries this year. Even over the medium term we will probably have to live with an unemployment rate markedly above the level of the 1960s. For this reason alone the domestic pressure on government to take steps to defend existing structures will not let up, although this kind of policy is demonstrably unable to preserve threatened jobs on a lasting basis. The creation of up-to-date jobs in growth sectors that are able to compete internationally is made more difficult. Basically, the role of government should only be to support the private sector's readiness and ability to adjust by improving the background conditions. However, this does not include appeals to buy home-produced goods, and the Federal Republic will not be running a "Buy German" campaign.

Raising the innovative potential of the private sector is a crucial part of improving these background conditions. But under no circumstances ought we to allow the mainspring of structural change—that is, the pressure and rewards of competition in the marketplace—to slacken. This applies at both national and international levels.

I will not deny that when pressure for change is acute, there can be good justification for government aid; it can become almost imperative for solid social reasons. Yet such measures should be planned as temporary and tail off as much as possible with time. The OECD Council recently made this call in its guidelines on positive adjustment.

This is how our participation in the renewed Multi-Fiber Arrangement and the European Community crisis measures for steel should be seen, for example. It would be fatal for the Multi-Fiber Arrangement to become a permanent feature in world trade, instead of permitting a smooth internal restructuring of the industry during a limited transitional period. The slimming down of both plant and work force in this sector in recent years shows that the protection afforded has been properly understood by the affected companies. And like the Multi-Fiber Arrangement, I see the crisis measures for steel in the Community and the USA as temporary external relief to allow restructuring to go ahead. It was only

on this understanding that my government reluctantly went along with these measures at all. But I am bound to add that I see the point of view of anyone who finds them unpalatable. The Western industrial nations carry a large amount of responsibility in view of their big role in world trade. Hence, the extension of the trade pledge by the OECD Council last summer is a welcome reaffirmation of a trade policy in which the "beggar-thy-neighbor" philosophy has no place.

The GATT negotiations, whose substantive part has just been concluded, point in the same direction. I am pleased that we have managed to end them before the Manila conference in May, although some are calling the outcome a mediocre compromise. I do not share this skepticism. Apart from the tariff cuts, and these have not been as big as we should like, it has been possible to deal extensively for the first time in multilateral negotiations with the area of non-tariff barriers to trade. The results attained here are important because policymakers concur that non-tariff barriers have grown to unwelcome proportions in recent years. I consider in this context the acceptance of a code on subsidies to be extraordinarily valuable. It is directed against unequal competition and unequal opportunities among world trading partners and lays the foundation for the tighter international discipline we have been seeking.

Another aspect worth stressing is the projected control of selective safeguards. The developing nations have the not wholly unfounded suspicion that selective safeguards are primarily aimed against them. We were opposed to the revision of this clause for a long time and only agreed to the new version on condition that selective safeguards were made subject to much stricter discipline. This reduces the dangers but, I admit, does not remove them altogether.

I am particularly unhappy about the possible treatment of new suppliers entering the market. I well understand the concern of the developing countries at any rate, and it would be tragic if they judged the MTN on the strength of the revised safeguards clause and lost sight of the positive discrimination which has been envisaged to favor their trade.

I will put it another way: Basically, it is a matter of bringing the developing nations more fully into the international economy. This is one of the biggest challenges of the 1980s and at the same time one of the greatest opportunities facing our present international economic system and its organizations. The way it works will show whether it deserves the epithet "liberal." We only need to look at the present distribution of world product and world trade to realize, I think, that common humanity and a concern for the social peace of the world urgently demand a redistribution towards the Third World. The current North-South dialogue is in fact not dealing with whether this should happen, but really with how it is to be done. The call of the developing countries for a centrally-administered transfer of industries from the industrial countries to the Third World seems to me the wrong way to go about it.

So far, the industrial nations have largely argued from a

defensive stance. It seems to me vital for us to be more positive and convincing in presenting market-based alternatives and in making it clear we are ready to adapt ourselves to new structures. This includes wider opening of our markets, perhaps on preferential terms, to manufactures and semi-manufactures from Third World countries. If this is to work, the industrial structure of their economies must be diversified and a technologically-based infrastructure developed; both will bring release from their one-sided dependence on commodity production.

The freedom of international capital movements is also a significant factor. More and more voices are being raised in protest that persistent employment problems and growing foreign investment are leading to the export or destruction of domestic jobs. In the last analysis, this is simply spreading protectionist pressures to the field of capital. I believe it is a mistaken view that foreign investment destroys secure domestic jobs. Empirical studies show in fact that *on balance*, such activities abroad lead to more trade in goods and services and create permanent new jobs, even if in some specific industries employment problems may be accentuated. Direct foreign investment is especially important in terms of integrating the developing nations more fully into the world economy. It brings in long-term capital and transfers of technical and managerial know-how, encourages diversification of the economy, strengthens the host country's export industry and improves working and training opportunities, laying the foundation for a lasting improvement in living conditions. It might be objected that many of these effects could be gained without private capital. To a certain extent this cannot be denied. However, I see the main advantage of private investment in the fact that the investing company is fully committed to the economic success of its venture. This is a strong motive, and we have seen that some developing countries have been able to turn it to their benefit. However, a good investment climate is necessary if foreign venture capital and foreign technology is to be attracted—and evidently a growing number of developing countries want this. The need to reach an international consensus on this issue has been underlined in the communiqué of the economic summit in Bonn and elsewhere.

To sum up, finally, I would say that the task of securing and strengthening our well-established, liberal world economic system has in recent years become not easier but more difficult. To the principle of maximum freedom of movement in international economic relations we owe much of the prosperity we have achieved. This principle is coming increasingly under fire, and not just from the Third World. Upholding this successful principle thus requires greater attention and greater effort from us than in the past. Only together are we likely to master this new challenge. What we need, in my opinion, is a common design which traces the latitude between acceptable compromise and the unrelinquishable cornerstones of our liberal system. It is the only way of developing the present order in a meaningful direction which is also of benefit to the nations of the developing world. ■

TRILATERAL

One of the Trilateral Commission's cardinal objectives when it was created in 1973 was to bring Japan more fully into the discussion of international issues. As the Commission is about to enter its third three-year period of existence, Trialogue asked Kiuchi Miyazawa, a founding member of the Commission and a participant in the Tokyo meeting, to reflect upon his experience of "trilateralism." Following are some of the major points made during the conversation by Miyazawa, currently a member of Japan's Diet and former Minister of Economic Planning, of International Trade and Industry, and of Foreign Affairs.



Trilateralism Six Years Later

From a Japanese point of view, I believe the Trilateral Commission has played an immensely useful role in bringing us more closely into the international concert. First, and most important to us, Japan was not merely invited to be a "charter member" of the new organization. It was involved since the very beginning in the exploratory stages which led to the Commission's creation. This was probably the first time Japan had been associated as an equal partner in a discussion group of such importance and magnitude. Second, unlike the United States where businessmen and lawyers often find their way on loan to the government, private citizens in Japan seldom have a chance to see and think about world affairs from a general and broader point of view. Their joining the Trilateral Commission has enabled them to do just that.

In addition, although the Commission membership excludes government officials, important former government people are members, and in many cases these people still have a great influence upon their followers. As a result, discussions within the Commission do affect the thinking of our governments and in some cases—although indirectly—their policy decisions. In this sense, I believe that the Commission has made a difference—even if a number of crucial problems, trade relations for example, still exist among the trilateral countries.

KIICHI MIYAZAWA

A New Concern for Security in Japan?

On the security question, Japan is clearly more on the receiving side than on the giving side. True, we do realize that we are "in the same boat" with other trilateral countries, and yet the Japanese people remain probably the least security-conscious people among the industrial democracies. We do realize that we are contributing very little to the security of the "boat," but in strictly military terms and hardware-wise, I do not see any possibility for Japan to make a significant contribution.

Surely, developments in the last two or three years, particularly in the evolution of the balance of power in Asia, may be said to have increased somewhat our concern for security, but on the whole, this concern is not to any great extent superior to what it was ten years ago. Any nuclear involvement is totally excluded. Rearmament itself is still something which most Japanese refuse to consider, and the possibility of establishing a military draft is totally out of the question. As a result, our allegedly growing concern for security is likely to translate itself into greater acceptance of higher spending to strengthen our existing defense forces and, above all, greater appropriations for their modernization. In addition, the very existence of Japan's civil defense force, the constitutionality of which was very controversial a decade ago, is now widely accepted. But beyond these elements I do not see any significant change taking place.

The Vitality of Democracy

I believe that the most important bond between the trilateral countries is the value which we attach to human beings; nothing can compare with this in importance. The very fact that we share that same system of values is by far our strongest link. I vividly remember that, at the time of the creation of the Trilateral Commission, some views were expressed to the effect that, since security was one of our concerns, we might include members from communist countries in our group. An authentic security debate, it was argued, was difficult without them. Subsequently, however, we all agreed that, since we do not share with them this same system of values, having them in the group would basically run against the spirit of our Commission. This, I think, shows that our shared belief in certain values is what keeps us together.

I do recognize that, in some of our countries, democracy and its governability appear to be more threatened than in others. Yet, we may well have passed the most serious stage of this "crisis of democracy"—and in the end, I cannot think of any better means of governing ourselves and I firmly believe that democracy will stay with us. As to the oft-mentioned decrease in the values of the nation among the young, I also think that it has already peaked. The worst phase in this respect occurred before the oil crisis when there was full employment and the likelihood of any large-scale war seemed almost nil. Curiously, this seemed to nullify the *raison d'être* of the government, especially in the mind of the young. Then came the oil crisis. It brought home the sudden precariousness of a number of vital things, like employment, which used to be taken for granted—overall, it may well have been a blessing in disguise. In any case, at least in Japan, it certainly enhanced the cohesion and the seriousness of many of us, especially among the younger.



The June 1979 Tokyo Summit

In all candor, the greatest significance of summit meetings is that they are being held at all. Successfully organizing a summit in Tokyo is, in itself, a most important accomplishment. Again, for the heads of our governments to get together and discuss matters of major concern is in itself greatly significant. Otherwise, frankly, I do not expect much from the summit, some of the current irritants in U.S.-Japan and EC-Japan relations—particularly in the field of trade—are complex issues; these problems have strained our relations to an alarming degree, and they can only be solved with time and through a process of trial and error which requires foresight and restraint on the part of our partners as well as on ours. But I have good hopes that in time they will be overcome. ■

III

SEMINARS ON CURRENT DEVELOPMENTS IN TRILATERAL REGIONS

The first day of the Tokyo plenary meeting was devoted to a series of seminars on current developments in Japan, in the countries of Western Europe, and in both Canada and the United States.

The discussion of the Japanese situation was introduced by Masaya Miyoshi, Director of the International Economic Affairs Department in the Federation of Economic Organizations (Keidanren), and Yasuo Takeyama, Managing Director of the Japan Economic Journal (Nihon Keizai Shimbun).



Miyoshi and Takeyama, with the three Chairmen of the Trilateral Commission, T. Watanabe, D. Rockefeller and G. Berthoin.

Dialogue reproduces below in extenso Mr. Takeyama's presentation, "Japan at the Crossroads," the text of which was distributed at the time to the participants. Mr. Miyoshi, for his part, devoted his introductory remarks to current economic developments in Japan. Having stressed Japan's remarkable economic recovery following the 1974 oil shock, Mr. Miyoshi observed that, despite a spectacular expansion of domestic demand, the rapid impact of the recent appreciation of the yen had prevented Japan from achieving its 7 percent growth rate target. Addressing the trade issues which have been at the center of the debate between Japan and its trilateral partners, Mr. Miyoshi emphasized that the growth of domestic demand and the sharp appreciation of the yen have brought about since the middle of 1978 a clearcut reversal of the continuous current account surplus trend which characterized the three previous years. He did recognize the highly competitive nature of the Japanese market and the number of indigenous hurdles it places in

front of foreign traders' efforts. However, he characterized this market as a large and open one, which is by no means more protective than other trilateral markets, provided that Western businessmen show a strong and continuous interest in the market; choose appropriate marketing strategies; realize the importance of close personal contacts; and achieve a high degree of flexibility and adaptability for their products. Stressing the considerable effort made recently by Japan to promote imports of manufactured goods—the proportion of which has risen dramatically in relation to overall imports—Mr. Miyoshi detected a notable improvement likely to continue in Japan's overall trade posture vis-à-vis the other trilateral countries.

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The discussion of current developments in North America was introduced by Walter Heller, Regents' Professor of Economics at the University of Minnesota and former Chairman of the President's Council of Economic Advisers (1961-64), whose remarks on the U.S. economic situation are reproduced here in extenso; and by Michael Kirby, President of the Institute for Research on Public Policy in Montreal, who gave a vivid description of Canada's political scene before the May 1979 general elections, which have since seen the defeat of Prime Minister Trudeau's Liberal Party and the victory of Mr. Clark's Progressive Conservative Party.

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The seminar on current developments in Western Europe was opened with brief remarks by six speakers: Thierry de Montbrial, Director of the Institut Français des Relations Internationales, reviewed the operation and implications of the newly established European Monetary System; Lord Shackleton, Deputy Chairman of Rio Tinto-Zinc Corporation Ltd., described the political situation of Great Britain as it was on the eve of last May's general elections; Piero Bassetti, a member of Italy's Parliament, devoted his presentation to the Italian situation before the general elections

which were to be held there in June 1979; Heinz-Oskar Vetter, President of the German Federation of Trade Unions (DGB), directed his comments at the June 1979 elections to

General of the Commission of the European Communities, addressed the problem of the enlargement of the EC in view of the expected entry of Greece, Spain, and Portugal; fi-



Seminar on current developments in Western Europe.

the European Parliament, and at the prospects of this important European body, to be composed for the first time of representatives directly elected by the people of the member countries of the EC; Edmund Wellenstein, former Director-

nally, Carlos Ferrer, Chairman of the Spanish Confederation of Employers' Organizations and Chairman of Ferrer International, reviewed the current political situation in Spain and his country's successful transition to democracy.

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Japan at the Crossroads

Yasuo Takeyama

Managing Director/Editorials
The Nihon Keizai Shimbun

The present day political and psychological mood in Japan represents a peculiar amalgam of basic characteristics of the contemporary Mass Democratic Society—the legacy of traditional Confucianism and Samurai traits and the closed society mentality of the insular nation.

Japan is at the crossroads. It is viewing itself and the political and economic pressures from outside with an ambivalent and mixed feeling: pride in its postwar social and economic achievements in contrast with a sense of guilt and frustration, self-satisfying complacency with deep-seated anxiety about the future, an inclination to fall back to the status quo with the contrasting inherent dynamic forward-looking energies.

With these contradicting socio-psychological factors cancelling out each other, Japan has been forced by the outside world to go through an agonizing reappraisal of its national objectives, under which Japan has endeavored to reconstruct the democratic economic empire from ashes with its people's traditional ethics of hard work, a relatively simple materialistic way of life and painful, continuous industrial adjustments.

Whenever I ponder the politico-psychological syndrome of contemporary Japan, I recall a far-sighted diagnosis on the emerging Mass Society made in 1930 by the great Spanish thinker José Ortega y Gasset in his masterpiece, *The Revolt of the Masses*. He

depicted the features of the Mass Society as follows: "Our age is characterized by the strange presumption that it is superior to all past time. We live at a time when man believes himself fabulously capable of creation but does not know what to create. Lord of all things, he is not lord of himself. He feels lost amid his own abundance. Hence the strange combination of a sense of power and a sense of insecurity. Our epoch is superior to other times, inferior to itself. Strong indeed, and at the same time uncertain of its destiny: proud of its strength and at the same time fearing it."

* * *

Since the Nixon Doctrine was announced in 1970, a real watershed year, the history of mankind has entered into a great historical transitional period. The frames of reference have become more complex and complicated, compared with those of the previous decades up to the end of the 1960s. The Cold War was replaced by detente, the competitive coexistence between West and East. Then came the emergence of North-South problems, which was eventually dramatized by the oil crisis of 1973. Now we are in the midst of a fourth stage under which each nation has been striving to secure its own national survival, regardless of the political

ideologies, as we now can witness in the communist countries and the Southern countries.

A viable and workable international political and economic order is not yet in sight. Since the time when I predicted President Nixon's historic trip to China on June 9, 1971, I have held the following historical perspectives: 1) It would not be surprising if it took at least 10 to 15 years for the free world to recreate an alternative relatively stable world politico-economic order, if it happened at all, for unfortunately, we may not ever succeed in rebuilding a desirable order; 2) The year 1980 plus or minus two years (i.e., the four years from 1978 to 1982) will eventually prove to be a decisive historical phase in shaping the basic global framework for the 21st century.

The particular characteristics of the Japanese *modus operandi* are sometimes single-minded and very efficient in implementing clearly set national goals. Once the definite national objective of catching up with the West was accepted, Japan has been very successful in mobilizing and channeling the whole energy of its people to achieve its objectives.

In those good old days, governmental bureaucrats, as experts who could efficiently implement these goals, were very active. It was also not necessary for businessmen to worry about creating any profound business ideology; they could just comfortably subscribe to the slogan: "What is good for GM is good for the Nation." The "creative conformity," nurtured by the Japanese type of closed collectivistic organizations, functioned very efficiently and effectively, leaving no discrepancy between the so-called functional rationality and the substantive rationality in Max Weber's sociological terminology. Everybody was happy and self-confident. But these good old days came to an end in 1970.

Now the urgent task and challenge for Japan is to select and set a new national goal for its future. In this respect, the bureaucrats have lost their equanimity. The vested interests they stubbornly cling to are their privileges and the desperate effort to maintain the status quo. The politicians, who are expected to play the role of vision-setter, have not been successful so far as setting a new national goal to attract the zeal of people—maybe because they, for so long, have depended comfortably on the bureaucrats for policy formulation. The national policy formulation process is ambiguous and in disarray. These may be the social and political structural reasons underlying Japan's "immobility" and the typical Japanese responses to outside pressures in a "too little, too late" fashion.

We also cannot deny the fact that the bipolar world system of two superpowers over the last quarter century forced the Japanese to indulge themselves in a sense of powerlessness and futility in exerting a responsible role in the international political scene. In addition, the security umbrella, provided for Japan by the U.S.-Japan Security Pact, blurred the realistic political sensitivity and political will of the Japanese to look forward and act resolutely, if necessary, to secure its survival and to contribute in a positive posture for the peace and prosperity of the world.

With its tremendous economic potential, the kind of leadership role—in the moral, economic, diplomatic, cultural or military dimension—that Japan wants to assume is not yet clear. In his far-sighted article entitled, "Japan's Dilemma: To Act or Not to Act," in the fall of 1974 issue of the U.S. magazine *Foreign Policy*, Professor Wakaizumi drew a clear picture of the cross-currents of views among Japanese intellectuals, contrasting "forward-looking activism" (or "positivism") with "low-profile passivism." Although I was honored in his article as one of the potential leaders of the positivist approach, I had to concede, together with Pro-

fessor Wakaizumi, that "the number of the positivists among Japan's leading intellectuals is still small today" (1974). Many of the positivists share the ambivalent view that while Japan should be proud of having conducted a rare historical experiment for the future—developing an economically strong nation without turning it into a militarily strong power—at the same time, relying heavily on the U.S. for security has not been necessarily pleasant for Japan, as an independent nation, and by and large has injured our national pride.

Since 1974, many things have happened in the international political arena. China emerged as an influential political power. The Sino-Soviet confrontation has become more tense than ever. And the Sino-Vietnamese war confused many people about distinguishing communist ideology from national interest. The economic capability of West Germany and Japan has become enhanced. The Carter Administration is now, at long last, giving the impression of shifting away from its past posture of seeming "to react in surprise and confusion rather than initiate" to a more tough strategic posture, as demonstrated by the strong commitments given to Sadat and Begin, and quiet suspension of the U.S. troop withdrawal from Korea. We were also very much interested to read in the *Washington Post* on March 16 that Chancellor Schmidt recently expounded his vision on the future of Europe as a future increasingly reunited, at least culturally, from France to the USSR. I found his reported remarks that "the Japanese would sit on the fence and follow whoever leads, so it is now up to the European, especially the French and Germans to lead" very amusing.

We naturally have to watch the fundamental developments in the world political economic situations very carefully if we are to be prepared to set our new national goals. And while Japan seeks to reappraise and reformulate its national objectives, the framework of Japanese diplomacy is already fairly clear.

Within the context of the so-called Japanese multidimensional diplomacy, I, for one, can easily foresee some of its features: 1) The close relation and partnership with the United States will remain the cornerstone of Japanese foreign policy; 2) many Japanese have some kind of special affinity toward China, but it may be an overstatement at this juncture to say that "the China-Japan co-prosperity sphere, including Australia, is to be the future center of the world," as General Sir John Hackett narrated in his fascinating book, *The Third World War — August 1985*; 3) until and unless the illegitimately occupied northern territory problem is solved satisfactorily, Japan-Soviet relations will not be truly genuine and cordial; 4) the Japanese sincerely want to promote friendly and cooperative relations with Western Europe on a mutually beneficial basis. Yet it seems appropriate to caution you that not a few informed Japanese still remember with bitterness how the Europeans, at the closing stage of the Smithsonian International Currency Negotiation of December 1971, pulled the rug from under Japan's feet.

To consolidate trilateral relations, many of us recognize that Japan has to take some concrete positive measures in the management of its national economy, consonant with the principles of "mutuality," "reciprocity" and "transparency." As a major step to be taken, I personally welcome a substantial appreciation of the yen, so that Japan can increase foreign imports, and automatically restrain its exports while, at the same time, curbing its domestic inflation. Economic growth and prosperity without inflation would be the most striking contribution that Japan could make to world economic health. Reciprocal treatments, including allowing foreign

(Continued on p. 20)

The U.S. Economy, Inflation and the Dollar

Walter M. Heller
Regents' Professor of Economics
University of Minnesota

My approach today will be to look at the U.S. economy, inflation and the dollar through the lens of economic policy. As a point of departure, let me recall that last October and November, President Carter, under the force of relentless economic circumstance—under the force of a surging inflation and a sinking dollar—put in place a balanced anti-inflation policy. Its inner logic was sound:

- On one hand, it embodied monetary-fiscal restraints to curb excess demand and gradually cool down the economy—presumably without the hot meltdown of recession.
- On the other, he applied voluntary (or semi-voluntary) wage-price restraints designed to curb cost-push inflation by converting as much as possible of the cutback of overheated demand into a reduction of price and wage inflation and as little as possible into a loss of jobs and output.

Given the structural and institutional rigidities in the U.S. economy, it costs between \$150 and \$200 billion of lost output to knock 1 percentage-point off of our underlying or basic inflation rate. A series of econometric studies shows that, left to itself, the economy will convert roughly five-sixths of a demand cutback into a reduction of output and jobs and only about one-sixth into a cutback of inflation. Thus the inner logic of the voluntary wage-price program was to improve that trade-off, i.e., to serve not as a substitute for monetary-fiscal discipline but as a handmaiden to it.

But the economy refused to cooperate. Real growth jumped from a 2-1/2 percent rate in the third quarter to a booming 7 percent rate in the fourth, in the process generating sparking profits to inflame the wage desires of American workers. Even the fallback to a lackluster 7/10 of 1% rate of advance in the first quarter does not, as we shall see in a moment, provide conclusive evidence of the slow-down the White House is seeking.

Indeed, the guarded, almost perverse, reaction of economic observers to the first quarter drop-off reminds me of the perverse definition of an economist as one who, when observing that something works fine in practice, wonders whether it will work in theory!

In any event, the bridegroom of easier labor and product markets is late for the wedding with its handmaiden, the wage-price guidelines. At this moment the guidelines in particular and the anti-inflation program more generally are under siege, attacked from the *demand* side by an overly strong economy; from the *supply* side by the new oil price eruption, bad luck on food prices, and a disturbing run-up in other world commodity prices; and from the *cost-push* side by a Teamsters' wage settlement that has badly denied the 7 percent guideline. Under these onslaughts, can the program survive?

Before we can form a reasoned judgment on that question, we need to feel the pulse of the real economy and take a careful reading on inflation. What are the recession and inflation prospects?

Recession?

One finds a sharp division of opinion between those who expect merely a growth recession, a slowdown in output, and those who expect a classic recession, a drop in output. Almost no one expects actual GNP advances in the next year to keep pace with the estimated annual growth in U.S. *potential*, even at its recently downgraded rate of 3 percent per year. But given continuing high rates of inflation, that still leaves plenty of room for conflict between the hawks who are telling Chairman Miller and the Federal Reserve: "Don't just stand there, do something!" and the doves whose message is "Don't do something, just stand there."

And each group, in today's ambiguous and puzzling U.S. economy, has plenty of grist for its mill. The hawks discount the slow first quarter, citing not just severe weather but the fact that unemployment has held at a low 5.7 percent rate even with large additions to the labor force; they point out that labor inputs rose at a brisk 4.3 percent pace; that operating rates in manufacturing continue at a high 86 percent of capacity; that capital goods demand is 30 percent above a year ago; and that commercial and industrial construction is booming. And they remind us that the flat first quarter last year was followed by a near-9 percent jump in the second quarter.

By the way, most of Mr. Carter's economic advisers are among the hawks or near-hawks. They would be quite startled to read the heading on page 43 of the excellent Trilateral draft report on Major Payments Imbalances which reads: "Inducing Expansion More Difficult than Inducing Contraction." Messrs. Blumenthal, Schultz and Kahn would respectfully disagree.

The doves, including Chairman Miller and a majority of the Federal Reserve Open Market committee, appear to view the U.S. economic scene rather differently. They see the first quarter numbers as truly reflecting a weaker economy, with personal income and industrial production advancing at only half the pace of last year's fourth quarter, housing starts almost half a million units lower, and consumer credit growing \$2-1/4 billion less than in the fourth quarter. And the doves remind us that in 1974, the failure to distinguish between *apparent* and *real* strength in employment, orders, and inventory investment led to fiscal and monetary overkill which, coupled with the oil price explosion, sent the U.S. spinning into the worst recession in 40 years.

But this time around, it is a much closer call. It is only by a narrow margin that I side with the doves in believing that, after a considerable rebound this quarter, the U.S. economy will continue to soften in the second half of the year. Why?

- First, because in spite of the income tax cut in January, consumers did not put in a very robust performance in the first quarter, and they now face a \$2 to \$3 billion rise in tax rates each quarter

as inflation pumps income into higher brackets; they still face a \$4 billion increase in payroll taxes later in the year (because of a rise in the wage base); and oil price increases will siphon away up to another \$10 billion a year of their purchasing power.

- Second, housing will fall from over 2 million starts last year to perhaps 1.7 million this year.

- Third, overall government purchases will rise only 1-1/2 percent in real terms this year as against an average rise of 3 percent in 1976-78 and 4 percent in the 1961-75 period.

- Strength in exports and in business capital spending for machinery, equipment and plant—while very welcome—won't be enough to offset the softening in the other sectors of the economy.

So, to borrow an apt phrase I once plucked from a report of the Tokyo Marine and Fire Insurance Co., I believe the second half of the year will "progress in stagnancy." As against a 4 percent rise in real GNP between the fourth quarters of 1977 and 1978, I anticipate less than a 2 percent gain in 1978-79.

Will the slowdown in GNP turn into a gentle slide below zero for a couple of quarters next winter and thus qualify as a recession? Again, the odds are slightly better than 50-50 that it will. Yet, substantively, the central point of policy significance is the prospect of several quarters of sluggishness and growing slack in the U.S. economy in 1979-80, not recession as such. Whether the timing of the slowdown is such as to qualify it officially as a recession is secondary—except, perhaps, to pundits and politicians.

Fiscal-Monetary Policy

Implicit in this forecast of a soft U.S. economy is a judgment that U.S. monetary-fiscal policy is restrictive and will become more so. Let me make that explicit.

As to budget policy, I have already cited some evidence on taxes and government purchases that suggests moderation if not outright restriction. The projected shrinkage in the federal deficit from \$49 billion in fiscal 1978 to \$33 billion this year and \$28 billion next year (on Mr. Carter's no-recession assumption) is further evidence of the move toward more restrictive fiscal policy. (But don't be surprised if the actual deficit in fiscal 1980 weighs in at about \$40 billion as the slowdown shrinks revenues and boosts transfer payments.)

An interesting perspective on U.S. deficits is provided by recent OECD figures showing overall government deficits as a percentage of GNP in the seven major OECD countries. For 1977, 1978 and projected 1979, the U.S. (to use Mr. Miyoshi's metaphor) won the gold medal with the smallest deficits, averaging less than 1 percent of the GNP. Germany's government deficits, by contrast, averaged 3 percent, and Japan's, 6 percent, of the GNP (or, more precisely, GDP).

Looking ahead to 1980, Mr. Carter's budget proposal reflects a coupling of his innate fiscal conservatism with the "Proposition 13 mood" of the country. Let me cite four quick measures of how restrained the Carter budget is:

- It calls for only a 7.7 percent rise in spending as against an average of 12.2 percent from 1973 to 1978.

- It would bring the ratio of federal spending down to 21 percent of GNP from its high of nearly 23 percent in 1975-76.

- The \$531 billion of projected spending falls \$20 billion short of merely funding current services under current laws.

- And in economic terms, the high-employment deficit would shrink from \$31 billion in 1978 to \$23 billion in 1979 and \$8 billion in 1980.

In the U.S., that truly qualifies as fiscal austerity. And the Congressional budget committees, far from upsetting the fiscal

appreciation, have gone Mr. Carter one better by shaving the Carter deficit by another \$5 to \$10 billion.

Turning to monetary policy, has it been as restrictive as the high nominal interest rates and the phenomenal slowdown in money supply would lead one to believe? The monetarists, at least the true believers, have no doubts. "Don't just stand there, undo something," is their urgent advice to the Federal Reserve. Ease now, lest the shrinking money supply plunge us into dire recession.

What may have escaped them is that less money is doing more work. Astute managers of cash, both in business and in households, are quite sensibly redeploying their funds from bank deposits—which *do* show up in M_1 and M_2 —into money market funds, Treasury bills, commercial paper and so on, that *do not*. So a smaller amount of measured money is supporting a larger flow of transactions.

This is not to say that money has not been effectively tightened. Indeed it has, up to and especially including last November 1. Since then, Mr. Miller and his cohorts have steered a steady course, holding the "Federal funds" interest rate right around 10 percent while the money supply did its partial disappearing act and the dollar strengthened.

It has been fascinating to watch the policymakers in Washington, with the Treasury and White House advisers pressing Mr. Miller to raise interest rates and tighten credit, and Mr. Miller asserting the Federal Reserve's independence and insisting that "we're in the range of properness."

Both the Federal Reserve and the White House seem to have been "minimaxing," i.e., seeking to minimize their maximum risks. The White House and Treasury seek to minimize the maximum risk of inflation and of appearing to do too little. Chairman Miller and the Federal Reserve are minimizing the maximum risk of severe recession and of appearing to do too much.

Does all this mean that U.S. interest rates are at their peak and are now headed down? I doubt it. Even Mr. Miller has said that one more upward move may have to come before rates ease a bit. That may still prove to be the course of financial rectitude, wisdom and risk-minimization.

Inflation and Wage-Price Restraint

That leads us directly into the prickly subject of inflation. Will the strong head winds of U.S. inflation continue to blow for many months ahead and, in the process, demolish President Carter's wage-price program? Or are they about to subside or at least drop from gale force to prevailing Westerlies? Let me expose you to some quantitative and qualitative evidence that yields a moderately optimistic answer. (But as I do, I'm sure you will bear in mind that economists have hardly distinguished themselves as inflation forecasters in the 1970s—in 1973-74, we were caught with our parameters down, and again last year, we substantially underestimated inflation forces in the U.S.)

Picking apart the generally dismal double-digit inflation numbers of recent months (I refer to the consumer and producer prices indexes—the GNP deflator has held in about the 8-1/2 percent area for the past half year), one can find some rays of hope on two fronts:

- From October to March, taking out energy, housing and the farm component of food, the remaining two-thirds of the Consumer Price Index has risen at a 6-1/2 percent rate. What's the purpose of this calculation? After the next couple of months—when the inflation readings are bound to be bad—the farm, housing and later the energy components of inflation should taper off significantly.

- The average hourly earnings index, which was up 8.4 percent

from February to October last year, has held to an 8.3 percent rise from October to March—no acceleration of underlying wage-price is reflected here.

On the qualitative side, one can see a number of inflationary forces that should be less virulent as the year goes on:

- The worst of any food price rise, barring drought or deluge, lies behind us.
- The stabilizing of the dollar will reduce the import-price push.
- The peaking of interest rates will remove another cost-push force, especially from housing and business costs.
- Oil price impacts will be less pronounced later in 1979. Granted, the 20 percent to 25 percent rise in OPEC prices this year will add from \$10 to \$12 billion to the U.S. fuel bill. But perhaps three-quarters of this cost and price upthrust will be behind us by late summer. It is true that Mr. Carter's decontrol program will raise the average price of domestic oil from \$10.44 per barrel in December 1978 to \$15.60 in December 1980. But the price impact in 1979 will be modest, and the overall effect of full decontrol (after October 1981) on the price level is estimated variously from 0.5 percent to 0.8 percent.

Finally, on inflation, the easing of demand pressure is a must. If such pressure continues unabated, the wage-price guidelines will crumble, and the absolutely critical attempt to lower the orbit of the wage-price or price-wage spiral—or circle—will be defeated. But will the easing come in time to rescue that handmaiden, that damsel in distress?

- It is true that the Teamsters' settlement bent the 7 percent guideline, that the rubber workers union will also stretch it, and that Mr. Fraser of the United Auto Workers has threatened to run over it. But all is not lost—non-union settlements have generally come within the guidelines, some stretching can be accommodated, and if some easing of demand pressures and of inflation begins to be perceived within two or three months, I believe the effort *can* survive and make a visible contribution by the end of the summer.
- I say this in particular because U.S. businesses have shown a widespread—not universal, but widespread and genuine—will to cooperate not just in holding wages down, but in holding prices in check.

The quarter-page advertisement General Motors took out in many papers last week serves to illustrate this. GM urged everyone, and particularly its suppliers, to commit themselves to comply with the Carter wage-price standards. To take my cue from Mr. Takeyama's comment this morning, the White House fervently hopes that "what is good enough for General Motors is good enough for the country."

Also, on the Carter wage-price restraint program, I would remind you that Mr. Nixon's semi-voluntary Phase II was widely ridiculed and virtually dismissed in its early phases in 1971-72. But it ended 1972 as one of the most successful experiences in postwar incomes policy (just before it was dropped in January 1973).

Are mandatory controls on the way in 1979 or 1980? The U.S. public wants them, demonstrating that it had failed to learn its lesson on mandatory wage-price controls (perhaps because we economists have failed to get the lesson across). Well over 50 percent say "yes" on public opinion polls asking whether ceilings should be put on prices and wages. But several factors militate against them:

- First, to a man, the Carter policymakers abhor the straightjacket of such controls—the loss of economic freedom, the chicanery and cheating they invite, the warping of resource allocation they generate, and so on. Alfred Kahn, as usual, puts it most graphically: "Direct controls are a stinking mess."
- Second, leading members of Congress that would have to legis-

late controls authority—like Congressman Reuss and Senator Proxmire—have voted sharp opposition.

- Third, the business community, which tacitly and often vocally supported controls in 1971, is almost solidly opposed today.

In brief, I count the odds at roughly three to two against surrendering to direct controls.

The Dollar

I have left the fate of the dollar to last, partly because it will inevitably come into focus in tomorrow morning's discussion, partly because you all know more about it than I do, and partly because the future of the dollar rests in large part on the course of U.S. domestic policies on output, employment and inflation.

Just a brief listing of pluses and minuses may serve as a useful checklist for appraising the future of the dollar. What pluses lie behind the remarkable resiliency of the dollar to shocks in the past 5-1/2 months?

- Clearly, the dramatic policy turn on November 1, the new resolve and commitment to stabilize the dollar even at some loss in domestic growth, looms large.
- The U.S. turn toward domestic fiscal conservatism plays a companion role in the eyes of foreign observers.
- Convergence of growth rates in the trilateral world and the likelihood of greater convergence in inflation rates is an important factor.
- The shrinkage of our trade and current account imbalance—while blunted by OPEC actions—is hopeful. After a dramatic improvement during 1978, when the current account deficit fell to \$17 billion for the year, a further improvement to a \$10-\$12 billion range is in prospect this year (\$4 billion worse than before OPEC oil price increases and decontrol).
- The decontrol of domestic crude oil prices will in time be a plus for the dollar.
- A renewed influx of long-term capital in response to U.S. social and political stability, good bargains in U.S. property and companies, and lessened currency risks, is another plus.

The major minus (apart from OPEC oil price boosts, which are a "mixed curse") would be a renewal of reserve diversification away from the dollar. A failure of U.S. efforts to cope with inflation would surely accentuate these portfolio shifts out of the dollar.

Conclusion: Looking Ahead

Looking beyond 1979 and across the valley of mild recession, what can U.S. trading partners anticipate as to economic policy under the pressure of the 1980 elections?

I believe that both the economic configuration—the persistence of high inflation coupled with a U.S. commitment to stabilize the dollar in the face of pressures for reserve diversification—and the political configuration point to a policy of moderation in policies for renewed expansion. The U.S. locomotive will not go roaring out of the station.

That seems to contradict history, the political-economic cycle and the cliché that election years breed expansion—and inflation. Do I really believe that water will run uphill? I can only respond that, leaving personal preferences aside, one must acknowledge that the political topography has changed. Political advantage now seems to lie more in a successful assault on inflation than it does in all-out war on unemployment.

Why not try to reconcile the two—anti-inflation and pro-employment—by imposing mandatory controls, as in 1971, and behind that protective barrier, pump up the economy by tax cuts and easy money? As I indicated earlier, I believe the odds are rather good that Carter and Congress will not succumb to this temptation.

Beyond 1980, I look for greater stability, a better productivity performance and less inflation in the U.S. economy as, among

other things: (1) our huge influx of workers in the 1970s is digested and becomes a seasoned part of the labor force in the 1980s; (2) private capital investment accelerates under the influence of labor shortages, lower taxes and favorable government policies; and (3) the costs of government regulation, both economic and social, are somewhat eased. Nirvana? Hardly. But a distinct improvement over the turbulent seventies? An entirely reasonable expectation. ■

(Continued from p. 16)

companies to make take-over bids for Japanese companies, should be implemented as early as possible. The Japanese agricultural policy also has to be reviewed thoroughly, not only to promote the import of relatively less expensive foodstuffs but also to implement basic economic restructuring for our own benefit.

In essence, the internationalization and incorporation of the Japanese economy more tightly into the world economy on the mutually beneficial basis could be a new national economic goal for Japan. Whether Japan likes it or not, the time will shortly come when she will follow the course I have drawn here. What is necessary for Japan is a strong political will to lead its people in this direction. I may have to caution myself, however, that it will not be done overnight.

To induce Japan in this direction, Americans and Europeans should keep the following points in mind: 1) The Japanese society is stable and resilient, yet swift, profound and unpredictable changes in the domestic political regime and foreign policy could eventuate if Japan's external environment became suddenly unbalanced; 2) unsettling changes could occur, if, for example, the absence of a unified and clear U.S. strategic policy continued and Japanese confidence declined in the U.S. security commitment, or if the present system of trade and monetary cooperation began to wither and the Japanese concluded they must again strike out on their own; 3) the only sensible alternative for the Western world is to enfold Japan securely in a strong community of all the developed democracies (North America, Western Europe, Australia and New Zealand).

(Continued from p. 9)

shared this concern and expressed their hope that the report's proposed OECD Working Party would assist in the much needed coordination efforts.

• *The impact of government regulatory policy.* As was noted by an American participant, regulatory programs have been "the most rapidly expanding realm of American government," and their impact on the structure of industry is "significantly larger" than some of the policies discussed in the task force draft—including, for example, impact on economic productivity, on the competitive position of U.S. industries vis-à-vis foreign industries, on the relative competitive position of firms within industries in the United States, and on the structure of sectors in the American economy. In this participant's words, the direct cost of American industrial compliance with government regulations exceeds \$100 billion annually, and the indirect cost of recent government regulatory activities on basic capital formation processes and on the growth rate of the U.S. GNP is "even more disturbing."

• *Taxation.* Noting that tax policy "must have something

In this respect, I would like to call particular attention to the following three points: 1) Many ordinary Japanese are dismayed at being penalized for Japan's economic success and hold the deep-seated feeling that this is not fair. They instinctively know that U.S. and European industries will not be able to increase their competitive edges automatically, even if Japan painstakingly volunteers to restrain her exports. 2) Many Japanese know that in the United States and Western European countries, skilled labor is almost fully employed, even though they claim that unemployment rates are substantially higher there than in Japan. If so, it is quite natural for the Japanese layman to request that our American and European friends not blame Japan for all their economic difficulties but strive by themselves to implement vigorously a retraining program for the unemployed. 3) As we subscribe to the golden rule that "stability begins at home"—the words of my mentor, the late Dr. Karl Blessing, President of Bundesbank in West Germany—and as we have achieved the position of "the world quality leader," according to Dr. J.M. Juran, the internationally renowned U.S. expert on quality-control, after strenuous nationwide efforts through total quality control movements and productivity production schemes, we may be entitled to advise our American and European friends "to put your own houses in order first" in order to curb inflation and raise productivity and to implement an appropriate retraining program for the unemployed.

Japan is now at the crossroads. We ourselves are striving to set a new course for Japan. Our future course of action will also be greatly influenced by U.S. and European policies in the next few years. ■

to do with investment and innovation in our industrial economy," a U.S. participant particularly criticized the U.S. approach of offering tax credits for investment in plants and equipment, and favored instead a substantial cut in the corporate income tax.

* * *

In closing, several American participants observed that structural and industrial policy in the United States is "an underdeveloped, underdiscussed, and not particularly well understood phase of economic policy in action," and one of them welcomed the contribution of the task force report as a "consciousness raiser" in this respect. At the international level, a number of Commissioners cautioned that bad industrial and structural policies may foster an insidious protectionism unless our countries move in tandem. As was noted by the authors, there is an erosion of international economic cooperation largely due to countries' trying to take care of structural problems in damaging ways—hence their report's call for closer concertation among the trilateral countries and a more transparent sharing of information and data on their respective policies. ■

IV

CHINA AND THE INTERNATIONAL COMMUNITY

In the wake of the normalization of relations between the United States and China, a session of the Tokyo plenary meeting was devoted to the role of the People's Republic in the international community and the prospects for relations between the trilateral countries and China. These debates were highlighted by the presentations of: Endymion Wilkinson, expert on Chinese affairs presently with the EC Commission; Yusuke Kashiwagi, President of the Bank of Tokyo, Ltd.; Michel Oksenberg, China expert in the U.S. National Security Council; and Kiichi Saeki, President of Nomura Research Institute. We reproduce below large excerpts from these four presentations.



From left: Wilkinson, Kashiwagi, Oksenberg, Saeki, Conference Chairman Watanabe.

ENDYMION WILKINSON:*

The passing away of the veteran political elite in China which had made the revolution also means that the possibility of individuals virtually shaping society and controlling politics is now reduced. From now on the tendency will be increasingly for social forces to exert a greater influence on politics. Matters such as the man-in-the-street's desire for improved living standards and greater freedom from personal controls will have to be taken far more into account. *This is another reason to suppose that economic development will continue to be the main focus of the present regime in China.* Whether it means that the regime will become more liberal is however a different matter altogether. The "four modernizations" do not include political modernization. The present regime is based like its predecessor on Communist Party control of all aspects of life. More democracy would mean by definition a reduced role for the Party, and it will therefore in a fundamental sense probably resist such a tendency.

New tensions in China may well develop because of the Party's inability to meet rising expectations for a higher living standard, or possibly because of the conflict between the popular desire for personal freedoms and the repression of the Party's control. But

such tensions will be of a different nature from the struggles of the last twenty years, nor will they of necessity bring to a halt the pursuit of economic development.

If the Party can achieve its stated goal of making China "a strong socialist country by the end of the century" it may well be able to repress or postpone any fundamental alteration of the political system. For this reason alone I believe that it can be expected to follow the policies of Vice Premier Deng, even after his demise. There are then reasonable grounds to suppose that China will pursue policies of economic modernization, bringing her into closer relations with the trilateral countries, for the foreseeable future. . . .

The euphoria both inside the country, as well as outside it, which greeted China's new commitment to economic growth, has now worn off. It is therefore easier to assess just what opportunities the opening of the China market presents for Europe. Today, Europe's trade with China is minutely small. The nine members of the European Communities, for example, exported more to Singapore in 1978 than they did to all of China. During the last five years, China has taken less than 1 percent of the EC's total world exports. Imports from China amount to less than half of one percent of the EC's total imports.

The small size of the trade reflects the relatively small size of China's total foreign trade. Even if China's total trade grows very rapidly, and at an increasing pace, in the coming years, for Europe it will still remain a relatively small market. A reasonable estimate, based on extrapolations of current levels, suggests that total Chinese imports by 1985 may amount to about \$30 billion. The Chinese leaders have frequently made it clear that they will diversify their sources of supply. Let us assume an even three-way split between Japan, the U.S. and Europe. Then the China market for each would amount to about \$10 billion in 1985. This would represent a ten-fold increase from current levels of Europe's exports to China. It would also make the China market much more important for Europe than it is today. Ten billion dollars would represent about 2.3 percent of our total exports in 1985. That is slightly less than the 3.5 percent of our exports which go to the Soviet Union at the moment.

If the Chinese have decided to diversify their suppliers for political reasons, then they will probably also seek capital funds in a balanced way from different sources. Europe can hope to supply capital funds, but they will probably not be huge, as China will probably cut back her targets and also wish to avoid getting too heavily into debt.

Turning to the economic consequences of China's modernization on her exports to Europe, the story is not encouraging. It is doubtful whether Europe will ever be able to absorb significant quantities of Chinese coal or oil. China's natural resources are

*In his address to the Trilateral Commission, Mr. Wilkinson spoke in a personal capacity.

huge, including rare minerals, but to date they have not been greatly exploited.

That leaves light industrial goods like textiles. Such industries are among the fastest growing in China. Textiles alone were China's top foreign exchange earner in 1977, accounting for no less than 30 percent of all her exports. That year no less than one third of the EC's imports from China were textiles.

Fears of China's exports do exist, and not only in Europe. But are they justified? I think not. First, the problem of absorbing imports in sensitive sectors from developing countries is hardly a new one. Furthermore, the quantity of China's exports is not enormous. Currently she has about 2 percent of the EC's textile imports. Compare this with Hong Kong's share of 10 percent. China's domestic market is huge and, as consumer demand grows there, the rate of growth of exports will be kept down. . . .

Now China is seeking to modernize once again and she has turned mainly to the trilateral nations. It is a unique opportunity. Clearly it is in our interests to respond positively. By contributing to the development of a more prosperous China, we contribute to her stability. Also the increase of the purchasing power of China, as one of the major markets in the world, is in our interests.

Every nation has the sovereign right to build up its own defense capability. If the Chinese ask us for defensive weapons (as indeed they have done), then we should be prepared to consider supplying them. . . . In cooperating with China in her modernization plans, we should avoid foolish talk of playing a "China card," that is to say, cooperating with the Chinese, whether economically, militarily or diplomatically, in order to reduce Soviet pressures on Europe. Such talk is a myth: China is not a passive card to be played. Nor do we wish to improve our relations with China at the expense of our relations with the Soviet Union. In order to avoid the mistakes made on previous occasions when China has attempted to modernize, we should cooperate in China's modernization plans *at her pace*. We should also seek to reduce external pressures on China.

YUSUKE KASHIWAGI:

Modernization appears today to have become an established line of policy. Of course, in view of the wild swings of policy that have taken place over the past thirty years, one is unavoidably tempted to become skeptical about the durability of the new policy. Nevertheless, we can probably expect it to continue uninterrupted for a protracted period—barring any now unforeseen drastic changes—as it is a continuation of a policy promulgated in 1975, and as it also seems to be fervently welcomed by a wide spectrum of the population. . . .

Looking at the composition of China's trade, one can see that China needs to import, first, foreign grain (and fertilizers), secondly, such intermediate materials as iron and steel, and thirdly, plant and equipment. China does not depend so much on the imports of finished manufactured goods for consumption. In order to pay for these imports, she exports agricultural products, light industry goods and crude oil. Economic modernization of China, therefore, aims at creating a basis for balanced economic growth by eliminating the need for food imports and establishing a powerful industry capable of supplying necessary investment goods to every sector of the economy.

The task of quickly modernizing the Chinese economy, disrupted by the Cultural Revolution and its aftermath, will surely be a startlingly hard and time-consuming one. One can, in this re-

spect, point to many obstacles and difficulties in the way of implementing such an ambitious modernization plan.

First, can China's existing infrastructure cope with the tide of industrialization, and can it be reinforced and extended successfully? Recent reports on the congestion of ports and roads already seem to suggest a deep-rooted difficulty. Second, we are told that the disruption of the Cultural Revolution is most conspicuous in the field of education. This has affected adversely the quality of the labor force, although workers are reputedly well-disciplined and eager to learn. Insofar as China is intent on absorbing Western technology quickly, this could present itself as an obdurate obstacle. Third, the level of China's technology seems lopsided and engineers appear to be scanty, which is going to be a big headache for economic planners. Finally, any modernization process tends to give rise to balance-of-payments problems, and China will not be an exception. With import requirements so pressing and substantial in the years ahead, and an export drive likely to cause domestic strains and to face competition overseas, a gap in China's international payments account is bound to occur, the magnitude of which will be a constraint upon the progress of modernization. . . .

As for the West's participation in China's modernization, it can be summed up as an expansion and diversification of trade with emphasis on the provision of capital and know-how in the widest sense of the word. But the extent to which the West's provision of capital and know-how will reach in the foreseeable future principally, if not entirely, depends on the requirements and absorptive capacity of China itself. China's requirements are now becoming more realistic. What is vital not only to China but also to the rest of the world is, of course, a sustained economic growth, and a sustained economic growth can only be realized on the basis of a balanced development of each sector of the economy. Also, sustained economic cooperation by the Western countries and Japan presupposes political stability of China and should be founded upon a well-balanced, global strategy. By a global strategy, I mean that the economic relations with other parts of the world should never be neglected, particularly those with other developing nations. This is crucial to the stability of international economic relations.

Insofar as China's imports of plant and equipment from the West and Japan will be substantial in the years to come, and given the limited amount of her foreign exchange holdings and earnings, assuming a reasonable rate of increase of her exports, China is bound to depend heavily on credit from abroad. . . . However diversified the methods of finance for modernization may be, a fact will remain that the problem of modernization finance is going to be a formidable one, especially if financing is to be on a commercial basis. . . .

Considering the current prospects for expansion of exports and the ability to pay, commercial credits will certainly not be unlimited but be of reasonable amounts. They may be insufficient to cover the requirements to finance the import of plant and equipment and otherwise needed for the modernization program. I think official funds will, therefore, almost certainly have to be introduced in one form or another to fill the gap. In this sense, we should be reminded that economic cooperation with a modernizing China applies, after all, to a developing nation—which is to say that, if rapid growth and modernization is to be achieved in spite of real balance-of-payments constraints, funds on a longer term and at lower interest rates are required. The experiences of Indonesia and other large developing countries would, I hope, shed some light on this problem.

MICHEL OKSENBERG:

The first issue the United States faces is how to keep our relations with the Soviet Union and China in proper balance. Our objective is simultaneously to improve relations with both the Soviet Union and China. We do not wish inadvertently to tilt in one direction or another. At the same time we do not wish our policy toward one to become hostage to, or derivative of our policy toward the other. We do not wish to impair our relations with one due to the intransigence of the other. We most certainly do not wish to use one against the other, or manipulate the Sino-Soviet dispute for tactical advantage. We are not China card players, and we do not wish to exacerbate Sino-Soviet tension. A Sino-Soviet military conflict, after all, would have potentially profound and unpredictable consequences for the international system. We therefore have and will continue to think gravely of actions that could risk such a war. . . .

If we cannot assume the absence of Sino-Soviet military conflict, so, too, we cannot assume the Sino-Soviet conflict, at its current level of intensity, to be a permanent feature of the international landscape. In short, in the post-normalization era we must continue the policy of a balance in our relations with Peking and Moscow, realistically recognizing that our interests with each are different, and avoiding needless provocations of either. . . .

Our relations with China are important, but can never substitute for our Japanese connection, nor does China wish that. Nor will our China relationship come at the cost of our relations with the other Asian countries. . . . We have enormous security and economic interests in South Korea, Japan, all the Pacific Islands through the Philippines, and in Southeast Asia. This is the most vibrant area in the world today. The best way to protect our interests on the rim of Asia, I submit, is through a constructive involvement on the mainland of Asia, undertaken in harmony with Japan and Western Europe. Improved Sino-American relations, therefore, are supportive of, and not harmful to, our traditional relations in the region. Our China connection enhances the security and prosperity of the countries in the region, by removing any incentive China may once have had in driving us from the rim of Asia. In short, the Sino-American relationship will facilitate the continued active involvement of the U.S. in the Western Pacific. . . . We do not foresee our new China relationship as a substitute in any way for our military force requirement in the region. To the contrary, we believe our military strength and the

counterweight it offers provide the underpinning for a genuinely constructive relationship with Japan and China. . . .

We are not building an alliance with China. . . . The Carter Administration has asserted on many occasions that it considers a strong, secure and peaceful China in our interests. . . . China contributes significantly to the maintenance of the global equilibrium simply by maintaining its own unity and removing itself as an arena of great power competition. . . . However, the unity and independence of China must come from within. The real source of China's continued stability will be the strength and performance of its economy. . . .

As China turns to the West for trade and capital, I think the industrial democracies should respond with a sense of realism in terms of the likely size of the China market. At the same time, recognizing history and the way the Chinese view their world, we must guard against appearing to the Chinese to be colluding against them.

KIICHI SAEKI:

In building their diplomatic relations with China, neither Japan nor the United States had any intention of impairing the relations with the Soviet Union. They made no commitment to take a joint action with China against the Soviets. Japan, in particular, acted with much caution not to invite such a misunderstanding by the Soviets. However, inspired by China's intense antagonism against the Soviet hegemony and emphasis on the necessity of countering it, Moscow may show an excessive reaction based on the misunderstanding that Washington, Peking and Tokyo could form an encircling net. . . . In short, the signing of the Japan-China peace and friendship treaty and the U.S.-China rapprochement are basically factors contributing to the peace and stability of Asia and the world, but on the other hand they could be factors bringing an adverse effect. By acting wisely, we should be able to strengthen the effect of the factor contributing to the peace and stability.

It does not seem impossible to adjust the different purposes and conflicting interests among Japan, the United States and European countries in their relations with China: 1) These nations will be able to further some common interests with China, but none of them share the same value and social systems with China. Therefore,

Martine Trink, Commission's New European Secretary

In May 1979, Martine Trink became the European Secretary of the Trilateral Commission. The European group in the Commission, under the chairmanship of Georges Berthoin, has its administrative center in Paris.

Miss Trink was an economic reporter for the French daily newspaper *Le Figaro*. She was educated at La Sorbonne in

Paris, where she received a B.A. in Anglo-American Civilization in 1973 and a doctorate in Political Philosophy in 1976. Before joining *Le Figaro*, she studied at the Paris Political Science Institute. As the Commission's new European Secretary, she succeeds Dr. Hanns Maull, now a foreign affairs analyst and commentator for the *Bayerischer Rundfunk* in Munich.

even if any of these nations seeks to have an especially amicable relation with China, there will be a limit to the success it will have. 2) Japan has no intention to approach China at the risk of antagonizing the Soviet Union. Japan has neither the intention nor power of helping China militarily. It has neither the intention nor power to monopolize the Chinese market. Sometimes Japan may consider the United States to be undependable, but it cannot possibly deem China or the Soviets to be more dependable than the U.S. 3) The United States would not attempt to improve its relations with China at the expense of its relations of peaceful coexistence with Russia. It seems that while wanting a strong and stabilized China, the U.S. realizes that there is a limit to the intimacy that can be reached with a country that has such different values and systems as China. Also, there is a limit to raw materials, fuels and industrial products the U.S. can import from China, and this will eventually determine the volume of American exports to China. 4) China may look an attractive market to European countries, but actually it is a faraway country. To Europeans, China and Japan may seem to be alike, but a closer look will reveal how the two countries differ from each other.

It seems inevitable that Japan, the U.S. and Europe will vie with each other for the Chinese market. However, it would be possible for them to set up rules for competition and to cooperate with each other to avoid a futile competition on the Chinese market.

I think China will basically follow the practical policies aiming

to achieve "four modernizations." There seems to be a near consensus on this guideline, and thus there seems to be no other alternative line to follow. However, there will be repeated trials and errors with regard to the method, speed, and extent of implementing the practical measures for the four modernizations. In my view, it will be necessary for China to innovate its institutions in order to effectively carry out the four modernizations. However, it is unclear how much institutional innovation China will undertake which might affect the foundation of its socialistic system. I interpret the recent developments in China as signifying the start of its new policy of carrying out the four modernizations in a more balanced shape and at a steadier pace. I also feel that Japan, the U.S. and European nations have begun to take a more realistic view of China and treat it more prudently. This should be a welcome trend not only for China but also for us who want to promote friendly relations with China.

From the viewpoint of national security, it is most desirable for Japan to maintain peaceful, friendly relations with China. It would also serve the common interests of Japan, the U.S. and Europe to receive China, which is taking more realistic, rational and open policies than previously, into our international society. These countries should cooperate with each other to facilitate China's modernizations and encourage the country to develop so as to fulfill its share of responsibilities in the international community while employing the open system. ■

TRILATERAL COMMISSION WELCOMES NEW MEMBERS FROM SPAIN

The Tokyo plenary conference was the first Trilateral meeting to be attended by a delegation of newly invited Commissioners from Spain. Speaking on behalf of his Spanish colleagues, Carlos Ferrer, Chairman of the Spanish Confederation of Employers' Organizations, responded to the words of welcome of the three Chairmen and expressed the eagerness of the new Spanish section of the Commission to

collaborate in future Trilateral activities. After having briefly reviewed the present economic and political outlook of Spain, Señor Ferrer stressed the significance of Spain's expected entry into the Common Market and the great potential contribution of his country to the stability and progress of the Southern European region.

The Trilateral Commission was formed in 1973 by private citizens of Western Europe, Japan, and North America to foster closer cooperation among these three regions on common problems. It seeks to improve public understanding of such problems, to support proposals for handling them jointly, and to nurture habits and practices of working together among these regions.