

**BILDERBERG  
MEETINGS**

**GLENEAGLES  
CONFERENCE**

**25-27 April 1986**

BILDERBERG MEETINGS

GLENEAGLES  
CONFERENCE

25-27 April 1986

NOT FOR QUOTATION

## CONTENTS

LIST OF PARTICIPANTS .....	5
INTRODUCTION .....	10
AGENDA .....	11
I. THE SOVIET UNION UNDER GORBACHEV: FOREIGN POLICY IMPLICATIONS	
Working Paper .....	13
Opening Remarks from the Panel, I .....	19
Opening Remarks from the Panel, II .....	20
Discussion .....	21
II. THE WESTERN GLOBAL RESPONSE TO THE SOVIET CHALLENGE	
Opening Remarks from the Panel, I .....	27
Opening Remarks from the Panel, II .....	28
Opening Remarks from the Panel, III .....	29
Discussion .....	30
III. THE FRAGMENTATION OF THE WORLD ECONOMY: DEBT, CURRENCY DISORDER, PROTECTIONISM, UNEVEN GROWTH	
Working Paper .....	35
Opening Remarks from the Panel, I .....	41
Opening Remarks from the Panel, II .....	42
Opening Remarks from the Panel, III .....	44
Discussion .....	44
IV. CURRENT EVENTS: TERRORISM	
Opening Remarks from the Panel, I .....	51
Opening Remarks from the Panel, II .....	51
Opening Remarks from the Panel, III .....	52
Opening Remarks from the Panel, IV .....	53
Discussion .....	54
V. SOUTH AFRICA	
Working Paper .....	57
Opening Remarks from the Panel, I .....	61
Opening Remarks from the Panel, II .....	62
Opening Remarks from the Panel, III .....	64
Discussion .....	65
CLOSING REMARKS .....	68

## LIST OF PARTICIPANTS

### CHAIRMAN:

LORD ROLL OF IPSDEN\*  
 Joint Chairman, S.G. Warburg & Co., Ltd.

### HONORARY SECRETARY GENERAL FOR EUROPE AND CANADA:

VICTOR HALBERSTADT\*  
 Professor of Public Finance, Leyden Univeristy

### HONORARY SECRETARY GENERAL FOR THE U.S.A.:

THEODORE L. ELIOT, JR.\*  
 Executive Director, The Center for Asian Pacific Affairs, The Asia Foundation

SWE	CARL JOHAN AABERG	Under-Secretary of State
NOR	TORVILD AAKVAAG	Director General, Norsk Hydro A/S
UK	ANTONY A. ACLAND	Permanent Under-Secretary of State and Head of the Diplomatic Service; Amba- sador-Designate to Washington
ITA	GIOVANNI AGNELLI**	President, Fiat S.p.A.
DEN	TAGE ANDERSEN*	Managing Director and Chief Executive, Den Danske Bank
AUS	HANNES ANDROSCH*	Chairman of the Managing Board of Directors, Creditanstalt-Bankverein; For- mer Minister of Finance; Former Vice Chancellor
USA	GEORGE W. BALL**	Former Under Secretary of State
FRG	MARTIN BANGEMANN	Minister of Economic Affairs
UK	JOHN F.H. BARING	Chairman, Baring Brothers & Co., Ltd.
USA	ROBERT L. BARTLEY	Editor, "The Wall Street Journal"
ICE	EINAR BENEDIKTSSON	Ambassador to the United Kingdom
USA	JACK F. BENNETT*	Director and Senior Vice President, Exxon Corporation
TUR	SELAHATTIN BEYAZIT*	Director of Companies
CAN	CONRAD M. BLACK*	Chairman, Argus Corporation Ltd.
UK	LORD BOARDMAN	Chairman, National Westminster Bank PLC
USA	NICHOLAS F. BRADY*	Chairman, Dillon, Read & Co., Inc.; Former U.S. Senator (New Jersey)
NETH	HANS VAN DEN BROEK	Minister for Foreign Affairs
USA	RICHARD R. BURT	U.S. Ambassador to the Federal Republic of Germany
TUR	YAVUS CANEVI	Governor of the Central Bank
GRE	COSTA CARRAS*	Director of Companies
SPA	JAIME CARVAJAL URQUIJO*	Chairman, Banco Hispano Industrial
USA	JOHN H. CHAFEE	U.S. Senator (Rhode Island)
FRA	ALAIN CHEVALIER	Chairman, Moët Hennessy
USA	HENRY F. COOPER, JR.	Deputy U.S. Negotiator, Defense and Space Group
USA	KENNETH W. DAM*	Vice President, IBM Corporation; For- mer Deputy Secretary of State
FRA	DAVID DAUTRESME	General Partner, Lazard Frères & Cie.
BEL	ETIENNE DAVIGNON*	Director, Société Générale de Belgique; Former Member of the Commission of the European Communities

USA	ROBERT A. DAY, JR.	Chairman, Trust Company of the West	INT	MAX KOHNSTAMM**	Former President, European University
NETH	WILLEM F. DUISENBERG	President, De Nederlandsche Bank NV	BEL	LÉON J.G. LAMBERT*	Institute
UK	JOHN L. EGAN	Chairman and Chief Executive, Jaguar PLC	INT	ALEXANDRE LAMFALUSSY	Chairman, Groupe Bruxelles Lambert S.A.
USA	DANIEL J. EVANS	U.S. Senator (Washington)	LIE	H.S.H. PRINCE HANS-ADAM VON LIECHTENSTEIN	General Manager, Bank for International Settlements
USA	MURRAY H. FINLEY*	President, Amalgamated Clothing and Textile Workers Union	SWI	FRANZ J. LÜTOLF*	General Manager and Member of the Executive Board, Swiss Bank Corporation
IRE	GARRET FITZGERALD	Prime Minister	ITA	ANTONIO MACCANICO	General Secretary, Office of the President of the Italian Republic
CAN	BARBARA FRUM	Host of "The Journal" (Television Program of the Canadian Broadcasting Corporation)	CAN	DONALD S. MACDONALD*	Senior Partner, McCarthy & McCarthy
CAN	ALLAN E. GOTLIEB	Ambassador to the United States	GRE	STEPHANOS MANOS	Member of Parliament
UK	LORD GREENHILL OF HARROW	Former Permanent Under-Secretary of the Foreign and Commonwealth Office; Director of Companies	USA	CHARLES MCC. MATHIAS, JR.*	U.S. Senator (Maryland)
CAN	ANTHONY G.S. GRIFFIN**	Director of Companies	POR	LEONARDO MATHIAS	Ambassador to the United States
SWE	STEN GUSTAFSSON*	Chairman of the Board, SAAB-SCANIA AB	USA	DONALD F. MCHENRY	University Research Professor of Diplomacy and International Affairs, Georgetown University; Former Ambassador to the United Nations
ICE	GEIR HALLGRIMSSON*	Governor of the Central Bank; Former Prime Minister; Former Minister for Foreign Affairs	FRA	THIERRY DE MONTBRIAL*	Director, French Institute of International Relations; Professor of Economics, Ecole Polytechnique
USA	ARTHUR A. HARTMAN	Ambassador to the U.S.S.R.	ITA	MARIO MONTI*	Professor of Economics and Director of the Centre for Monetary and Financial Economics, Bocconi University, Milan
UK	DENIS W. HEALEY	Member of Parliament; Opposition Spokesman on Foreign Affairs	NETH	H.M. THE QUEEN OF THE NETHERLANDS	
USA	HENRY J. HEINZ II**	Chairman of the Board, H.J. Heinz Company, Inc.	NETH	H.R.H. PRINCE CLAUS OF THE NETHERLANDS	
UK	LORD HOME OF THE HIRSEL	Former Prime Minister; Former Chairman of Bilderberg Meetings	ITA	TOMMASO PADOA-SCHIOPPA	Deputy Director General, Banca d'Italia
USA	ARNOLD L. HORELICK	Director, The Rand/UCLA Center for the Study of Soviet International Behavior	UK	MICHAEL PALLISER	Chairman, Samuel Montagu & Co. (Holdings) Limited; Chairman of the Council, International Institute for Strategic Studies
USA	ROBERT D. HORMATS	Director, Goldman Sachs International Corporation; Former Assistant Secretary of State for Economic and Business Affairs	USA	ROBERT L. PFALTZGRAFF, JR.	President, Institute for Foreign Policy Analysis, Inc.
AUS	HANS IGLER	Partner, Schoeller & Co. Bankaktiengesellschaft	DEN	HERBERT PUNDIK	Editor-in-Chief, "Politiken"
FIN	JAAKKO ILONIEMI	Member of the Management Board, Union Bank of Finland; Former Ambassador to the United States	UK	ROBERT P. REID	Chairman, Shell UK Ltd.
SWI	ROBERT A. JEKER	President of the Executive Board, Credit Suisse	UK	MALCOLM RIFKIND	Secretary of State for Scotland
UK	SIMON JENKINS	Political Editor, "The Economist"	UK	MICHEL ROCARD	Member of Parliament (Socialist Party)
SWI	PAUL R. JOLLES	Chairman of the Board, Nestlé S.A.; Former State Secretary for Foreign Economic Affairs	FRA	MARIANO RUBIO	Governor, Bank of Spain
USA	DAVID T. KEARNS	Chairman, Xerox Corporation	ITA	RENATO RUGGIERO	General Secretary, Ministry for Foreign Affairs
USA	HENRY A. KISSINGER*	Professor, Center for Strategic and International Studies, Georgetown University; Former Secretary of State	UK	JOHN SAINSBURY*	Chairman, J. Sainsbury PLC
FRG	HANS KLEIN	Member of Parliament for the CDU/CSU; Spokesman on Foreign Affairs	CAN	JEANNE SAUVÉ	Governor General of Canada
UK	ANDREW KNIGHT*	Chief Executive, "The Daily Telegraph"	ITA	GAETANO SCARDOCCIA	Editor, "La Stampa"
			FRG	WALTER SCHEEL	Former President; Former Chairman of Bilderberg Meetings
			FRG	HELMUT SCHMIDT	Former Chancellor
			FRA	E. ANTOINE SEILLIÈRE*	Director-General, Compagnie Générale d'Industrie et de Participations
			UK	PATRICK SHEEHY	Chairman, B.A.T. Industries PLC

POR	ARTUR SANTOS SILVA	Former Under-Secretary of the Treasury; Former Vice President, Bank of Portugal; President, Banco Portugues de Investimento
UK	JOHN SMITH	Member of Parliament (Labour Party)
FRG	THEO SOMMER*	Publisher, "Die Zeit"
ITA	LUIGI SPAVENTA	Professor of Economics, University of Rome
UK	DAVID STEEL	Member of Parliament; Leader of the Liberal Party
BEL	FRANK SWAELEN	President, Christian Democratic Party
TUR	SEYFI TASHAN	Managing Director, Foreign Policy Institute
NOR	NILS MORTEN UDGAARD	Deputy Secretary, Prime Minister's Office
USA	PAUL A. VOLCKER	Chairman, Board of Governors of the Federal Reserve System
FRG	ANGELIKA E.C. VOLLE	Research Fellow, Deutsche Gesellschaft für Auswärtige Politik (German Society for Foreign Affairs)
AUS	FRANZ VRANITZKY	Federal Minister of Finance
UK	H.R.H. THE PRINCE OF WALES	
NOR	NIELS WERRING, JR.*	Chairman of the Board, Wilh. Wilhelmsen Limited A/S
USA	JOHN C. WHITEHEAD	Deputy Secretary of State
DEN	NILS WILHJELM	Minister of Industry
USA	LYNN R. WILLIAMS	International President, United Steel Workers of America
USA	FRANK G. WISNER	Deputy Assistant Secretary for African Affairs, Department of State
FRG	OTTO WOLFF VON AMERONGEN**	Chairman of the Board of Management and Chief Executive Officer, Otto Wolff A.G.
SPA	JUAN A. YAÑEZ-BARNUEVO	Director, Department of International Affairs of the Office of the Prime Minister
UK	LORD YOUNG OF GRAFFHAM	Secretary of State for Employment
ITA	PAOLO ZANNONI*	Vice President, Defense Systems, Fiat USA, Inc.

#### OBSERVER

AUS	GEORG ZIMMER-LEHMANN	Managing Director, Creditanstalt-Bankverein
-----	----------------------	---

#### RAPPORTEUR

USA	GRANT F. WINTHROP	Director, Wood, Struthers and Winthrop Management Corporation
-----	-------------------	---

#### IN ATTENDANCE

ITA	ALFREDO AMBROSETTI	President, Studio Ambrosetti; Organizer 1987 Conference
NETH	SASKIA TEN ASBROEK	Executive Secretary, Bilderberg Meetings

UK	ALEC S. DONKIN
USA	CHARLES W. MULLER

Organizer, 1986 Conference  
President, Murden and Company

#### LIST OF ABBREVIATIONS:

AUS	Austria
BEL	Belgium
CAN	Canada
DEN	Denmark
FIN	Finland
FRA	France
FRG	Federal Republic of Germany
GRE	Greece
ICE	Iceland
INT	International
IRE	Ireland
ITA	Italy
LIE	Liechtenstein
NETH	Netherlands
NOR	Norway
POR	Portugal
SPA	Spain
SWE	Sweden
SWI	Switzerland
TUR	Turkey
UK	United Kingdom
USA	United States of America

\* Member of the Steering Committee  
\*\* Member of the Advisory Committee

## INTRODUCTION

*The thirty-fourth Bilderberg Meeting was held at the Gleneagles Hotel, Auchterarder, Perthshire, Scotland on April 25, 26, and 27, 1986. There were 109 participants from 19 European countries, the United States, and Canada. They represented government, diplomacy, politics, business, law, labor, education, journalism, the military, and institutes specializing in national and international studies. All participants spoke in a personal capacity, without committing in any way the organizations or governments to which they belonged. As is usual at Bilderberg Meetings, in order to permit frank and open discussion, no reporting of the conference proceedings was allowed.*

*In opening the conference, Lord Roll of Ipsden, the Chairman of the Bilderberg Meetings, welcomed the participants to Gleneagles. He then read the text of a message of thanks and good wishes, sent on behalf of all those at the conference, to Her Majesty Queen Elizabeth. The Chairman also took note of the death of Olof Palme, who had attended many past Bilderberg Meetings and had been scheduled to be a participant and panelist at the Gleneagles Conference.*

## AGENDA

### I. THE SOVIET UNION UNDER GORBACHEV: FOREIGN POLICY IMPLICATIONS

Moderator: Theo Sommer  
Working Paper Author: Arnold L. Horelick  
Panelists: Arthur A. Hartman  
Denis W. Healey

### II. THE WESTERN GLOBAL RESPONSE TO THE SOVIET CHALLENGE

Moderator: Donald S. MacDonald  
Panelists: Henry A. Kissinger  
Michel Rocard  
Helmut Schmidt

### III. THE FRAGMENTATION OF THE WORLD ECONOMY: DEBT, CURRENCY DISORDER, PROTECTIONISM, UNEVEN GROWTH

Moderator: Lord Roll of Ipsden  
Working Paper Author: Robert D. Hormats  
Panelists: Alexandre Lamfalussy  
Paul A. Volcker  
Lynn R. Williams

### IV. CURRENT EVENTS: TERRORISM

Moderator: Etienne Davignon  
Panelists: Richard R. Burt  
Renato Ruggiero  
Theo Sommer  
John C. Whitehead

### V. SOUTH AFRICA

Moderator: John Sainsbury  
Working Paper Author: Simon Jenkins  
Panelists: Hans van den Broek  
Leonardo Mathias  
Donald F. McHenry

*The conference program included a cocktail reception and dinner attended by Prime Minister Margaret Thatcher.*

## I. THE SOVIET UNION UNDER GORBACHEV: FOREIGN POLICY IMPLICATIONS

### *Working Paper*

In the early 1980s the image of a Soviet Union that was at once the "strongest military power in the world" yet at the same time an "economic basket case" became the point of departure for a great deal of prognostication and punditry. Allowing for exaggeration in at least one if not both parts of the cliché, the disparity between the Soviet Union's success in amassing military power and its failure in virtually every other sphere of national performance described a paradox of enormous significance for the future of both the USSR and the world order.

Precisely what that significance may be was then and remains today a matter of great uncertainty and debate. In the early 1980s some argued that the leaders of a militarily powerful but internally weakened USSR were more likely than ever to resort to external aggression in order to seize crucial new geopolitical positions and resources before their own declining domestic capabilities and more competitive Western adversaries closed their "window of opportunity." Since the most striking new evidence of Soviet decline at that time — the CIA's forecast of an imminent downturn in Soviet oil production — coincided roughly with the Soviet invasion of Afghanistan, this belief spawned predictions of a dramatic Soviet breakout into the Persian Gulf calculated to deal a mortal blow to the oil-hungry West.

Others foresaw precisely the opposite Soviet behavior. Anxiety about the progressive weakening of the USSR's domestic foundations would compel Soviet leaders to turn inward, pare down external ambitions, and make concessions to secure access to the Western capital and technology needed to modernize the Soviet economy.

Soviet behavior thus far in the 1980s has clearly refuted the dire predictions of the pessimists. Although less starkly falsified, the optimists' predictions have also not been fully borne out. There was no major Soviet geopolitical advance into the Persian Gulf or elsewhere, but neither were there any major Soviet retreats. Indeed, leaders of Brezhnev's generation stubbornly resisted the idea that the Soviet domestic predicament was so grave as to require radical internal repairs and corresponding adjustments in Soviet external behavior.

In the year since he took over the reins of leadership, Gorbachev, by contrast, has repeatedly made clear his conviction that deteriorating domestic conditions endanger not only the future prosperity of the Soviet Union, but also its status as a world power. "What is at stake today," Gorbachev has told the party, "is the ability of the Soviet Union to enter the new millenium in a manner worthy of a great and prosperous power . . . Without the hard work and complete dedication of each and every one it is not even possible to preserve what has been achieved." To paraphrase Solzhenitsyn, to remain a great power the Soviet Union must now become a great country.

The new Soviet party program calls the USSR's attainment of strategic parity with the United States "the historic achievement" of socialism. Brezhnev will be remembered by his heirs as the leader who permitted the stagnation of the Soviet economy and the demoralization of Soviet society while presiding over that historic achievement, an achievement, moreover, that failed to yield the expected foreign policy payoffs.

The Third World prizes of Soviet expansion in the 1970s have become not promising outposts for further expansion, but besieged, unstable client regimes struggling to survive against anti-Communist national liberation movements their rule has spawned. The massive military buildup of the Brezhnev era, while it substantially improved global and regional military balances in the Soviet Union's favor, did not buy for the Soviet Union enhanced political influence commensurate with

*N.B.*

*For the purpose of this report, the discussions of the various agenda items have been re-ordered according to subject matter. Thus, the various individual interventions are not necessarily reported in the exact chronological order in which they were made.*

*Grant F. Winthrop, Rapporteur*



its increased power. Most importantly, it did not secure from Western Europe the deference that Soviet leaders believed was their due in the light of the altered correlation of forces. In the crucial test of Moscow's pretensions to play the role of Europe's security manager, the Soviet Union failed in the early 1980s to head off the deployment of U.S. intermediate range missiles in Europe.

What Brezhnev's military buildup and muscular displays in the Third World did produce, however, was a powerful American backlash, which began to build in Carter's last years and was greatly broadened and accelerated under Reagan. Ironically, this backlash began to gather momentum precisely at the time when Moscow had begun to slow the rate of its own military growth in response to the Soviet economy's slowdown. And it grew in strength precisely at a time when the USSR was least well disposed to match it. In the mid-1980's, Brezhnev's heirs confront what they see as serious challenges to their military gains of the seventies.

In the strategic nuclear area, a whole series of U.S. modernization programs will over the next decade be yielding new, highly capable deployed systems. Expensively acquired Soviet advantages in prompt hard-target counterforce and long-awaited improvements in homeland air defense appear destined to disappear as the United States proceeds with its strategic modernization efforts. The fielding by the U.S. of highly accurate ICBMs and SLBMs equipped with multiple warheads will increasingly place at risk the large-silo-based ICBM force that is the cornerstone of Soviet strategic nuclear prowess.

In the theater nuclear arena, the failure of Soviet efforts to derail NATO's INF decision has led to U.S. deployments that will substantially reduce both the political and military advantages Moscow had hoped to enjoy by augmenting its long-range theater nuclear capabilities with massive SS-20 deployments.

In Europe, where extensive modernization of Soviet forces enlarged the margin of Soviet conventional warfare advantages substantially in the 1970s, new NATO "deep strike" concepts and technologies for implementing them could, if successfully developed, challenge the viability of Soviet military strategy for Europe (specifically, Soviet assumptions about NATO's ability to break up or slow down decisively a massive Soviet conventional campaign without recourse to nuclear weapons).

Above all there is the SDI program, which arouses Soviet concerns along a number of dimensions. First, concern about SDI as a range of potentially deployable multilayered space-based ballistic missile defense systems of varying degrees of potential effectiveness; second, about SDI as the leading edge of a broadly based U.S. military technology effort featuring sensors, computers, computer programming, signal processing, and exotic kill mechanisms, not limited in military application to space-based ballistic missile defense; and, third, about SDI as the technological centerpiece of a broad global U.S. political, military, and economic challenge to the hard-won geopolitical and strategic Soviet gains of the past two decades, a challenge that threatens the superpower status of the USSR at a time when it is hard put to make massive new exertions merely to hold its own in the world.

The combination of what is perceived as a gathering challenge to the most important Soviet military gains of the past and a conviction that the rebuilding of the USSR's weakened domestic base can no longer be delayed shapes Gorbachev's foreign policy and impels it to pursue proximate objectives that are largely defensive.

Gorbachev's first priority in foreign policy is to consolidate weak or threatened positions. Above all, this applies to Eastern Europe. The prolonged and still not fully resolved Polish crisis has made a deeply unsettling impression on the Soviet leaders. It was probably the single most preoccupying external policy issue on the agenda during Gorbachev's Politburo break-in years (he was elected in 1978). The challenge for Gorbachev is to find ways to keep the populations of Eastern Europe

pacified without increasing Soviet subsidies, risking politically dangerous reforms, or permitting excessive levels of economic intercourse with the West. So far the watchword has been tighter discipline.

Even before Gorbachev's investiture an increasingly skeptical view of Soviet prospects in the Third World was evident in Moscow. Earlier it had been hoped that the creation of Marxist-Leninist "vanguard parties" in Soviet client states would solve the problem of securing long-term Soviet influence and reliable outposts for further expansion. Bitter experience has brought a deeper Soviet appreciation that influence in the Third World is limited without control and that control can either not be attained at all in remote areas or is too costly for what it buys. At a minimum, Gorbachev will be more selective than his predecessors about making new commitments and more sensitive to the economic and political costs of making bad choices. If challenged frontally by the United States in any region where Soviet interests can readily be defended — e.g., in Afghanistan and perhaps Angola, but not in Nicaragua — Moscow will respond defiantly. But if its credibility is not placed under severe challenge and if ripe fruits do not simply fall into its lap, the Soviet Union will for the time being prefer to avoid new and costly involvements in the Third World.

Toward the West, the circumstances argue above all for a Soviet policy aimed at breaking the momentum of Washington's global counteroffensive, and particularly at containing the security challenge of U.S. and NATO military programs. Gorbachev is not likely to "yield to provocations" by Washington and will seek to avoid both political and military confrontation. He will prefer to moderate the U.S. military challenge by political means because meeting it head on with a "crash" defense effort requiring a major reallocation of scarce technology resources, would be highly disruptive to his program of economic modernization and growth acceleration. It would probably foredoom his already over-ambitious five year plan. And it would impair his political efforts to deal with the U.S. challenge.

While loath to use a term that conjures up historic images of truly desperate circumstances in Soviet history, Gorbachev in fact would like what Lenin called a *peredyshka*, that is, a respite from the heavy American competitive pressures that threaten to divert Soviet resources and energies from what are for the time being the more urgent tasks of rebuilding the bases of Soviet power.

Gorbachev's dilemma is that he must seek a *peredyshka* without seeming too eager for it. Lenin unabashedly sought a breathing spell after the revolution and civil war when Russia was palpably weak, lacking external assets or commitments, and with nothing at stake beyond sheer survival. Gorbachev must worry about the Soviet Union's empire, its credibility as a superpower, and his own reputation as the new leader of a proud and mighty state.

To this difficult foreign policy change, Gorbachev has brought a verve and energy long absent in Moscow and a flair for public diplomacy well attuned to the television age. But he has not yet displayed a comprehensive strategy for managing the multiple foreign policy challenges he faces.

Periodically, Gorbachev implies that he will seek to de-emphasize the centrality of Soviet relations with the United States. "The world," he said at the recent party congress, "is much larger than the United States." One of his key advisers, Aleksandr Yakovlev, calls openly for a policy of "Europe first." The past year has seen a widely publicized Soviet effort to activate Moscow's diplomacy in the Far East, with renewed overtures to China and Japan. But Gorbachev seems no more willing, or able, than his predecessors to make the compromises required for substantial improvement of the Soviet position. In Tokyo, Shevardnadze, while more affable to Gromyko, was just as unyielding on the pivotal Northern territories question. Some modest improvement in Soviet relations with China has been achieved because China, like the Soviet Union, has preferred a relaxation of tensions while

attending to economic modernization. But a more fundamental breakthrough in relations is blocked by persistent Soviet refusal to address China's basic security concerns: the threatening Soviet military presence in Mongolia and along the Sino-Soviet border; Moscow's alliance with Hanoi; and the Soviet invasion of Afghanistan.

Gorbachev's European diplomacy has been bolder and more flexible than his predecessors', but no more successful. He seems unable to understand how Europeans view their security dilemma and therefore he has miscalculated badly in fashioning arms control proposals meant to appeal to Europeans. In October he greatly diminished the attractiveness of his radical proposal for a deep cut in strategic nuclear arms by leaving the huge Soviet intermediate range missile force out of the package and compounded the error in Paris by practically inviting President Mitterant publicly to rebuff his proposal for separate negotiations on French and British nuclear forces. In January he may have thought he was correcting the October mistake by proposing a radical zero/zero INF solution along with a freeze of French and British forces. If so, he again badly misjudged the European reaction to a Soviet offer than came more than three years too late, that is, after the trauma of U.S. INF deployment had already been absorbed and the fear of "decoupling" had become the most salient concern.

At bottom, despite all the talk about shifting to a more Euro- or Asian-centered orientation, Soviet foreign policy under Gorbachev is if anything more preoccupied with the United States than before. Gromyko's departure from the Foreign Ministry was not the harbinger of a downgrading of relations with Washington. A day after Shevardnadze replaced Gromyko, Moscow announced that Gorbachev and Reagan would hold the first summit meeting of Soviet and American leaders in more than six years. Gorbachev went to the summit without having secured in advance any of the concessions he sought and he joined the American president in assessing positively a meeting that was conducted on an American agenda without any major substantive agreements that addressed Soviet concerns. And last month Gorbachev brought home to Moscow to serve directly under his command in the Central Committee Secretariat, Anatoly Dobrynin, the Soviet official most deeply involved with the United States and now suddenly the senior party apparatchik with foreign policy responsibilities.

If the United States remains at the center of Gorbachev's foreign policy, arms control is at the center of his American policy. Gorbachev has dramatically altered both the style and substance of Soviet arms control diplomacy. Historically, the Soviets have preferred to respond to American initiatives and not to break new conceptual ground themselves. They have clung doggedly to positions once taken and have altered their proposals only slowly and incrementally. And when forced in the past to choose between constraining the United States or protecting existing Soviet forces and ongoing Soviet programs, Moscow has invariably opted for the latter.

The two most "serious" and far-reaching features of Gorbachev's recent proposals go precisely in the opposite direction: to break the back of the challenge posed by the SDI and to constrain U.S. strategic modernization generally, Gorbachev in October 1985 offered radical reductions in Soviet offensive forces that went very far beyond any cuts previously proposed or rumored by Moscow. His proposal included a "concentration" limit that would in effect have required a reduction of almost 50% in the Soviet ICBM warheads and a comparable associated reduction in Soviet ICBM throwweight — the principal objectives of U.S. strategic arms control policy since 1977. In January 1986, Gorbachev further offered to delink INF from START and space weapons agreements and to eliminate entirely the force of some 250 triple-MIRVed SS-20 Soviet missiles targeted on Europe in return for the elimination of the smaller U.S. INF force now being deployed and for a freeze on British

and French independent nuclear forces. Whatever the net political-military gain that Moscow presumably sees in such a trade — probably from the "decoupling" effect on NATO that withdrawal of U.S. INF systems would entail — the offer to eliminate the entire Soviet SS-20 force in Europe represents a radical break with past Soviet military and arms control policies and suggests that Gorbachev, under conditions of the 1980s, sees arms control tradeoffs differently from his predecessors.

Why this change? Gorbachev and his advisers may calculate that the marginal strategic advantages acquired by the USSR in the 1970s that have so gravely concerned the United States — the prompt hard-target kill capabilities of the Soviet ICBM force, the large breakout potential inherent in their huge throwweight edge, the massive preponderance of their SS-20 force — are in any case wasting assets that are being eroded by U.S. and NATO programs; and that by trading them away now, the USSR could secure some relief from the heavy competitive pressures exerted by new U.S. high technology programs, slowing them down if not halting them during the lifetime of an offensive reductions agreement.

Others in Moscow may believe that such concessions are an unacceptably high price to pay for what Washington is likely to offer in return, that they are at a minimum premature, and may in the end be unnecessary. They may prefer to bet that the most ambitious new U.S. programs will in the end fail to achieve their objectives, be stretched out interminably, or be killed off by a future administration with only arms control posturing by the Soviet Union required to help the process along. They may see ongoing Soviet programs as holding out the promise of maintaining and even enlarging the Soviet gains of the 1970s — a new generation of Soviet ICBMs and quieter SSBNs to preserve force survivability and still more accurate RVs to augment the already substantial Soviet hard-target capability.

So long as the Reagan administration is unwilling to place on the table for negotiation the issue of greatest concern to the Soviets — constraints on SDI — alternative Soviet arms control perspectives can be accommodated within the parameters of Soviet proposals that condition far-reaching concessions on U.S. acceptance of what are still clearly non-negotiable Soviet demands. Should the negotiations reach the point of real bargaining, however, Gorbachev could face the first serious internal challenge to his leadership since his installation in March 1985.

How should the West respond to Gorbachev's evident desire for a *peredyska*? We can dismiss it as a mere ploy to secure for the Soviet Union a breather to set its house in order before resuming a broad offensive against us. Or we can explore the opportunity to use our greatly improved bargaining position to conclude arms control agreements that address long-standing Western strategic concerns and foster a safer and more stable strategic environment.

The issue has become key to a debate, thus far concentrated in Washington, between two alternative approaches for dealing generally with the Soviet Union during Reagan's final term, and particularly with respect to arms control. Both approaches proceed from the common premise that a shift in favor of the West is occurring in what the Soviets call the global correlation of forces. Different policy conclusions are drawn from this assessment, however.

One view supports a policy of "squeezing" the Soviets, seeking deliberately to maximize competitive pressures on the Soviet Union during a period of its relative weakness. This approach would attempt to press favorable trends still further in the hope of securing an even more substantial shift in the correlation of forces, eventually compelling Soviet retreats on a global scale, or, if the Soviets exhausted themselves economically in an effort to avoid concessions or retreat, inducing an internal Soviet crisis that would gravely weaken the USSR or even compel system-altering transformations with revolutionary long-term benefits for the West.

With regard to arms control, the "squeeze" approach would call for the United States to take an essentially uncompromising position on the whole range of issues at Geneva, making at most only marginal, essentially cosmetic adjustments designed not to enhance the negotiability of U.S. positions but rather to help manage domestic and alliance political concerns. Protecting the SDI from arms control constraints is the central preoccupation of the "squeeze" position. Some "squeezers" believe that SDI's strategic potential for the United States is so great that it must not be placed on the negotiating table; others believe that withholding SDI from the negotiations is likely to preclude a compromise arms control agreement that would at best product marginal benefits while squandering hard-won U.S. gains and momentum. SDI in this view should be used as leverage on Soviet force structure, not indirectly through enhanced arms control bargaining strength but directly, by compelling the Soviets to restructure their forces to compete in areas of comparative U.S. advantage.

A second view supports an alternative policy of "dealing." It holds that the United States should take some initiatives in exploring ways to break the arms control deadlock. Partisans of this view generally believe that a sustained state of high tension between the United States and the Soviet Union is potentially dangerous and surely corrosive to the Western alliance if the United States is believed to be at fault. A credible attempt at arms control negotiations is held necessary to sustain public and congressional support for the administration's long-term armaments program.

Advocates of this view tend also to believe (like those who favor squeezing) that the correlation of forces is shifting against the Soviet Union. They prefer, however, to negotiate from that improved position now rather than gamble on the outcome of a totally unregulated arms competition of enormous and possibly unsustainable cost, incalculable risk and indefinite duration. Soviet anxiety about an intensified new round of strategic arms competition is held to provide an opportunity for inducing the USSR to consider basic tradeoffs in strategic weapons negotiations — tradeoffs that would involve deep cuts in Soviet offensive forces of greatest U.S. concern in return for an easing of U.S. competitive pressures in areas of greatest concern to the Soviets.

It may be that the West will prove incapable of concerting a strategy that can balance competitive pressure and political resourcefulness so as to extract gains that now seem attainable, while constraining future Soviet aggressive options. Perhaps we will have to take our chances with the opportunism and ad hockery to which democracies tend especially to be attracted when the tides of fortune are running in their favor. It is ironic that in a period of adversity the West succeeded in concerting a strategy for managing relations with a Soviet Union that was an ascending power, but that a coherent agreed strategy for managing relations with a Soviet Union that is declining seems to elude us.

Failure by the United States and by the Western alliance to agree on a common strategy for dealing with the Soviet Union in the Gorbachev era will not only mean losing the opportunity either to "squeeze" the Soviet Union effectively or to "deal" with it profitably, but could leave us with the worst of both worlds. If Moscow gets its own act together, policy initiative will pass to the Soviet leaders by default. In these circumstances, the Kremlin will surely try to have its cake and eat it too; Gorbachev will still strive to secure the *peredyska* he needs, but without strong incentives to make compromises requiring him to give up anything of real value.

The Soviet Union under Gorbachev is not merely seeking a *peredyska*; it is pursuing a fundamentally new approach to world affairs. The most striking indication of this is in the preamble of Gorbachev's speech to the Party Congress, where he refers to the growing interdependence of the nations of the world. He appears to be rejecting the theory of the two camps — capitalist and socialist — that has dominated Soviet policy since 1917. Gorbachev is the first Russian leader to "conceive of the possibility of building a comprehensive system in which the two sides work together," and he must be taken seriously.

Some important new elements are emerging in Soviet policy:

— The relationship between the Soviet Union and the Eastern European countries is changing. Gorbachev has accepted the right of the Soviet satellites to "find their own way toward socialism." Particularly impressed by the success of East Germany, he is looking for useful models to follow in meeting the problems faced by the Soviet Union.

— Gorbachev has accepted, and is no longer fighting against, Eurocommunism.

— He accepts the possibility of working with social democratic parties and with the church.

— Gorbachev subscribes to the view that "he who is not against us is with us," and his approach to Western Europe is more flexible than that of his predecessors.

The central foreign policy problem facing Gorbachev is Soviet-American relations, particularly in the areas of security and disarmament. The Russians view the arms race, with the increasing application of high technology to weapons systems, as itself a potential cause of war. Mutual fears of a first strike are becoming highly destabilizing, as the actual mechanism of launching offensive weapons comes increasingly under the control of computers.

The centrality of relations with the U.S. in Soviet policy is illustrated by Gorbachev's assignment of Dobrynin to the top foreign policy post in the Politburo. From his many years in the U.S., Dobrynin "well understands the battle between the pragmatists and the ideologues in Washington, and the gap between rhetoric and reality." Additional significant changes in foreign policy personnel can be anticipated, with a shift of power from the foreign office bureaucracy toward the party *apparatchik*, as well as a larger role for the think-tanks.

Dealing, as opposed to squeezing, is the proper course of action for the West to follow. If the West opts for continued military competition, the Russians are likely to be the winners, particularly in the short run. This argues for continuing to abide by the terms of the SALT II Treaty. The United States is certainly going to have its military programs cut back by Congress, and will soon face difficult choices between various types of nuclear weapons and conventional weapons, both inside and outside the NATO area. If the U.S. is forced by Congress into making unilateral cuts, will the Soviets reciprocate or try to exploit the situation? They will most likely reciprocate, and these reciprocal unilateral cuts will result in meaningful arms agreements.

## *Opening Remarks from the Panel, II.*

Gorbachev is certainly a more attractive personality than his predecessors. He expresses himself clearly, and appears to be more comfortable with an open acceptance and analysis of his country's problems. But there is a tendency, both in the West and in the Soviet Union, for people to project their own hopes and feelings on the man; this tendency should be avoided. We should look back at the history of the Soviet Union, with its long tradition of authoritarianism, and realize that it cannot be escaped as quickly as one man might like. Soviet leadership has in the past been faced with severe institutional strains, and efforts by leaders like Khrushchev and Kosygin to make reforms led to their being pushed aside.

Once again, the leader of the Soviet Union is faced with a severe challenge. His choice is to continue an ideologically based running of the economy and of state systems, or to make changes. The fundamental question is not whether he is going to try to make changes, but whether he will be able to. Will the party leadership give up power and privilege in order to make the economy more efficient?

Gorbachev's speech to the Party Congress did not signal any change. It was an "ideologically consistent and conservative statement," which he had to make in order to reassure the party members that he is not going to make radical changes. His words about change and reform and interdependence do not yet have any real content, and we in the West should not jump to conclusions as to what content might be put into them.

The trying of new approaches in some of the Eastern European economies seriously worries Soviet leaders, and there is considerable debate about it going on in the Soviet Union. It is at least a positive development that these debates are beginning to come out in the press and in discussions with Soviet leaders. But an indication of the official Soviet view appeared in a recent article in the Soviet press that attacked every reform put forward in Eastern Europe, attacked the whole notion that, in Marxist-Leninist terms, basic changes can be made in the way economies are run. It would mean a weakening of the party structure, which cannot be allowed. The article went on to attack what the Chinese are doing, and to argue that eventually they will see the folly of their ways and the party will reassert control. Gorbachev and his colleagues were brought up in the party structure, were formed in the ideology of the party, and do not want to change it. Rather they want to make it work and believe it can be made to work without major changes.

Until the domestic issues are dealt with, there will be no real foreign policy, in a strategic sense. The current approach to foreign policy issues is just a carry-over from the past. The Soviets will be looking for foreign policy approaches that avoid the kinds of internal struggles that will prevent them from solving domestic problems. So far, there has been a good deal of public relations posturing rather than serious negotiating, because the leadership does not want to come to terms with major decisions in the areas that could "weaken the general coalition that is running the country." With the arrival of Dobrynin, policy making is moving from the foreign office to the central committee, but it is not yet clear what this will produce or how it is going to work. It is certainly likely that tensions will arise between Dobrynin and the foreign minister. With his extensive knowledge of the West, Dobrynin will likely exercise a more creative and challenging foreign policy than has so far been seen.

But the West should not be discouraged by all this. The best thing we can do is to think about policies based upon our own interests, on maintaining our own strength, but which offer the Russians the opportunity of talking and negotiating with us. We should continue to put forward proposals that are imaginative, creative, and attractive to the Soviets and that produce stability and balance. But we

have to be careful not to give the Russians the idea that they can have a free ride in any area; we must convey to them that there will be a price to pay for excessive adventurism.

## *Discussion*

A number of participants expressed concern that many in the West had developed unrealistic expectations of what might transpire in the Soviet Union under Gorbachev's leadership. There was a tendency to "mistake style for substance" in assessing the new Soviet leader, as one speaker put it. This had been especially true in Western media coverage, which had tended to portray Russia under Gorbachev as a "Camelot on the Volga."

A British speaker warned that the West should not become "too obsessed" with the idea that Gorbachev's leadership would be all that different unless he was able to accomplish major changes in the Soviet system. He did represent a change in style, was "fresh" and therefore could pursue a "tolerant" foreign policy without much opposition. But he had so far not exhibited any intention to change the system. What would happen when, after five years of his "hectoring and long-windedness," the Soviet economy was as stagnant and unsuccessful as ever?

The answer, in an American's view, was that when the leadership saw that efficiency was not being achieved by exhortation, discipline, and abstinence from drink, it would then be faced with tough fundamental choices. The failure to achieve the growth rates called for for the remainder of the century would bring to a head the conflict between those resisting a departure from central planning and those willing to try new methods.

Another American participant saw three possibilities arising from continued stagnation of the Soviet economy. (1) Even without major structural change, there could be some small successes, which the leadership would trumpet as major successes. (2) If there were not even small successes, there could be a return to a modified form of Stalinism, toward which Gorbachev had already shown a tendency. (3) Structural change could arise out of desperation.

Several participants wondered if it was realistic to expect fundamental change in the Soviet system. An American pointed out, by way of comparison, that the Reagan Administration had come into office with significant new programs aimed at dealing with problems such as economic inefficiency, inflation, unemployment, government regulation, etc.; it had, in short, put into effect major changes, but without making any basic changes in the American system. Why would the same thing not be true in the Soviet Union? The tactics might change, but not the underlying interests. Perhaps the change of leadership was really not all that profound.

Another speaker from the U.S. observed that the analysis of Russia's problems presented by the working paper and the panelists was not new. The debate about dealing versus squeezing was an old one. The real question was whether there was something in the Western response to the Soviet Union that inhibited its leaders from giving priority to domestic affairs. Or was there something fundamental in the Soviet system that always resulted in the leader opting against basic reforms that he allegedly wanted?

Another American gave some credence to this latter notion when he observed that Russian leaders had not successfully carried out domestic reforms in the past.

Indeed, both Khrushchev and Kosygin had been pushed aside precisely because they had moved toward reforms. It seemed that there was something basic in the Marxist-Leninist system that "true believers" — and Gorbachev was one — were not willing to put aside.

Other participants commented on a variety of factors that might inhibit basic change in Russia. A Briton pointed out that the Russians had been extremely concerned about events in Poland. Would that not inhibit them from moving rapidly toward domestic reform? Another speaker from the U.K. observed that a market economy could not function without giving individuals choice, and the problem facing Gorbachev in giving individuals choice was that it implied a degree of individual freedom. Even if the Soviet leadership recognized the necessity for economic decentralization, could they afford the political decentralization that surely would accompany it? A Swiss speaker wondered whether decentralization was possible in a "multinational state" like the Soviet Union. Was it really just a question of reducing the discipline of the party system, or was the problem that loosening the system might lead to upheaval among the various nationalities?

A British speaker felt that too much emphasis was being placed on the need for fundamental change in the Soviet Union. Gorbachev could accomplish, and already had done, a great deal by making changes at the margin. He had brought his own people into all levels of the party structure. Market mechanisms were beginning to come in, and other changes could be expected. It was likely that the Soviet Union would once again soon achieve growth rates higher than those of most OECD countries.

Other speakers expressed confidence that Gorbachev would be able to make significant changes. Encouraged that the Soviet leader was "more open, receptive, and analytical" than his predecessors, a Briton found it hard to believe that Gorbachev would not be capable of "adapting his country to the real world" and pulling it away from some of its traditional constraints. In another British participant's eyes, Gorbachev was "intelligent, well-educated, and modern in outlook." It was neither significant nor conclusive that there had not been fundamental change in his first year in office. Time was on his side; he could reasonably expect to be in power for twenty years or more. Already he had moved to surround himself with his own people, and by offering the prospect of stable leadership to a population dispirited and disillusioned by a succession of leadership changes, he had dramatically improved the morale of the Soviet people. Gorbachev, the speaker continued, clearly perceived the widening gap between his country's economic development and that of the West. It was improbable that he was prepared to preside over a period of economic decline.

A French speaker suggested that it was worth remembering that, over the past 13 years, the Soviet Union had achieved, with low efficiency, the same average growth rates (about three percent of GNP) as the Western economies. If Gorbachev were able to mobilize even a small segment of the population, might not the result be a significant increase in productivity without major structural change?

An American participant responded that it was misleading to compare the Soviet Union's three percent growth to that of the Western economies because it was based on a far smaller per capita GNP. The growth that had occurred was in the wrong sectors — those that produced outmoded, non-competitive goods. The old methods by which the Soviet Union had achieved growth in the past — exploitation of cheap resources and plentiful labor — were no longer available. What was needed was a change in labor productivity, and this could only come about with a change in incentives.

Addressing the notion that, if fundamental reforms had not been made in the past, they were unlikely to be accomplished by the current leadership, an American argued that the traditional analyses of the problems of the Soviet Union were

Western ones and had not been echoed inside the Soviet Union. Today, their own analyses of their problems were much closer to ours. Furthermore, there had been no real progress in the past because Brezhnev had been unwilling to weaken the military priority, to deemphasize foreign-policy goals, or to risk cuts in consumption. He feared the potentially destabilizing consequences of cutting the standard of living, so cuts were made in investment and the economic future of the Soviet Union was "mortgaged to an ambitious political and military build-up and an unwillingness to risk instability by cutting consumption." The result was that the bills were now coming due, and Gorbachev had far less elbow room than his predecessors.

If we accepted that Gorbachev really did recognize the need for basic changes in the Soviet system, participants in the discussion wondered what the implications might be for specific areas of Soviet interest around the world. A French speaker thought it possible that the Russians might attempt a "major breakthrough" in the Far East, in relations with Japan and China. Might not the time be right for some sort of concession in the northern territories dispute with Japan, for example? Perhaps the Soviets could make a deal allowing Japanese participation in the economic development of Siberia in exchange for Japan's neutralization.

In response to this hypothesis, an American speaker saw "no sign" that the Russians were about to make "the slightest territorial concession" to Japan, or to thin out their forces along the Chinese border. But a Briton, while conceding that the Soviet Union had so far failed to make "the obvious and painless concessions" in the region, very likely soon would, particularly if China were to throttle back on its program of reform. With respect to Japan, if the Soviet goal was to secure Japanese involvement in its economic development, a major change in relations was not necessary. Already the Japanese were helping the East Germans, and their assistance was available to the Russians as well.

With respect to the Eastern European countries, considerable concern was voiced by participants. What was the Soviet attitude toward its allies, many of which had, as a German pointed out, found a middle ground between opening their economies to the West and remaining members of a Soviet-dominated Comecon? Trade with the West was vitally important to these countries, and, so far, Russian appeals for them to downgrade their relations with the West had fallen on deaf ears. It was important for the West to continue trade and other links with the Eastern European countries.

An American felt that Gorbachev's concept of interdependence might have major consequences for the Eastern European countries. It could be interpreted as a new policy of opening up Soviet markets to the West and allowing Eastern Europe to continue earning foreign exchange by exporting to market economies. But the Communist Party had called for greater integration among socialist states, which could be seen as trying to prevent Eastern Europe from making too much economic progress and to make them divert their best goods from Western markets to Soviet markets. So far, there appeared not to be a decision to go one way or the other, but there were strong indications of a greater emphasis on contact among non-market nations.

Several speakers felt that economic decentralization in the Soviet Union would not necessarily lead to political decentralization, and that this might have adverse consequences on the Eastern European countries. If Gorbachev succeeded in increasing Soviet productivity, would he try to exert greater pressure and control over his European allies, wondered a Belgian. An American agreed that there was a real danger that economic decentralization in the Soviet Union could lead to a tightening of control. One way the Soviets might seek to gain access to technology, he suggested, would be to squeeze their satellites, who had managed to get and

learn to use technology. In this sense, economic change and political change might lead in different directions.

A participant from the U.K. was less worried. He observed that there were extensive ties between Eastern Europe and the West, both multilateral and bilateral. Some Eastern European countries had joined the World Bank and IMF. There was extensive contact and trade. The Russians had not yet been able to force Eastern Europe to supply the Soviet Union with quality goods. It was important for the West to maintain and increase these links with Eastern Europe.

A number of speakers felt that Gorbachev's acceptance of the necessity for economic modernization in the Soviet Union boded well for progress in arms limitation. A Finn observed that the rapid pace of technological change in recent years had wrought important qualitative changes in arms. The Soviets were having difficulty enough, due to the curtailments in their purchasing power brought about by the drop in energy prices, in acquiring equipment and technology to modernize their economy, let alone pouring money into the military sector. They would have to establish priorities. A German agreed that the Russians would never achieve the growth rates called for in their plans if they shifted resources into the military. Any additional burden in the arms field would limit the development of the standard of living. Thus Gorbachev placed great emphasis on arms control. Perhaps it was in the West's interest to offer him a "way out of the high cost of competing with the U.S. from a weaker economic and technological base."

An American disagreed that Russian military spending would be constrained by the need for economic modernization. Economic factors were, on the other hand, already limiting American programs, and budgetary considerations would go further than arms control agreements in limiting U.S. programs. There was "no discernable evidence" of any such restraint in the Soviet Union. Their arms control proposals might evidence a change in style and tactics, but not in substance. The Russians were testing new systems and were proceeding with research and development of a strategic defense capability while seeking to halt the U.S. defense program. In the INF area, Gorbachev's zero-option proposal was unsatisfactory because it failed to address the deployment of new SS-21 and -23 missiles, which had substantially the same target capability as the SS-20's.

Strongly disagreeing with the foregoing remarks, a British speaker argued that the U.S. had outspent the Soviet Union and the West had outspent the Warsaw Pact in arms in the last decade or more. Gorbachev's current zero-option proposal was better than Reagan's 1981 version because it would leave no land-based missiles pointed at Europe. One technological development that had had a profound effect on the Russians was the development of the concept of nuclear winter. This concept should have major implications for the way in which the U.S. and the Soviet Union regulated military competition and sought security. It had been a dominant factor in the shift in Soviet attitudes and policy under Gorbachev. The Russians had decided they could not afford to fight a nuclear war. The speaker saw no similar progress in thinking on "the other side of the Atlantic."

Commenting on current Soviet arms control proposals, an American believed "there was something in them for the West." The Soviet Union's proposals to reduce ICBM warheads and throw-weights would result in meaningful cuts in its capabilities. Indeed, the Russians could be abandoning their quest for a first-strike capability against U.S. land-based forces. And in considering their INF proposal, it had to be recognized that the SS-21, -22, and -23 missiles were also capable of carrying conventional explosives, and it was debatable whether they would be held back for nuclear use in the event of a conventional confrontation.

According to an Italian speaker, Europe was deeply concerned that progress be made in arms control. But, at this point, progress in the strategic area was perhaps more important to Europeans than progress in the INF area, because of the fear of

decoupling. In any event, it was important to maintain cohesion in the alliance by finding a balance between the necessity for a strong defensive capability and achieving progress in arms control.

A number of participants wondered about the implications of economic change for Soviet society. A Belgian asked if, with Gorbachev publicly recognizing that "all was not well in the Soviet Union," the Soviet people could join in the criticism without fear of committing an act of treason. Or was the power to criticize in Gorbachev's hands alone? An American thought there might be "a new era of self-criticism" developing in the Soviet Union. He cited as possible evidence a recent editorial in *Pravda* that criticized the party organization. The editor responsible had been dressed down, but not fired, as would usually have been the case.

And what about the introduction of new technology in Soviet life? The Belgian speaker wondered how the party leadership would react when it realized that technology made central planning less important and was not an instrument for political control. The introduction of new technologies would indeed put pressure on the secrecy of Soviet society, said an American participant. To get the maximum benefit from technology, there had to be communication. A computer was a means of communicating and a printing press — two things the Soviet leadership had always tried to control. Already there were indications that the leadership was attempting to control the use of computers, to prevent them from communicating outside a particular institute, for example. When Soviet technicians realized they were not getting full advantage of new technologies because of such restrictions, the pressure between the efficiency proponents and the party ideologues would increase. Conceivably new technology could lead to more communication and therefore greater stability in the Soviet Union.

A few speakers questioned the assumption underlying the discussion that internal reform in the Soviet Union was necessarily good for the West. To what extent was it a Western interest that the Russians increase their productivity, wondered an Italian. An American thought it dangerous to assume that reform in the Soviet Union would lead to a foreign policy "more congenial to the West," or that it would make the Soviet Union easier to deal with from a foreign policy and security perspective.

Addressing these concerns, an American said that whether Soviet modernization was good or bad for the West depended on the "character of political changes that accompanied the economic modernization." Modernization that forced Soviet leadership to abandon the military priority and devote their attention to domestic concerns, such as consumer satisfaction, would be positive. But modernization that increased "the volume of discretionary resources available to a politician not otherwise constrained" would not be desirable. In short, economic modernization was not an "unmitigated good."

Was there, wondered a number of participants, an optimum course of action that the West could follow so as to influence what happened in the Soviet Union? To what extent were Gorbachev's actions alterable or dictated by the Western response, asked a Briton. Would a cooperative approach encourage him to move in a "more open" direction? Would a confrontational approach put him in a defensive posture? Or did the Western attitude have any effect at all?

An Italian said that the U.S. could consider the two approaches, squeezing and dealing, but that, for Europe, there was only one option, dealing. Even if there was nothing really new in Soviet attitudes and policies, there was the appearance of a new set of circumstances. The perception in Europe was that Gorbachev represented change. The West therefore had to adjust its strategy to what seemed to be a turning point in Soviet policy.

While dealing, which included economic cooperation, bilateral contacts, progress in arms control, was favored by many European speakers, a Turk warned that, to

the Russians, dealing meant "deal and expand." The West should be careful not to "let its resolve weaken."

An American participant argued that there were different gradations of dealing, ranging from soft dealing to hard dealing. But squeezing alone, without any dealing, was a risky strategy that the West might not be able to sustain and to which the Soviet Union might respond in "ways that could endanger us both." What the West did certainly had an effect, but it was wrong to think we could manipulate Soviet domestic development. Our efforts to do so could have the opposite effect of the one desired. Our best course was to "influence the external environment in which the Soviet leaders make their domestic decisions . . ." We should make that environment "less hospitable for Soviet aggrandizement." But we should always "be ready to reciprocate Soviet restraint."

It was another American's view that the West could not influence Soviet modernization much by selling them physical equipment. But we could influence them by the way we handled our own economies. We could also have an effect by promoting exchanges of people, encouraging communication and contact, and trying to break down the secrecy barriers. We should continue non-strategic trade and keep coming up with creative proposals. But we should abandon any "social engineering instinct" that we could predict the effect our actions would have on developments inside the Soviet Union. Our policy should be based on our own national interests, on staying engaged with the Soviets, and trying to move them toward positions that would lead to greater strategic stability.

## II. THE WESTERN GLOBAL RESPONSE TO THE SOVIET CHALLENGE

### *Opening Remarks from the Panel, I.*

We in the West should be asking ourselves not what the Soviet Union intends to do, but what we should be doing. The notion that the Russians have a carefully designed and detailed foreign policy is not born out in practice. Almost every breakthrough in relations has been the result of a Western initiative to which the Russians responded.

The great advantage of the Soviet Union is its persistence in sticking to whatever course it has adopted. But at some point in the future, the Russians are going to realize their present attempt to make their system more efficient is not going to work, and they are going to have to undertake more fundamental reforms. This realization may cause intense domestic controversy in the Soviet Union, with a resulting weakening of their foreign policy. It could also coincide with a realization by the Russians that the Chinese experiment is succeeding. If these realizations did coincide, the Russians will have to decide whether or not to deal with at least part of the foreign policy environment before undertaking fundamental domestic reform; the result might be a dangerous period in the 1990's.

Whatever happens, the West must communicate to the Soviet Union what it means by peace. We tend to practice "diplomacy by conversion," believing that a "magic moment" will arrive when the Russians suddenly recognize the advantage of peace and a great reconciliation will follow. This is wrong. Whatever the long term intentions of the Russians might be, their bureaucratic incentives now are not to "rock the domestic boat" by making controversial changes in military and foreign policies.

In the area of arms control, the current Soviet proposals are aimed at freezing the existing relationship of forces at a lower level. The existing relationship favors them, not because they necessarily have a first-strike capacity, but because the U.S. has foregone one. In a "tit for tat" nuclear war, the Russians would probably have more endurance than the West in terms of weapons systems and certainly more in terms of public support. Furthermore, we have done nothing to redress the existing imbalance in conventional forces. Thus, to maintain the *status quo*, even at a lower level, risks the emergence of pacificism and unilateralism in the West. It might also lead to a situation the Soviet Union could exploit, particularly if developments in China resulted in the opening of a second front for the Soviet Union.

The West's current arms control proposals do not help matters much. Assuming the West could not stick to its opening position and moved toward the Soviet position, the result would be a compromise that failed to change the fundamental imbalance. We seem to be heading into "a liturgy of arms control in which an agreement becomes an end in itself." Symbolism is replacing substance in the debate. We ought to be asking ourselves where we want to be in 10 years time and work back from there to a present position.

With respect to SDI, we ought to analyze what combination of offensive and defensive weapons will correct the imbalance of forces, or will make the use of nuclear weapons less likely. The Western democracies cannot stick to a position of total vulnerability indefinitely without demoralizing their populations. The notion that SDI research is permissible but deployment is not will result in no effective research being done in the West because governments will not invest money in research that is not going to be translated into deployment. The problem, which we seem intellectually unable to deal with, is what limitations on deployment related to what limitations on defensive weapons are necessary to produce maximum stability.

In the sphere of U.S.-European relations, there has been a series of events outside the NATO area in which the various allies have not only disagreed with each other, but have actively opposed each other. This is a particular problem for the U.S. insofar as it has a major portion of its armed forces tied up in the NATO area and cannot use them in contingencies in other areas without the permission of countries that may oppose the U.S.'s perception of its vital interests. The problem facing the West in the coming decades is how to prevent North-South issues from becoming East-West ones, and East-West issues from becoming transatlantic ones. We need to discuss where we agree and where we disagree, and what to do when we disagree. What is the permissible scope of disagreement going to be in a crisis?

In both East-West and transatlantic relations, we must ask ourselves where we think we are heading, and put it in a context that we can place before the Soviets. Otherwise, negotiations with them become purely technical debates. We must present the Politburo with a vision of the future, other than a numbers game, that it has to study. We have to face our differences frankly, not in a spirit of anger or recrimination, and determine what they mean for our foreign policy.

#### *Opening Remarks from the Panel, II.*

Gorbachev will need a lot of time to introduce far-reaching changes into the Soviet system; it will be several years before any changes are made that effect foreign policy. Thus, the West is still confronted with a military challenge. Although the Soviet Union is now on the defensive strategically, we cannot lower our defenses. A good global reaction capacity to the Soviet threat must be maintained.

One weakness in decision making and continuity of policy in our alliance is that we are responsible to our populations, and this is not always the most effective system. The Soviets have the advantage of centralized control. The West, which is only partly an alliance, has no centralized command; we respect the sovereign rights of our democracies. Therefore, to achieve cohesion in our response to the Soviet challenge, we need to work out a consensus among the leaders of our democracies. This is especially important if quick action has to be taken.

SDI presents a challenge to the alliance. What are the consequences for Europe of SDI? The new doctrine of strategic defense has not been fully developed, as SDI will not protect Europe from short- and intermediate-range missiles. What happens if, in the next 20 years, budgetary constraints cause the U.S. to focus on strategic defense at the expense of counter-offensive weapons? Furthermore, we should not be "putting all our eggs in the nuclear basket." What happens if there is a conventional confrontation in Europe? What about the development of the Soviet Union's chemical warfare capacity? We must work out our response to Soviet military action, whether nuclear or conventional. We are faced with fundamental questions and strategic choices.

The West's response to Soviet arms control proposals is of great importance to public opinion, especially in Europe, with respect to medium-range and tactical nuclear weapons. We are finding it difficult to work out a common response. One of the problems is that there really is no European strategic response. If, as John F. Kennedy described it, the Alliance stands on two pillars, the U.S. and Europe, then the European pillar is somewhat lacking, and we need to do something about it.

We also need to work out a response to problems in areas not covered by NATO. It is in such areas that fighting usually breaks out. In the Mediterranean, we are acting as individual nations, and not as an alliance. But there is a cultural aspect to our alliance in the sense that we all belong to the same sort of society; hence we should have a common policy. This is especially important in our efforts to work with the moderate Arabs.

Here, the American action in Libya has had a negative effect. It has accentuated the gulf between the U.S. and Europe in dealing with these kinds of problems. It has risked provoking problems with the Saudis, the Egyptians, the Algerians, and the Jordanians, none of whom have been involved in terrorism, but have had to back Khaddafi. Considering the implications of the U.S. action, a few hours of reflection before taking such action is really not enough. We need to agree on what our policy in the region is going to be. One of the problems is that our diplomatic traditions in the area are different. For example, the U.S. has a "privileged" relationship with Israel that Europe does not share.

Another challenge facing the West is how to deal with the indebtedness of third world countries. This is a geopolitical question as well as a financial one. It is of particular importance in Africa and Latin America. We need to work out a geopolitical approach to prevent these countries from falling into the Communist orbit. We need to think about forging a link between geopolitics and finance. From the point of view of third world economic development, the next GATT round is of great importance.

We have given our alliance certain legal powers, but not a strong central command nor a great deal of discipline. To have done so would not be in keeping with our democratic traditions. The alliance is "an assembly point for sovereign democratic states." Right now we have a mixed strategy for responding to the Soviet challenge, and no real consensus. Perhaps this is something for the think tanks to work out — how to forge a consensus on a global response. We need to choose a course of action that will preserve the cohesion of the alliance.

#### *Opening Remarks from the Panel, III.*

Since 1981, the alliance has been characterized by an "abdication" of Europe in the face of U.S. unilateralism. This has been exemplified by the termination of the INF talks in Geneva without European consultation, the American attack on Libya, which left Europe "speechless in sterility," and by the current arms control situation, in which a "revolution in military strategy" — SDI — is being thrust on the Europeans without any consultation.

At the same time, there has been a revitalization of the U.S., and a revival of the American attitude of "naive optimism," and of the "arrogance of power." Europe has viewed with mixed feelings American policies toward such countries as Grenada, Nicaragua, and Libya. It has been powerless to do anything about the "self-centered set of American budget policies carried out at the expense of the smooth functioning of the world economy." In relations with the Soviet Union, the U.S. appears to have no concept, save that of an "economic war of attrition by means of the arms race." Reagan's skill as a communicator to the American people does not extend to the Europeans, for whom Gorbachev's credibility is growing.



Looking ahead to the year 2000, there will be four "great common markets" in the world: China, the Soviet Union, the U.S., and Japan. China will continue to develop economically, and, in spite of occasional mistakes and setbacks, will have a large-scale economy by the end of the century. Politically, it will pursue a policy of equidistance between Moscow and Washington. The Soviet Union will continue to be "humble and ill-functioning," but will at least have the advantages of a single, unified economic policy. It will continue to pursue parity with the U.S., and, if not contained, to follow a strategy of cautious expansion. By 2000, the economic and strategic power of the U.S. will have increased substantially. Its foreign policy will be hard to predict, given its changeable nature. Finally, Japan will continue to thrive, with a unified economic policy and no burden of defense spending.

Then there is the European Common Market, in which ministers and heads of state argue about everything, a massive bureaucracy turns out vast sets of regulations, and there are 12 tax systems, 12 legal systems, and 11 currencies. By the end of the century, Europe will still be dependent on the U.S., perhaps even more so in the defense area.

Looking at the immediate future, the West has no choice in its relations with the Soviet Union but to pursue a double-track strategy of containment by sufficient defense and arms control agreements on the one hand, and economic and political engagement on the other. Europe has to do three things in particular: increase economic cooperation with the Soviet Union and Eastern Europe, complete the formation of the ECU, and bring France back into the military structure. This last would have to be done under some forum other than NATO, but, if it were done, the American military presence in Europe could be greatly reduced.

The outlook for closer cooperation among the allies in foreign policy is not promising. Nor is the outlook for developing a new military strategy for Europe to replace the current strategy, which is 20 years old and does not take into account the vast changes in weapons systems and in the ways of thinking about how they might be used. The alliance is not tackling these and other problems. Our main inhibition is our own "lack of will and mutual sensitivity." There has not been "grand-style cooperation" between the U.S. and Europe since 1976. It is unlikely to be revived without new international leadership, which will probably have to come from the U.S. But here, the outlook is not very bright, either.

#### *Discussion*

An American participant offered a generally positive view of Soviet-American relations, saying they were "better today than a year ago." The objective of U.S. policy was to "improve relations, to better understand the Soviets' objectives and actions around the world, and to help them better understand ours." Reagan was particularly eager to achieve a meaningful arms control agreement before his term in office expired, but he felt that such an agreement could not be reached without progress in other areas.

The U.S. had embarked on its arms build-up as a reaction to "aggressive Soviet expansion" around the world, the speaker continued. Of particular concern to the U.S. was Soviet behavior in Afghanistan, Angola, Cambodia, and Nicaragua. Human rights were also a major American concern, and the U.S. sought a curtailment of Soviet "oppression of human freedoms within their own country" and a lifting of restrictions on immigration.

The first summit meeting between Reagan and Gorbachev had established a dialogue and a pattern for future meetings. The recent postponement of the meeting between Shultz and Shevardnadze to plan the second summit was a disappointment, but the speaker was optimistic the second summit would take place. Progress was being made in improving relations, and Soviet-American relations, the speaker predicted, would be better a year from now.

A Canadian welcomed what he saw as the "reassertion of the traditional American preeminence in the alliance," even if it was something not all of the U.S.'s principal allies necessarily liked. The occasional "abrasions" that occurred between the U.S. and Europe were traceable to some degree to the American spirit of optimism, but not to any "arrogance of power." Because of Vietnam, Watergate, and the "irresolution" of the Carter era, the U.S. had "temporarily lost its way" and had not been able to assert itself in the alliance with its customary self-confidence. Indeed, there had been a period when the correlation of forces between the two superpowers had been so narrowly balanced that almost any initiative on the part of one of the European allies could alter the balance of power. This, in the speaker's view, had required the U.S. to "show greater deference" toward Europe — a state of affairs whose passing many Europeans now tended to lament. The tendency for Europeans to feel underconsulted and other strains in the alliance brought about by renewed American assertiveness should not be swept under the rug, but Europeans should at least recognize as a compensating benefit the return in the U.S. to a bipartisan foreign and strategic policy that had not existed for 20 years.

A Dutch speaker took issue with the notion that, as the U.S. had grown assertive, so Europe was growing weaker, and more helpless and lacking in determination. Despite all the difficulties faced by the EEC, nowhere else in the world was there such a great degree of cooperation among sovereign nations as that among the 12 members of the EEC. The Common Market had achieved significant success, particularly in the economic sphere, and the current economic outlook was particularly bright. Effective trade and agricultural policies had been developed, Spain and Portugal had been newly admitted, and monetary reform had been expeditiously accomplished, to name a few of the EEC's accomplishments. Cooperation extended beyond economic affairs, to foreign aid and defense, as well. "Europessimism" was not justified; Europe could stand firmly as a pillar in the alliance.

What was needed, continued the speaker, was greater cohesion in the alliance. Europe should not be confronted with unilateral U.S. actions, which were detrimental to cohesion. Close consultation, particularly on foreign policy toward regional conflicts, was vital to maintaining cohesion. This sentiment was voiced by several European speakers, who felt that consultation had not been adequate.

Greater cohesion among the European members of the alliance was particularly desirable, in the view of a Spaniard. Europe should draw closer together, even at the risk of a greater distancing between the two sides of the Atlantic — a risk worth taking "as long as the fundamentals of the alliance are maintained." A Turk agreed, arguing that the need for greater consultation within Europe was especially keenly felt by countries on the flanks, such as Turkey and Norway, which often felt underconsulted. A Swede added that the efforts of neutral European nations in responding to the Soviet challenge were an important part of overall European strategy and should not be overlooked.

But, in the view of some speakers, there were limits to the effectiveness of consultation. An American observed that it was invoked "as though it were a magic formula for solving problems within the alliance." There were a host of issues on which the allies could consult endlessly and still disagree. It was the obligation of the U.S. to consider European views, but, in the event its vital interests were at stake, it had to have the right to act unilaterally. Did Europe have the right to veto

the American definition of what constituted vital interests? The Europeans had to decide not only whether or not to support U.S. actions, but also to what extent they would carry their disagreement. Was the time right after an action the best time to be vocal in disagreement? In view of the controversy surrounding the American action against Libya, perhaps it made sense for the U.S. to consider other basing arrangements for some of its forces in Europe — its F-111's, for example — so that they would be available for out-of-area contingencies without the U.S. having to obtain permission from the country where the forces were now based. Consultation should not mean each side paralyzing the other.

A Canadian agreed that it was unrealistic for Europe to expect the U.S. to consult each European government before embarking on even a "modest undertaking" that it felt affected its own strategic interests. He found it encouraging that the U.S. once again recognized it had strategic interests in the world and was determined to defend them. A British speaker observed that, while consultation was important, it was too often true that only after the U.S. took action did Europe do anything. Consultation was no substitute for European action.

Another Briton felt it was all right for the U.S. to act in accordance with its judgement of its vital interests, but it was "essential to get that judgement right." One interest had to be balanced against another, such as weighing the importance of sustaining an alliance against the need to deal with terrorists. A French participant agreed that the U.S. had to weigh other arguments before taking an action. What the West needed was a new basis for consultation that should be worked out by think tanks or perhaps a special task force.

In the arms control field, it was an American's view that the U.S. had been consulting fully with its European allies. American negotiators in Geneva met regularly with the Atlantic Council, and Nitze was as that moment consulting in the Hague. Whether or not the Russians were seriously seeking an agreement was unclear. Gorbachev had been making speeches at home and around the world that "seemed to open new doors." But, so far, what Gorbachev had been saying had not been reflected in the positions of his negotiators in Geneva.

Another American found it hard to accept "the concept that there is a gap between the public and private positions of the Soviets." The public positions themselves were "not that exciting or acceptable." The Soviet aim to freeze the balance of forces would "contribute to the demoralization of the Western world." With respect to INF, the West had to decide what the deployment was really for. Was it purely military, or was it to link the nuclear defense of Europe with that of the U.S.? If the latter was true, then there was a critical point below which the number of missiles could not be reduced. We needed to have strategic rationale for the missiles.

Regarding SDI, another American wondered if it would not be applicable to the defense of Europe before the U.S. because the technology required to defend against slower-flying intermediate missiles was less complicated than that required to intercept ICBM's. A German speaker viewed this possibility as cold comfort, saying that research into lasers and kinetic energy and other components of SDI technology had been going on for years and could never become operational before the end of the century. Anyway, it was doubtful that such a defense would work against contour-flying cruise missiles. Even if SDI did work, continued the speaker, it would mean a major revolution in military strategy. The belief in nuclear weapons as the ultimate weapon was endangered by SDI. The West needed nuclear weapons only to deter the Russians from using theirs. The deterrence argument was true of conventional weapons as well, and it was urgent that the West do something about conventional defense. Indeed, there was no constructive thinking going on about military strategy in the West.

A Frenchman felt that it was a high priority to develop a new procedure or mechanism to think about the Western strategic concept. Here, the autonomy of French forces could play a role. An American president faced constraints in not being able to give the same priority to launching nuclear missiles in defense of Europe as he would give to the defense of the U.S. It was also likely the cost of maintaining U.S. forces in Europe would continue to be a problem. Europe faced a growing need to take responsibility for its own defense. A new European strategic concept could involve the use of French forces in service to the Alliance as a "quick response" force. An American agreed, saying that "French semi-autonomy has produced the most serious thinking on defense and foreign policy going on in Europe." A greater European contribution to its own defense was in the U.S.'s as well as Europe's interest.

The discussion, focusing as it did on the need for a comprehensive and cohesive Western strategy in responding to the Soviet challenge, prompted a participant to ask how we might "implement a strategic vision" in responding rationally to the Soviets. "If we accept a two-track strategy as the starting point, what rules of conduct could we adopt that are simple enough to be understood on both sides of the Atlantic and binding enough to be effective?"

From one American's point of view, the answer was that the West and the Soviet Union had to sit down and discuss the political issues dividing them. Each side had to try to define and put before the other its vital interests. If we could agree, then we should each respect the other's vital interests by not using force or covert military action against them. We had to find out if the Soviet Union was determined to refuse to accept vital Western interests, in which case we could at best achieve only "endless military containment." But as we sought to deal with the problems facing us, we in the West should remember that our "balance sheet" was far ahead of the Russians, whose system might soon be in crisis. In any event, in negotiation or in confrontation, "we need not fear the historical outcome."

### III. THE FRAGMENTATION OF THE WORLD ECONOMY: DEBT, CURRENCY DISORDER, PROTECTIONISM, AND UNEVEN GROWTH

#### *Working Paper*

There are many reasons for optimism about the international economic outlook. Impressive progress has been made in reducing inflation, interest rates, and inefficient economic regulations in most industrialized nations. The U.S. is in the fourth year of its recovery and European growth prospects look increasingly bright. Towards the end of 1985 the U.S. took a more active leadership role in addressing the problems of the world economy, the Group of Five agreed to try to better manage currency rates, the Baker Plan constructively addressed the Third World debt problem, and members of the GATT set a date to launch new trade negotiations.

But amidst progress there are underlying problems which jeopardize the longer term outlook. Like large tectonic plates, economies of many regions of the world are drifting apart. The U.S., Canada, Western Europe, and much of East Asia, although not without their problems, have improved the structures of, and the outlook for, their economies. Latin America, however, continues to suffer from a large debt burden that has led to social stress, high unemployment, and low investment. Africa's economies continue to deteriorate along with the health, nutrition and overall wellbeing of their peoples. The Soviet Union and much of Eastern Europe are becoming technological laggards — falling behind the major market economies. The Middle East has suffered a series of economic setbacks as the result of the collapse in oil prices.

This paper will discuss the major reasons for disparities in world economic performance, the relationship between them and persistent unemployment, trade, monetary, and debt problems, and policies that show promise of overcoming these difficulties.

#### MAJOR FORCES AT WORK IN THE WORLD ECONOMY

Three related forces have dominated developments in the world economy since the turn of the decade.

(1) **DISINFLATION.** As electorates and leaders came to recognize the corrosive effects of prolonged inflation in the 1970s — its erosion of purchasing power, its adverse affect on investment, and its divisive impact on society — there was a shift to strong anti-inflationary policies in most industrialized nations. Heavy regulation and rapid increases in government spending were replaced by steps to deregulate economies and curtail the growth of domestic programs. Restrained monetary policy in the U.S., and tighter fiscal policy in most other major industrialized nations, sought to lower inflation rates.

As these policies began to take hold, growth slowed and interest rates increased. Much of the borrowing of the Third World governments in the 1970s, as well as a large amount of investment in both industrialized and developing countries in energy, raw materials, basic industry and agriculture, had been based on the expectation that earnings would exceed interest payments. Prices had risen sharply in these sectors in the 1970s and many predicted further increases in the 1980s. But they failed to occur.

When interest rates increased in the 1980s, and growth weakened, many borrowers found that large scale borrowing and investment had led to substantial debt overhang and excess capacity. The cost of servicing debt was much greater, and their ability to increase earnings much less than anticipated. That contributed to the enormous debt problem from which many producers of energy, other commodities,

and basic industrial goods now suffer. As these producers attempted to compete with one another in a weak world market, prices for their products fell precipitously. Such price declines have been of major benefit to the world economy as a whole (by contributing to lower inflation and lower interest rates). They have been an important part of the economic sea change from an inflationary to a disinflationary environment. But they also dealt a major setback to localities (such as oil and grain producing states in the U.S.) and countries that depend on such goods.

The collapse of prices and revenues in these sectors — in contrast to the vigor of many others — has been one important cause of disparities in performance among countries and regions within them. Most dramatically, oil importers who, in effect, had suffered an enormous tax increase from sharp oil price rises in the last decade, now are benefitting from the large tax cut resulting from the collapse of such prices — increasing the availability of resources to spend on other products and reducing inflationary pressures. The massive shift of resources to oil exporters in the 1970s has been largely reversed in the mid-1980s.

(2) **REDUCED GOVERNMENT INTERVENTION IN ECONOMIES.** As part of the effort of governments to cut inflation, nearly all industrialized nations and many developing ones have significantly reduced government intervention in their economies. Regulations on aviation, telecommunications, energy prices and finance have been loosened. Growth in social expenditures has been slowed considerably in nearly all industrialized nations — in some cases a sharp departure from the steady expansion of such programs in the 1960s and 1970s. Wage indexation has been modified to reduce growth in labor costs. Government owned industries are being sold off in many parts of the world.

Greater scope for market incentives has contributed to non-inflationary growth and efficiency. Again, however, these developments have occurred unevenly. Those countries that have maintained a large, and often heavy handed, economic role for the state have tended to fall behind those that have reduced the state's participation in the economy. The success of many nations of East Asia can, in significant measure, be attributed to their encouragement of private investment, outward looking trade policies, and willingness to reduce the economic role of government. This contrasts sharply with the more inward looking, state dominated, economic strategy of much of Latin America — an approach which rendered most of that continent less able to cope with the shocks to the world economy of past years and resulted in its managing its debt problem less satisfactorily than much of East Asia.

And the Soviet Union along with most of its allies in Eastern Europe have slipped further and further behind market oriented industrialized nations in Western Europe, North America and East Asia. As the technological revolution proceeds elsewhere in the world, the Soviets struggle to keep up. However, incentives are severely distorted by the dominant role of government in allocating resources. Use of information technology is closely restricted. The Strategic Defense Initiative challenges that country to a technological duel for which it recognizes that it is ill prepared.

(3) **INTERNATIONALIZATION OF BUSINESS AND FINANCE.** In recent years international competition has intensified to the point that no major business can compete either in its home market or internationally without constantly searching out the lowest cost source of supplies, the most desirable locations for production facilities, and the most attractive financing wherever they can be found on this planet. Because much modern technology can be easily transferred among countries, more and more nations can make goods: the production and export of which was formerly dominated by the major industrialized nations. Countries which once attracted investors on the basis of low wages now do so by supplying low cost engineers and scientists.

Investment increasingly seeks out a secure environment and a favorable tax and regulatory climate, shunning countries or localities with negative attitudes toward the private sector or a record of political instability. Sharp differences in the investment climates among nations has led to changes in the allocation of new investment and, thus, in world trade flows. The U.S. and much of East Asia have been important beneficiaries of the search of investors for favorable business environments. And many parts of Asia have benefited from the search of companies for low cost, quality goods to sell in their domestic and international markets.

The rapid internationalization of finance has proceeded in parallel with that of production and commerce. The veritable explosion in the international mobility of capital has resulted from the dramatic expansion of offshore financial markets (particularly the Euromarket), deregulation of capital and currency markets in Japan and much of Europe, and new technologies for transmitting information and making transactions. Capital can now move rapidly in response to changes or anticipated changes in returns on investment or in national policies. And differences among policies and investment returns, within a floating exchange rate system which has shown a tendency to "overshoot," have led to exchange rate volatility and misalignments. Rather than serving to equilibrate trade balances, currency movements too often have exaggerated them.

#### IMPLICATIONS OF THESE DEVELOPMENTS

(1) **UNEMPLOYMENT.** Nothing highlights the unevenness and imbalances of the recent recovery so much as large pockets of persistent unemployment within our own countries. While employment in service, high technology, and some manufacturing sectors has increased, it has fallen in a number of others. There is high unemployment among 1) older workers displaced from their traditional jobs by the scaling down of capacity in sectors suffering from global over-capacity (including agriculture, "smokestack industries", and raw materials), 2) job displacement due to domestic and international competition, and 3) younger workers, primarily in urban areas, who often find it difficult to secure entry level jobs.

Although over time demographic trends in most industrialized countries will lead to a narrowing of the gap between jobs and available labor, the social costs of current high unemployment are enormous. Urban unemployment in Europe and North America, particularly among minorities in the U.S., is a potentially explosive problem as frustration leads to alienation, bitterness and, potentially, social unrest. And too often the basic domestic causes of unemployment are obscured as a disproportionate share of blame is placed on imports.

(2) **DEBT.** A second manifestation, and cause, of the unevenness in world economic performance is the Third World debt problem. Much of that can be attributed to the interaction between, on one hand, economic policy distortions within a number of developing countries — particularly in Latin America and Africa — and, on the other, the shift in the world economic environment from high inflation and low real interest rates to low inflation and high real interest rates. Countries that had borrowed for unproductive or unwise purposes, or pursued rigid domestic economic policies, have coped poorly with the volatile changes in the world economy. As noted, for commodity and oil exporters the impact of recent events has been particularly severe. The sharp price increases in these items in the 1970s led ultimately to increased capacity, conservation, and substitution. Price declines in oil, tin and other commodities in the 1980s are the direct consequence of the powerful market forces that earlier price increases unleashed. And protectionism plus overvalued exchange rates in many Third World countries impaired their ability to compete in many industrial products.

Although improvement in external payments balances has taken place in Latin America following a tightening of domestic demand, sharp cutbacks in investment, and exchange rate devaluations, internal adjustment there has proved more difficult. Large government deficits, high subsidies, and a poor investment environment still persist. These contribute to inflation and price distortions, particularly in agriculture. The continuation of large Third World debt is a cause of slow growth and high unemployment in countries directly affected as well as a drag on global growth and trade, a threat to our financial system, and a potential cause of political instability in many parts of the World.

(3) CURRENCY DISORDERS. Currency volatility and misalignments have been one result of a combination of differences in policy and performance in major industrialized countries and recent changes in the character of world financial markets. The impact of the dollar's strength, and uncertainty surrounding its future value, have affected virtually every major sector in the U.S. and abroad. The strong dollar was responsible for a significant portion of the U.S. trade deficit, and one reason for the rise in unemployment in U.S. sectors highly exposed to international competition. But it also helped other nations to boost exports and thus contributed to their recoveries.

While many techniques have been devised by the financial community to reduce the impact of currency volatility on trade and investment, their use has added to the cost of international business. And domestic labor adjustments in the U.S. to the high dollar, and abroad to the recent shift in currency values, are painful. They are a proximate cause of demands for trade restrictions and subsidies. Governments in Europe and Japan now — as has been the U.S. government in recent years — will be under intense pressure to subsidize domestic industries facing a decline in competitiveness as the result of the appreciation of their national currencies.

Europe has succeeded in creating the European Monetary System to reduce instability among currencies of member countries. Exchange rate volatility has led to growing interest in exchange rate reform — in effect picking up the debate where it was broken off in the early 1970s, when reestablishment of parities became impossible as the result of the oil crisis.

(4) TRADE DISTORTIONS. The volatility in currencies, enormous domestic adjustments to changing competitive positions, and shifts in trade flows have contributed to major trade frictions. Ironically, as governments have reduced their role in domestic economies they have intervened to a greater degree in international trade. In part they have done this to offset currency distortions, in part to avoid declines in jobs in weaker sectors, in part to preserve capacity in key industries, and in part to strengthen new high technology companies. The increase in agricultural production in countries that for years were major food importers, the diffusion of technical and industrial expertise around the world, and the vigorous competition from Japan and newly industrializing countries has added to concerns in the U.S. and much of Europe about the loss of world market share. In the U.S. the administration's once cavalier attitude toward the strong dollar, as well as its reluctance to provide redress under U.S. law, and in ways consistent with the GATT, to industries that sought import relief or other types of assistance, has led to a loss of domestic support for free trade by previous advocates thereof. It added to pressures for restrictive legislation — often as much to force the White House to take tougher positions as to protect U.S. industries.

The weakening to the legitimacy of, and compliance with, GATT rules by nearly all nations has encouraged countries to resort with increasing frequency to restrictive unilateral measures, subsidies or bilateral agreements. As these proliferate, leaders become subject to greater pressures for more restrictions; GATT rules once used as a defense against such domestic pressures no longer can be credibly cited by governments as an excuse for not acquiescing to many of these demands. Progress

has been made toward multilateral negotiations. But there is little consensus on how to improve the trading system and reduce trade barriers. Progress in reaching agreement to begin negotiations has been motivated more by a common desire to halt the erosion of the trading system than a common vision of how to improve it.

## NEW POLICY APPROACHES

An impressive increase in international economic cooperation has occurred of late. Recent meetings of the Group of Five, the Geneva agreement to begin in earnest preparations for a new round of trade negotiations, and the Baker initiative should lead to a more purposeful focus on monetary reform, trade and debt in the near future. Lower inflation has improved prospects for investment and non-inflationary growth, and given central banks the opportunity to lower interest rates with less risk of price increases. The question now is whether constructive ad hoc measures can be translated into sustained improvements in domestic policies (e.g., lower real interest rates, greater efficiency) and in the major institutions of the world economy.

There are three areas in which improvements are both needed and within reach.

(1) POLICY HARMONIZATION. Interest has increased in monetary reform to try to stabilize currency rates. Because of the relaxation of capital controls, the ease of moving money, and the size of the pool of highly mobile funds, restoring fixed parities will be difficult if not impossible. But greater stability is possible if procedures can be agreed for reducing disparities in policy and performance. The EMS has helped to restrain currency volatility in Europe, not so much by forcing exchange rate intervention but by averting serious policy divergencies and, in particular, by encouraging efforts to restrain inflation. A similar procedure could be instituted among a broader group of industrialized nations. But over the longer term efforts to reduce imbalances will succeed only if the ad hoc harmonization efforts among the major economies can be institutionalized. And the adjustment process will need to be made more symmetrical between surplus and deficit countries — by developing criteria for deciding whether in a given circumstance the surplus country should take measures to reduce its surplus by, for instance, tightening monetary policy or the deficit country should act by, for instance, easing monetary policy. Unless such an agreement can be reached, maintaining a "target zone" or similar system will be difficult. Because it is easier to identify the "wrong" exchange rate than to identify the "right" one, as the Group of Five is now discovering, the system is likely to evolve into one which stresses coordination to avoid extreme misalignments, with less attempts to manage rates in more normal circumstances where a consensus on misalignment does not exist.

In addition to trying to encourage effective short-term adjustment, harmonization should seek to reduce radical divergencies in tax and regulatory policies that lead to sharp differences in incentives (or disincentives) to save, borrow, invest or create credit. For example, financial and trade imbalances between the U.S. and Japan are in part the cause of, and should impel both nations to reexamine, disparate tax systems: the U.S. should reduce artificial incentives to borrow and disincentives to save, and Japan should reduce artificial incentives to save and disincentives to invest.

The impressive cooperation that has developed among finance ministries and central banks — as exemplified by recent Group of Five meetings — has raised high expectations. Parallel reductions in interest rates, reflecting lower inflation and preferences for using monetary rather than fiscal policy to boost growth, as well as the decline of the dollar, have led the public to anticipate further impressive results from policy coordination. But tensions within the Group of Five are likely to increase if disputes continue as to how far and how quickly the dollar should

decline before the U.S. feels the currency is low enough to lead to a substantial correction in its trade deficit.

While the dollar has declined sharply vis à vis a number of major European countries and the yen, it has appreciated against the Canadian dollar (the currency of the largest U.S. trading partner), the currencies of Latin America (roughly one-fifth of U.S. trade), and the Asian NICs. Thus the trade benefits for the U.S. from the dollar's decline are not as great as might be expected if one looks only at such currencies as the mark and yen.

(2) TRADE. The planned beginning of trade negotiations this year offers an opportunity to reverse the deterioration in the international trading system. But these are to succeed, deeply ingrained attitudes will need to change. Large numbers of Americans have convinced themselves that the U.S. is virtually free of barriers and can obtain increased access to markets abroad with few concessions on its part. Several U.S. trading partners appear to believe that the relatively small size of their economies permits them to protect their markets without damaging the world trading system, while the U.S., because of the enormous international impact of its economy, is urged to exercise substantial self-restraint. And many developing countries feel they can obtain concessions from industrialized nations while making only minimal efforts to reduce their own import restrictions. And heads of state and government will need to recognize the need for them to take a personal interest in the success of these negotiations — and apply appropriate leadership.

To achieve needed liberalization of international trade, negotiators will need to adopt improved "safety valves" to enable governments temporarily to limit imports that cause injury to industries and workers. To prevent abuse, negotiations will also need to provide tighter rules for international monitoring of such actions and counter-adjustment measures by the protected industries so that the duration of restraints is limited. Dispute settlement procedures, the slowness, ambiguity and evasions which undermine the credibility of the GATT, will need to be improved. Unless grievances can be expeditiously resolved, the negotiating process will be undercut by concerns over the difficulty of obtaining redress when others fail to fulfill commitments. And the major developing countries will need to be convinced to participate actively in the process. They are among the world's fastest growing markets and most active competitors. Failure to agree on an appropriate balance of benefits and obligations with them would condemn the trading system to frequent disputes and disruptions.

In the meantime the U.S. will experience strong internal pressures to limit the President's discretionary authority to deny import relief. The Congress may well link its mandate to the administration to proceed with negotiations to requirements that the administration take stiff action against surges in imports or to counter restrictive actions abroad. The danger, of course, is that if the U.S. or, for that matter, any other country adopts additional restrictions during this period, attaches overly demanding conditions to its commitment to negotiate, or expects too much of others compared to what it is willing to offer, the negotiations will fail to achieve progress. The result could be a series of unilateral measures. Collectively, they could shock nations to negotiate more purposefully; or it could set the world on a Smoot-Hawley type of downturn.

(3) DEBT. Overcoming the Third World debt problem will require continued efforts by indebted countries to get their economic houses in order and improve the environment for the private sector. Without this, financial assistance will be ineffective, funds will be badly utilized, and capital outflow (itself a symptom of lack of private sector confidence) will continue. The Baker Plan was intended to encourage sound policies in indebted countries as well as more lending by international financial institutions and commercial banks.

Critical external variables will be 1) interest rates, 2) commodity prices, 3) growth in the industrialized world, 4) the level of import restrictions in industrialized countries, 5) new government and commercial resource flows, and 6) the nature of new debt rescheduling agreements. The World Bank role as lender, advocate of policy improvements and catalyst for new private sector lending, will be critical during this period. It will increasingly be called on to demonstrate leadership in promoting development just as the IMF did in organizing rescue packages after 1982.

The central question in coming months will be whether the process of "managing" the debt problem in the expectation that it can be reduced in severity by growth and lower interest rates abroad, while the banking system continues to improve its ability to cope by strengthening its capital base relative to Latin American exposures, or whether a bolder set of measures can be devised to actually reduce the debt burden of the Third World. Because the latter would involve either a major writedown of debt by banks, which they understandably resist, or large resource transfers by governments, which taxpayers would resist, continued case-by-case management of the problem appears to be the likely course.

## CONCLUSION

Progress in addressing the above issues will help to promote a higher rate of world growth. But the key will be a willingness of governments to recognize the lessons of the last two decades. Large increases in government programs and sizeable budget deficits, followed by pressures on central banks to monetize them, led to inflation in the 1970s. Internal rigidities and regulations added to the problem. And large scale borrowing in the expectation of continued inflation have led to overcapacity and enormous repayment problems.

Each generation sows the seeds of the problems of the next. We have coped with the inflationary legacy of the last generation and paid the price of our overdependence on imported oil. The great danger now is that large government, corporate, agricultural, and energy-related debt could make our economies highly vulnerable to increased interest rates and financial disruptions. Unemployment in our countries can lead to intense social pressures. Deterioration of important developing nation economies risks economic, financial and political instability. Large trade imbalances foreshadow painful adjustment. And inadequate efforts to strengthen international institutions could deprive us of vehicles for addressing economic problems in future years.

### *Opening Remarks from the Panel, I.*

The prospects for growth in the Western industrialized nations in the coming year or two are reasonably good. But growth will not happen quickly; the immediate effects of disinflation will not be stimulative.

The anticipated rate of growth will not help solve the problem of unemployment, though it may prevent it from getting worse. And it won't even begin to solve the problem of international debt. Debtor countries will be helped by lower interest rates, but the gain may be cancelled out by lower export prices. These two factors will not work in the same way for all debtor countries. There may be an improvement for some and a deterioration for others. This at least works against the possibility of a debtor cartel arising.

With respect to exchange rates of the floating currencies, two developments are significant. First, the dollar-yen-deutschmark exchange rates are no longer misaligned, as they were a year ago. Second, a policy change by the U.S. administration led to the "Plaza" intervention. Should the current situation be deemed satisfactory, or should we seek a more formal arrangement among major countries to stabilize exchange rates? A return to the Bretton Woods system of fixed but adjustable rates is not realistic. What, then, about target zones? These are, in effect, reference zones from which variation of exchange rates would trigger consultation and policy responses.

There are four major arguments against target zones. The first is the ideological and philosophical argument, fashionable a year ago but now somewhat less fashionable, that the market should determine exchange rates. The second argument relates to the "overwhelming nature of international financial integration and the massive character of capital movements." How, in such an environment, can a target zone system be effectively managed? The third argument accepts that exchange rates are now in a roughly acceptable zone, but questions whether it is realistic to try to stabilize them at a time of huge current account imbalances in the world. It may be better to wait for better growth performance and resulting further exchange rate adjustments to take effect. The fourth argument against target zones asks what kinds of policies should or could be triggered if rates go out of the target zones. There is a danger that all the burden would fall on monetary policy, because governments are unwilling or unable to change fiscal policy.

The principal argument in favor of target zones is that, if nothing is done, (1) exchange rates will not stay where they now are; (2) the market desires some sort of official guidance as to the future direction of exchange rates and has developed expectations that some sort of action will be taken. The success of the EMS provides some lessons. The same sort of arguments were used against it. But it took a few years for the EMS to start working.

At a minimum, we ought to set into motion surveillance procedures over exchange rate movements. And governments should accept that there are "no taboos" with respect to policy mixes, so that the burden of action does not fall exclusively on monetary policy.

#### *Opening Remarks from the Panel, II.*

There has been considerable euphoria recently about the state of the world economy, as evidenced by soaring stock prices, lower inflation, falling interest rates, and some improvement in employment. There is a belief that budget deficits will come under control, and that sluggish growth will soon take off.

But one should be a bit skeptical about all this, because there are very real problems, which call for prudence. One of the problems is the exchange rate system, whose volatility "reflects a certain disintegrating tendency." From the U.S. perspective, the decline of the dollar has eased concern about its competitive position, but the trade deficit is still rising and is bound to stay high for a while. The U.S. will remain dependent on foreign capital inflows to finance the current account deficit, the budget deficit, and other domestic needs. The question must be asked how long can these inflows be counted upon, with exchange rates falling, lower interest rates, growth abroad requiring the use of savings, and the threat of protectionism. The belief of some that the dollar should fall even further is not consistent with the U.S. requirement of continued foreign capital inflows. The trade balance will not be improved without a shift of real resources which is responsive to changes in income flows as well as in exchange rates.

In the past few years, the U.S. has been growing faster than the other Western industrialized countries. And growth in other countries has been fueled to an extent by the overflow in demand growth from the U.S. This is true of Europe and Japan, and it is a situation not conducive to an improvement in the U.S. current-account deficit or in European and Japanese surpluses. We need a reversal of those growth patterns, with the U.S. ceasing to play such a large role as the motor for world growth, and Europe and Japan assuming more of that role. The "current challenge of economic policy in all our countries" is to see that that shift takes place "to the extent necessary to contribute to the greater world equilibrium that continued growth in the U.S. and other industrialized countries may be dependent on."

International debt, particularly of the LDC's, is another major problem. Before the decline in oil prices, the situation was gradually getting better in the sense of being less of a threat to world financial stability. There was also a movement in debtor countries toward restoring growth and reducing dependence on capital inflows from abroad. Fortunately, the Baker initiatives came along at a time of growing "battle fatigue" on the part of the borrowing countries, the commercial banks, and the creditor countries. The plan provided a fresh impetus and vision by setting out a "common sense bargain" which asks the debtors to improve their own economies as a precondition for the creditors' supplying the external resources to support growth. The steps that the debtor countries have been asked to take, such as to increase efficiency, provide a better climate for private investment, and allow more open trade, have been more quickly accepted than in the past because the regimes themselves, especially in Latin America, have changed. They tend to be more democratic, less authoritarian, and more open to liberalism in economic policy. The question is whether these ideological differences can be converted into reality, particularly in light of the decline in oil prices.

Dealing with debtor countries on a case-by-case basis is feasible up to a point. But if there is a major departure in any one of the countries, it will become generalized among all of them. If one doesn't pay, "it will prove infectious." Similarly, one can't be given a special deal on, say, interest rates, without all of them wanting the same deal. So the basic approach must be generalized.

Many of the debtor countries had reasonably good growth rates in the 1970's, but they were supported by an amount of external financing that could not be sustained indefinitely. A very large amount of that external borrowing was reflected in capital flight from those same countries. We need to help these countries establish a growth pattern less dependent on external finance.

There may be no practical alternatives to the Baker plan. A theoretical alternative is to provide much more official assistance, perhaps on a subsidized basis. But, as a practical matter, Europe and Japan are not going to contribute much more official money. Another possibility is a write-down or write-off by private creditors. But the commercial banks are not likely to be willing to do this, and it is not in the interests of the borrowing countries to take steps that might cut them off from normal access to private credit on favorable terms. This would also set back the effort to encourage more open economies, more internationalization, and private investment from abroad.

The approach that seems necessary is not that dramatic. It is the only one consistent with the long term interests of creditors and of debtors in rearranging their economic affairs in a way that growth can be sustained and enhanced without excessive reliance on assistance from abroad. The challenge is not an impossible one if we maintain the effort of the creditors and the spirit and morale of the debtors.

### *Opening Remarks from the Panel, III.*

Looking at the situation in the U.S. steel industry today, it is difficult to view the state of the world economy with much optimism. Since 1979, over 250,000 steelworkers — about 60 percent of the total — have lost their jobs. Since 1977, the capacity of the U.S. steel industry has been reduced by 32 million tons. And after all that, the industry functioned at only 65 percent of capacity in 1985. Other metal industries in the U.S. are in similarly poor shape.

The source of the problem is imports. The U.S. imported 25.3 percent of its total market in steel in 1985, even with voluntary restraints in effect. (Without them, the amount of imported steel would have been far higher.) In addition, there are indirect imports in the form of items containing steel. The U.S. is using as much steel as it ever has, but far less is produced domestically. Import penetration is far greater than in the EEC (seven percent) or Japan (six to seven percent).

There exists an enormous overhang in steel capacity in the world. The U.S. industry is forced to compete with producers with extremely low wage levels, in some cases in countries with little recognition of human rights and none of union rights.

In all the theorizing about free trade, there is a tendency to ignore the realities of the situation. We need to manage our trade flows, to strike a balance between protectionism and completely free trade. We need to enter into arrangements like the Multi Fiber Agreement and the U.S.-Canada auto pact.

### *Discussion*

The state of the world economy and the problems and challenges facing the Western industrialized countries were set forth in an Italian participant's presentation of the economic issues that would be taken up at the upcoming Tokyo Summit.

On the whole, the speaker said, the outlook was bright. The seven industrialized nations were entering their fourth year of growth, and the differential in their growth rates was decreasing. Inflation was lower, interest rates and oil prices had declined, there was a better alignment of exchange rates, and some progress was being made in dealing with the debt problem.

But there were some clouds on the horizon. Unemployment was still very high. There were still large budget deficits in many countries. Several countries had sizeable current account imbalances. The future behavior of exchange rates was uncertain. Trade barriers were still high, and there was a threat of protectionism. The debt situation remained serious, and there was uncertainty about the future of energy prices.

Against this backdrop, the main issues that would be discussed in Tokyo were:

(1) *Growth.* How were we to redress imbalances and assure sustainable, non-inflationary growth? What were we to do to reduce budget deficits and to correct current account imbalances? What should we do to increase demand in Western Europe and Japan? How were we to accelerate the process of structural adjustment in our economies? And how could we cooperate further in lowering interest rates?

(2) *The international monetary system.* Are we satisfied with what has been done, or must we do more, and how? How can we improve coordination of economic policies and multilateral surveillance?

(3) *Developing countries.* We had made some small progress in terms of lower interest rates and the Baker plan. It would be necessary to improve that plan by

adding a fourth element — the role of the industrialized countries. The main issues included the opening of our markets, a further decline in interest rates, and an increase in our export credit policy for those countries that had begun to make adjustments. In addition, we had to do something to promote the repatriation of flight capital.

(4) *Trade.* The next round of multilateral trade negotiations would present a major challenge. It would be different from previous rounds in the sense that the trading system had to be strengthened and enlarged to include the newly industrialized countries. We had to commit ourselves politically to the launching of the new round. We needed a consensus of the major industrialized nations as to when the new round would begin and what the agenda would be. We also had to do something to reduce subsidies in the agricultural field. We should not forget that the multilateral trading system had been "one of the main pillars on which we built our wealth, security, and freedom after World War I."

Addressing the question of international debt, a Swiss participant observed that, while it had appeared to be a liquidity problem two or three years ago, it had now become a structural and political problem. Handling it would require new methods. The Baker initiative was timely, but it had a shortcoming insofar as it only involved three of the four major players: the debtor countries, the lender banks, the multilateral lending institutions, but not the creditor governments. They would have to make a major contribution, because the amounts called for in the Baker plan to be made available by banks and lending agencies were unrealistic.

An American agreed that the political dimensions of the debt problem were "probably more important" than the economic ones. But he did not believe the answer to the problem lay in the "fourth leg," if that meant official money or outright subsidies. That would not even be in the bankers' interests.

It was a British speaker's view that the international debt problem had been exacerbated by "too much emotional talk about debts never being paid and the resulting collapse of the world financial system." When the loans were made, he continued, it was never anticipated that the principal would be repaid or that the countries could operate without a "substantial inflow of permanent capital." We had to require the debtor countries to service the debt, to better manage their economies, to accept and safeguard inward investment, and to reverse capital flight.

This last factor — capital flight — was a matter of deep concern to many participants in the discussion. A Swiss speaker felt that the problem could only be handled by the governments themselves. But a Spaniard pointed out that flight capital was often deposited in the same American and European banks making loans to the countries in question. Could some form of international cooperation be developed to "force back the money to the countries from which it fled?"

A Greek stressed the importance of foreign investment in helping to solve the problems of developing countries. At present, he observed, the huge Japanese trade surpluses were going into U.S. money markets. As the U.S. budget deficit declined, would it not be possible to encourage this money to be invested in those developing countries that were taking appropriate measures to put their economies in order? An American agreed that foreign investment in LDC's was "absolutely critical," and would help create a climate for indigenous investment.

Several speakers singled out Brazil as an example of a country that had made notable progress in improving its economy. It was true that it had been helped by the decline in energy prices, but, as an American pointed out, it had "rearranged its economy in a way that could support its external debt consistent with a return to [more rapid] growth rates." A Briton agreed that Brazil deserved much credit, but worried that, unless relief was forthcoming soon, "battle fatigue" in countries like Brazil that were making a real effort would become a serious problem.



A speaker from the U.S. felt that, if we differentiated between different categories of LDC's — Africa and Latin America, for example — then we should make distinctions in the way we treated the different categories in terms of debt management. African countries in particular called for different prescriptions. They had not had much growth in the 1970's, their debt was mainly official, and they had little they could turn into productive assets. A fellow American agreed that the situation of the African countries was different. Yet, he pointed out, many of their problems were the same — the inadequacy of incentives, major government subsidies, and corruption. Like the other debtor countries, the African countries needed improved economic management.

The possibility that political developments in debtor countries could cloud the current favorable outlook on the debt question worried a number of participants. This, said an American, was a legitimate concern, but there was cause for optimism. Mexico, for example, although it had a highly bureaucratized economy with many controls, and any economic liberalization was seen as a political threat, had still been stable for 50 years. And Argentina, with a governing party rooted in American-style urban intellectual liberalism, was nonetheless moving toward implementation of economic reform.

Turning to the subject of trade, an American observed that the problem of trade was closely linked to the debt problem. We could not ask the LDC's to liberalize their economies and look toward export-led growth if we were not willing to take the exports. The heavily indebted countries were highly dependent on the U.S. market. They had been able to export almost nothing to the EEC and Japan.

A German speaker observed that the developed countries tended to follow free market principles in their own economies, but not in international trade. They advocated free trade selectively, practicing protectionism in areas where they were not competitive. Unless they were willing to take responsibility for free trade, the next round of multilateral trade negotiations would not be successful. The developing countries could be expected to demand a "more balanced" situation. In this regard, the negotiations on a new Multi Fiber Agreement were particularly important. They would be seen by the developing countries as evidence of whether the industrialized countries were willing to balance trade, or to be selective. If a more liberal MFA could not be reached, then the next GATT round would be "dead."

A Canadian predicted that the next GATT round would be the most difficult yet. For the first time, developing countries would be at the table, taking political action through GATT rather than UNCTAD. Their agenda would be in conflict with that of the OECD countries. In addition, the U.S. and Canada would be coming to the talks at a considerable disadvantage, for the first time. Both were undergoing major structural change in terms of the displacement of old technologies and materials. The competitive situation was no longer in their favor. In agriculture, where economic displacement was also taking place, the U.S. and Canada faced a serious challenge from the other developed countries.

An American participant agreed that agriculture, in particular, had to be dealt with. Problems in that sector were "causing major trade distortions," and trade relations would deteriorate if nothing was done. It was worth remembering that there was significant farm belt influence in the U.S. Senate. A Canadian agreed that domestic political factors in the U.S. had to be considered. The new GATT round would likely be taking place soon before the expiration of the President's trade authority and the elections in 1988. It would be "very hard for the U.S. to sustain the free trade ideal."

Access to the markets of developed countries for the debtor countries was an important new dimension in trade policy today, said a Swiss participant. It would exacerbate the competitive situation. The debtor countries should be required to observe rules of reciprocity. An Austrian agreed, saying we had to look at "the

other side of the protectionist coin — export subsidies." We could not open our markets to products from developing countries while being shut out by highly subsidized export products.

The success of the next round of trade negotiations was crucial, said an American. The international trading system "virtually doesn't exist." If negotiations were not successful, the result would be bilateralism, unilateralism, protectionism, and "go-it-alone" policies.

An overall multilateral trading system was indeed indispensable, said a Belgian. But, if we were to have an adjusted system that dealt with the problems of the future, and not just customs duties, then we had to address the whole subject of currency-exchange rates. A German agreed with this, and added that the new GATT round would not succeed as long as "distortions of parities occur erratically." The major currencies had to have a system of stable exchange rates.

A number of participants felt the EMS provided a model for a system of target zones for the principal currencies. The establishment of the EMS, said a German participant, had had two major aims: to speed up the economic integration of Europe and to enhance trade within the EEC and between the EEC and the rest of the world. When the EMS was established, it was recognized that, for political reasons, governments preferred to let the market set the value of their currencies, rather than taking direct action to devalue or revalue. Fixed rates forced economic discipline on governments, making them avoid policies that contributed to budget deficits and trade imbalances. Central banks were forced not to monetize deficits by broadening money supply policies.

A new system of target zones, continued the speaker, should include, at least for the rest of this century, the dollar, the yen, and, ultimately, the ECU. (Until sterling joined the EMS, it would have to be the deutschmark.) The system had to carry the threat that there would be a penalty to pay for a government whose currency moved out of the target zone. Governments would have to "stand up and bear the consequences of public criticism."

A Dutch speaker observed that the EMS had worked "surprisingly well," thanks to the existence of a framework for economic policy, the political will to stick together, the external discipline imposed on governments, and the public psychology about what currencies should be worth. In the case of target zones, a looser system was called for. The markets, although they wanted some sort of official guidance, would "always want to beat the margins if they were known." Hence, the system might be defeated.

An International participant agreed with this, saying that the success of the EMS was due to its "constraining character." In order to have a constraining effect in a system of target zones, it would be necessary to have a published target zone and a set of consequences if a currency moved out of the zone. After ten years of letting currencies float, to move to such a system at once risked its failure. A less formalized system, with lesser constraints was needed at first — perhaps unpublished target zones.

An American emphasized that exchange rates were not "an independent variable." They depended upon such factors as inflation rates, potential growth rates, and the overall investment climate. What was particularly needed was a "more intensive dialogue to harmonize a range of policy variables." Without it, it would be difficult to agree on hard target zones. With the EMS, the EEC had made progress by establishing a framework for an improved dialogue on policies and by attempting to harmonize domestic policies. It was a useful pattern for the Group of Five to follow.

A participant from the U.S. expressed his concern that, amid all the talk of dealing with debt, harmonizing trade, and coordinating currencies, little had been said about the problem of jobs. Unemployment was still very high in the Western indus-

trialized countries, and something had to be done about it. It could not be left to the market.

Several speakers were particularly worried about unemployment in Europe. A Briton feared that unemployment was "becoming a European disease." In the last 20 years, the U.S. had created 20 million jobs, while the EEC had lost two million. There seemed to be a "loss of entrepreneurial activity" in Europe, especially in the U.K. This was attributable, in the speaker's view, to several factors: (1) an educational system that had taught the young to look down on careers in trade and industry and to regard wealth creation as "something not quite nice;" (2) a tax and fiscal system that had been seen as a redistributive mechanism, taxing not wealth, but the creation of wealth; (3) a general belief that "governments can make people good." The U.S. economy, on the other hand, was characterized by optimism, vigor, and individualism. Large enterprises were regulated, but the individual entrepreneur had a great deal of freedom. The opposite was true in Europe. Individual enterprise was virtually discouraged. Another factor contributing to unemployment, concluded the speaker, was the social welfare system in Europe, which was seriously out of balance. When individuals could receive 85 percent or more of their in-work income on the dole, there was little incentive to work.

An International participant agreed that Europe was hampered by a very rigid labor market, while a lack of rigidity had helped the U.S. On the other hand, productivity in the U.S. had been rising only very slowly, and this had helped employment. But it was not the best prescription for Europe.

Several speakers stressed the need for training and education in both the U.S. and Europe. An American pointed out that this was especially important in view of the "aging population pyramid," which implied that, in the future, fewer workers would be supporting a larger population of retirees. The answer lay in higher productivity, but workers required training for higher productivity jobs.

A Briton felt that the industrialized countries had been concentrating in recent years on restraining inflation rather than on promoting growth. Perhaps the time had come to emphasize inflation less and pay more attention to creating growth and employment opportunities. Were we not too cautious in always looking for financial stability?

An Irishman wondered if slow growth was a temporary phenomenon and more rapid growth would resume once structural adjustments were complete. Or was slow growth going to stay with us? We ought to be examining its fundamental causes. Was there a danger that the swing against the policies of the past was being carried so far as to "obscure the need for demand policies?"

Achieving a higher rate of growth in Europe and Japan was particularly important, in the opinion of several speakers. An Italian wondered what was the best way to stimulate domestic demand that was non-inflationary and created employment. Certainly labor market flexibility was part of the answer. But there were also capital constraints in Europe that had to be removed. The investment component had to be stimulated. Insisting on low real interest rates would encourage investment of a capital intensive sort. Another policy alternative would be to "facilitate the flow of financial resources to promising initiatives." Capital market flexibility was as important as labor market flexibility.

It was an International speaker's view that disinflation would have a beneficial effect on growth, because it amounted to an increase in the real money supply. Even if monetary policy remained unchanged, there would still be a stimulative effect. With stock markets and financial markets booming and interest rates declining there certainly was no liquidity problem. There was no point in trying to stimulate our economies further by monetary measures.

It was a British participant's view that oil price reductions had been, to a large extent, fueling economic growth and contributing to the lowering of inflation. But

lower-priced oil was undermining the economics of non-OPEC oil and was increasing world demand. The current ratio in world demand of 60 percent non-OPEC to 40 percent OPEC would reverse by 1990 if prices stayed low. The U.S. dependence on imported oil would move from the current 30 percent to over 50 percent. Here lay the seeds of another crisis in the early 1990's.

Other speakers shared this concern. A Belgian suggested that a new oil shock could result from Iran winning the war with Iraq and then forcing the Gulf states to cut production. An American believed that the current oil price situation would be reversed; the only question was when. A rise in oil prices would alter the inflation situation, because we had not made as much real progress against inflation as we should have. The decline in oil prices had obscured our continuing problems. Another American worried that, having worked in the 1970's to cut dependence on imported oil and increase reserves, we were now letting our guard down. A new dependence on Middle East oil had not only financial implications, but would be a real security problem.

Another worry for several participants was the consequences of our failure to control budget deficits. A Canadian pointed out that his country was a "worst case" example. In the last ten years, revenues had doubled while spending had tripled. Canada's debt had increased by 650 percent, from 19 percent to 50 percent of GNP. Interest payments had gone up from 12 percent to 32 percent of revenue. How long could this sort of thing go on? In the speaker's view, the Gramm-Rudman-Hollings Act in the U.S. had "the mark of despair but also the stamp of reality." We had to face the moral implications of our countries' living beyond their means year after year.

Another challenge we faced, an Austrian pointed out, was to overcome the "sovereign nation-state mentality" that too often prevented our working together. Sovereign governments had to discipline themselves, added an American. But because of the growing interdependence among our countries, there had to be a greater degree of "shared sovereignty." The cost to our domestic economies of international disruptions were far greater than they were 10 years ago. None of us could afford to go it alone.

#### IV. CURRENT EVENTS: TERRORISM

##### *Opening Remarks from the Panel, I.*

Terrorism has been with us for a long time, but state-sponsored terrorism is a relatively new phenomenon. The U.S. believes it is becoming a major world problem and is concerned that Europe is not yet so persuaded. Free nations must not tolerate state-sponsored terrorism, nor must they negotiate with or be intimidated by terrorists.

Libya is the principal sponsor of terrorism. It finances terrorist acts, it trains terrorist groups, it supplies arms, ammunition, passports and other documents to terrorists, and it uses its embassies, so-called peoples' bureaus, as weapons storehouses and sanctuaries for terrorists. Recently, Libya has been escalating its involvement in terrorism.

U.S. actions against Libyan terrorism are not new, and so the bombing raid should not have been a complete surprise. The U.S. first charged Libya with sponsoring terrorism in 1979. In 1981, the U.S. imposed limited trade sanctions against Libya and closed its Washington embassy. In 1986, total sanctions were imposed, and the departure of all American citizens from Libya was ordered. All commercial transactions between Libya and the U.S. were prohibited. The President considered and rejected military action at that time, but he reserved the right to use it in the future. American efforts to enlist the support of its European allies in combating Libyan terrorism met with little success.

Libyan terrorism continued despite these measures. The evidence of Libyan involvement in the bombing of the Berlin discotheque was "overwhelming and irrefutable." The U.S., in addition, received intelligence reports of a large number of actions planned by Libya against American citizens, mainly in Europe, but also in Latin America and in the U.S. And so, with peaceful measures exhausted, the U.S. decided on a "limited military action designed to persuade Khaddafi that he could not continue to attack American citizens around the world with impunity."

From a military point of view, the attack on Libya was successful. It is too early to determine what the effect might be on Khaddafi, but he has been "strangely silent" since the attack. The Soviet reaction was mild and not supportive of Libya. The public reaction of the Arab world was mild, and, privately, some moderate Arab states have voiced support of the U.S. action. But there seems to be a lack of support and understanding from the non-aligned nations and from some of the U.S.'s European allies. There is a degree of bitterness toward Europe among Americans as a result. It is to be hoped that this bitterness, as well as the European condemnation of the U.S. action, will be short-lived. The question we now face is what can we do together to influence Libya to cease its sponsorship of terrorism.

##### *Opening Remarks from the Panel, II.*

Neither the U.S. nor Europe has the answer to the problem of international terrorism. In the fight against international terrorism, it should be the principal objective of the alliance to use political means to isolate the terrorist movement. The use of force should not be renounced, but an attempt should be made to reach a con-

sensus on when force should be used. In the Achille Lauro incident, for example, Italy was ready to intervene militarily, as the U.S. had requested, but it first wanted to attempt to isolate the terrorists politically. The attempt succeeded, and there was no further loss of life.

It is appropriate to ask what international terrorism is. In addition to attacks against European and American citizens and interests, there have been terrorist attacks involving many other countries, particularly in the Middle East. International terrorism has many targets and many origins. Is it proper to fight against only one of the originators?

Europe and the U.S. are united in their opposition to international terrorism, but they have different perceptions about what is the best combination of economic, political, and military measures to use against it, and when to use them. Most Europeans feel that not all of the other possibilities of isolating Khaddafi were fully explored. Italy, for example, has taken several measures against Libya, in spite of its extensive economic interests there. They include an arms embargo, trade reduction, limitations on the number of Libyan diplomats and restrictions on their movements, new visa restrictions, and Italian control of Libya's diplomatic pouch. Nor is Italy opposed to using force when appropriate. In the wake of the Libyan attack on Lampedusa Island, Italy has declared its intention to respond militarily to another such attack.

In the case of international terrorism, the vital interests of the U.S. and of Europe are the same. Hence, we need consultations on how to combat the problem.

#### *Opening Remarks from the Panel, III.*

It is important to recognize that the differences between the U.S. and Europe on the subject of Libya do not arise from anti-Americanism in Europe. The American people and way of life remain very popular in Europe. But the differences over Libya do reveal a profound crisis in transatlantic relations — perhaps the worst crisis in the history of the alliance. When two-thirds of the American people support the raid on Libya and two-thirds of the Europeans oppose it, then we face a serious estrangement.

No one in Europe has any illusions about Khaddafi's behavior, but he is not the only one supporting terrorism, and may not even be the principal one. Strong doubts exist about Libyan involvement in the airport attacks in Rome and Vienna. The evidence is not that clear, and the best verdict that most Europeans can come up with is "not proven." This is why Europe did not go along with the U.S. on sanctions last January.

Even if the evidence against Libya was watertight, would that justify the attack against Libya on moral grounds? Would it vindicate the "killing of Libyan innocents in order to save the lives of Western innocents?" The killing and injuring of civilians in the U.S. bombing struck many Europeans as barbarism, as fighting terror with terror.

The raid was counter-productive. It has made Khaddafi into a hero in Libya. And other Arab nations, no matter how much they may dislike him, have been forced to rally behind him. The effects are especially damaging for moderate regimes like those in Tunisia and Egypt. In terms of the effect on relations with the Soviet Union, the raid may have derailed the next summit meeting.

Europeans are concerned that the American action will instigate "more murderous plots" from Libya or other nations. These may be primarily directed at

American targets, but their victims will include other nationalities as well, just as the discotheque bombing did. Perhaps terrorists will go after nuclear weapons in Europe. The fallout from the U.S. action could include "an endless series of reprisals and counter-reprisals, a new freeze in East-West relations, and a new estrangement in transatlantic relations." If the U.S. sees international terrorism as the West's number one problem, then its priorities are wrong.

The U.S. is also wrong to criticize the Europeans for not offering another alternative to military action. In some situations, there is no solution. It is wrong to conclude that it is better to do something than to do nothing. More energetic measures against terrorism, involving police, technical, and intelligence cooperation, are appropriate, but they should not be undertaken "in the framework of a new crusade."

#### *Opening Remarks from the Panel, IV.*

Rather than one dominant European response to the American action against Libya, there are differences of opinion. Some polls indicate considerable popular approval of the action. So we should not generalize about either European public opinion, or about the attitudes of European governments.

The U.S. has shared its evidence of Libyan involvement in the Berlin discotheque bombing with European governments, and they accept the evidence. The West German Chancellor has stated that his government has independent evidence of Libyan involvement. The evidence has not been made public because doing so would compromise the gathering of intelligence on terrorist activities.

The West has missed an opportunity for joint action on the problem of terrorism. The Europeans favor diplomatic action, but, to be effective, diplomacy must work "through a pattern of incentives and disincentives designed to influence behavior." Europe has not been willing to address this question; the argument that economic sanctions never work is an excuse for not fully examining them. Before the U.S. action, there was no discernable interest in Europe in taking action against Libya. In the communique following the meeting of EEC foreign ministers to discuss terrorism, Libya was not even mentioned.

It is an exaggeration to say that we now face one of the most serious crises in the history of the alliance. We have had disputes in the past over contingencies outside of the NATO area, and this one is not qualitatively different. But, in the long run, our failure to develop a consensus on how to deal with security problems in the third world will confront us with a profound crisis.

Since World War II, there has been a reversal of the roles of Europe and the U.S. with respect to the third world. Formerly, the Europeans, with their colonial interests, were willing and able to project military power into the third world. The U.S. tended to be anti-colonial and took a "moralistic approach" to the use of military power. Now the U.S. is a global power with security responsibilities in the third world, while Europe seems "increasingly parochial" and unwilling to support the U.S. in these commitments.

The West faces a serious problem if the European attitude is that the U.S. should only be able to use force in the direct defense of Europe, because when it uses force elsewhere it undermines domestic support in Europe for the alliance, and it undermines East-West detente. Growing European parochialism, in terms of its own security interests and its desire to preserve peace in Europe, will inevitably lead to

growing U.S. unilateralism. Libya is only the most recent example of the urgent need of the West to work out a common approach to regional security problems.

### *Discussion*

The grounds on which many Europeans opposed the U.S. bombing raid on Libya were set forth by an Irish participant, who expressed deep concern about the impact of the action on transatlantic relations. First, it was Europe that was most directly effected by the fallout from the American action, both in terms of possible new terrorist acts carried out on European soil, and in terms of the economic impact of the sharp decline in tourism resulting therefrom. Second, the Europeans felt they should have been consulted, not just informed, about the planned U.S. action. "An action on behalf of all civilized nations can not, by definition, be unilateral," said the speaker. Third, there was genuine European concern about the morality of the action. And fourth, the action was very likely counter-productive in that it might strengthen Khaddafi and weaken the stability of the moderate Arab regimes.

A number of speakers criticized the bombing as being a violation of international law. A Dutchman argued that the U.S. had failed to exhaust all political and diplomatic measures before taking the military option. There should have been attempts to put the issue of Libya's conduct before the UN Security Council or the International Court of Justice. It was an American's opinion that his country, in killing innocent civilians, had followed the principle of collective punishment as practiced by the Nazis in World War II. Europe, added a Briton, viewed the bombing with "particular revulsion" because of its own historical experience.

Many participants in the discussion were concerned about the effect of the U.S. action. A British speaker felt it would not reduce the risk of terrorism from Libya or anywhere else. To think that it would, added a German, was an example of American "naive optimism." Even if Libya were wiped out, terrorism would still function. History would show, worried an American, that the bombing had worsened the situation, with respect to terrorism and to the whole Middle East problem. A number of speakers thought that Khaddafi's position had probably been enhanced. There had been indications, said an Irishman, that his position in Libya was getting weaker, but now it was likely it had been strengthened. It was only natural that Libyans would rally behind their leader in such a situation.

Others expressed concern that Khaddafi's position in the Arab world might also have been strengthened. A Briton observed that "our friends in the Middle East" had been forced to publicly express support for the Libyan leader. This could have damaging implications for the stability of moderate Arab states who were facing the threat of increased fanaticism in their own populations. A Frenchman observed that the American action risked a rupture in relations with the very people we needed to maintain contacts with to make progress in the Middle East — Mubarak, Hussein, and the Saudis. A British speaker was sure the damage had been done, saying the raid "had destroyed Western influence in the Arab world and had gravely undermined the West's few remaining friends there."

The question of evidence of Libyan involvement in terrorist activities was a source of considerable debate among speakers. While no one questioned the evidence of Libya's role in the Berlin discotheque bombing, some participants felt that the evidence presented by the U.S. on a Libyan connection to the Rome and Vienna airport attacks was less than convincing. Why was the U.S. not more forthcoming with its sources, wondered some. An American explained that the U.S. was reluctant to compromise its sources of information. He went on to say that he was

troubled that the European allies doubted the evidence presented by the President and Secretary of State. A lack of trust among the allies would only foster American unilateralism. Another American felt it was wrong to "ask for judicial proof in circumstances that are inherently ambiguous."

Other speakers needed no convincing about Libyan involvement in numerous terrorist activities over the years. Khaddafi's support for terrorism had been well known for a long time, said a Briton. Europe had failed to take action, and thus had to bear some of the responsibility for the American raid. A countryman agreed, and wondered why no collective action had been taken against Libya when Khaddafi first transformed his embassies into "peoples' bureaus." It had taken the murder of a policewoman by Libyans inside the "peoples' bureau" in London to prod the British into closing it. Yet, the speaker continued, the U.K. had gone on training Libyan pilots. A German participant felt that Europe had been "much too timid" and should have closed the "peoples' bureaus," ordered European citizens out of Libya, and stopped buying Libyan oil. Europe should also have realized that "American patience was exhausted."

It was the view of an American that the bombing would probably never have taken place had the Europeans earlier taken the steps against Libya that they had been taking in the aftermath. But a British speaker doubted that the Europeans would have done anything had the U.S. not taken military action. It was all very well to call for diplomacy, but to be effective, diplomacy sometimes had to be "alarmed" by the use of force.

A Belgian intervened with the observation that it was not likely that the fundamental difference of opinion on the American raid would be resolved. It was appropriate, therefore, for us to turn our attention to the question of where we went from here in combatting terrorism.

A German observed that the ultimate test of the effectiveness of the U.S. action depended on the "degree of convergence between the U.S. and Europe on the question of fighting international terrorism." There was near unanimity among participants in the discussion that closer cooperation and consultation were essential. We needed first to put emotion behind us and try to reach a consensus on joint action to deal with the problem, said an Irishman. An Italian suggested that the upcoming Tokyo Summit would be a good opportunity to begin, not by agreeing on specific measures necessarily, but by sending a "message of cohesion and solidarity."

Consultation was all well and good, said an American speaker, but we also needed to determine what we agreed on and what we did not agree on. It was unrealistic to think we could all approach foreign policy problems the same way. There were going to be differing perceptions of vital interests, and we would have to isolate those interests where there was a need for autonomous action. We then had to agree on how to "limit the implications of the autonomous action." If we could not agree on everything, we had to figure out how to handle the disagreement. It was not in the European interest to undermine the U.S.'s determination to defend its vital interests, lest the U.S. do the same to the Europeans.

A German agreed that, if we could not work a common approach, then we should aim for a joint understanding of what the problems were, which ones had to be dealt with together, and which ones could be dealt with unilaterally. This would not necessarily lead to harmony — there would still be public reactions to unilateral action even if it had been agreed to in advance. But it was "better than being surprised."

In an American speaker's view, consultation went "hand-in-hand with responsibility." The implementation of the 1979 INF decision had been successful because both the U.S. and Europe had taken joint responsibility for implementation. In situations outside the NATO area, there was not the same sense of joint responsibility and common interest. But the West had made some progress in arriv-

ing at a joint approach to the Middle East problem. What was needed now was an agreement on a division of labor among the Western countries. We had to get away from the notion that Europe was the "good cop" and the U.S. the "bad cop." The "key to a successful consultation" would be Europe's "playing a stronger, more unified role and accepting more responsibility in regional security situations."

Another American stressed that the U.S. was ready to have consultations. But its objective was to stop terrorism, and consultation was no substitute for action. Consultation should not be used "to do nothing." It must lead to positive steps.

It was the opinion of several speakers that the place to start in dealing with state-supported terrorism was to examine its root causes. A Dutch participant pointed out that, in order to make progress in diplomatic efforts to enlist the support of Arab states in the fight against terrorism, the whole Middle East situation, the Palestinian issue in particular, had to be addressed. An American agreed, saying the Palestinian issue was "fundamental to Khaddafi's activities." In his view, the "deep Palestinians grievance [had] been allowed to fester far too long." We need to "give a new impetus to the peace process in the Middle East," advised an Italian. A German added that to give priority to the fight against terrorism while letting the peace process slide "did not betray much judgement."

But an American argued that progress in the peace process would not be enough to solve the problem of terrorism. It was no substitute for a concerted effort to fight terrorism. Radical elements opposed to progress in the peace process could be counted on to use terrorism to disrupt it. Furthermore, the Arab-Israeli dispute and the Palestinian situation were not the only serious problems in the Middle East. The contest between the moderate Arabs and the fundamentalists was an even more dangerous source of terrorism.

Turning to specific measures the West should take against Libya, an American called for improved cooperation in police and intelligence work, the closing of all Libyan "peoples' bureaus," the termination of all activities supportive of Libya, such as pilot training, and the cessation of purchases of Libyan oil.

Another American argued forcefully for this last measure. Europe was wrong to feel that economic sanctions would not be effective. It was true they had failed in the past, but the Libyan case was different. Its reliance on one export, oil, made it a "good candidate" for sanctions. The West, he concluded, should follow a triple-track strategy, comprising (1) diplomacy backed up by economic and diplomatic sanctions and the use of force as a last resort; (2) a more concerted European role in the third world; and (3) an active diplomatic process aimed at solving the problems in the Middle East and in other volatile regions.

A Belgian speaker concluded the discussion by stressing that there really was no divergence of opinion about Libyan involvement in terrorism, and the determination of Europe to take action would be apparent in the weeks to come, as Libyan diplomats were "sent packing." The debate about the U.S. raid had been emotional, but it was important that we allow the expression of emotion without jeopardizing the more profound common belief in preserving the alliance. Disagreements should not be allowed to influence that belief. We also had to be careful of the tendency of Europeans, when they disagreed with the U.S., to view it as being reckless, and the tendency of Americans, when they disagreed with Europe, to view it as parochial and inward-looking. Finally, it was important to have consultations about our involvement in situations outside the NATO area, and to accept the responsibility of the consequences of those consultations.

## V. SOUTH AFRICA

### *Working Paper*

#### THE WILL TO INTERVENE

Every western government is under pressure to "do something about South Africa". In most cases this means seeking an end to apartheid and a peaceful transition to black majority rule. This pressure is intense, demanding comprehensive intervention in the internal affairs of an autonomous state. Yet the forms of intervention are controversial, and the results embarrassingly elusive. This has led to frustration and a widespread cynicism over the will of western governments to "stand up to apartheid".

Four ways of exerting leverage over South Africa can be identified:

(1) Military confrontation, either direct or through proxies: now being pursued by Russia through support for Angola and the ANC in Lusaka.

(2) Friendly alliance and the exploitation of military and economic assistance. This was tried by the West in the 1950's and 60's but mostly served to increase security and self-sufficiency out of proportion to any increase in leverage. It was probably counterproductive to the struggle against apartheid (though not much).

(3) "Constructive engagement". Developing those contacts which are likely to be effective levers and using them selectively to achieve particular policy goals. Adumbrated by Dr. Chester Crocker, now of the State Department, it implies deep and controversial contact with South Africa and is vulnerable to the charge of appeasement.

(4) Disengagement. The withdrawal of political and economic contact, to isolate South Africa and put pressure on its policy-makers through exclusion. It is the policy adopted by the UN and Commonwealth and liberal politicians in Europe and America.

For western governments at present, policies 3 and 4 (the "thin carrot" and "big stick" options) are the most realistic. Debate between the two is lively. Disengagement has the best tunes. It is antagonistic and appeals to interventionists. As a global "law-and-order" policy, it is active rather than passive. Sanctions can be imposed and, if they fail to yield results, can be made more severe. Engagement is less rhetorical. It is covert rather than overt. Lack of obvious results means pressure to reverse rather than strengthen the policy — with the resulting mix of sticks and carrots "sending confused messages" to the victim nation.

Both options suffer from the difficulty of assessing leverage. Policy options tend to be discussed in terms of their ease of imposition, not the likelihood of their altering events on the ground in South Africa. Yet leverage is a function, not just of its own force, but of conditions at the other end of the lever. These conditions have been frequently misread by analysts in the two decades since Sharpeville.

Despite continuing, growing lawlessness, South Africa is not in a pre-revolutionary state. There is no alternative elite to seize power, as in Iran, or to mount a countervailing military challenge to a still-coherent white rule. Any coup in South Africa at present would more probably be from the right. Events are most likely to unfold as follows:

- Disorder rises and falls but on an upward graph, with the police/army exercising less authority over black homelands and townships.
- Black self-rule will spread de facto, but on a strongly tribal basis. Political barter will develop between white, coloured, Indian and black leaders, supplanting much of local government and fragmenting black power.
- Intertribal violence will increase — including between the whites. There will be a rise of militarism among Afrikaners and a return to romantic Kommando traditions. White terrorism will grow as will police indiscipline.

- Parliamentary and other freedoms will diminish. Society and the economy will become more besieged. South Africa's world image will mutate from that of a hated developed nation to one more appropriate to a conventional African or Latin American state.

External leverage on this process will be limited and will decline as security deteriorates. Embattled regimes customarily become more introverted, their rulers increasingly obsessed with sustaining a constituency of home support. Afrikaner Nationalists are xenophobic — unlike the English-speakers by whom westerners tend to judge South African morale. External measures taken against them must therefore meet two criteria: they must be capable of implementation AND they must demonstrably shift the Nationalist power structure in the desired direction. Measures directed primarily against English-speakers are unlikely to promote change and may have counter-productive side effects. (Recent pressure has seen liberal opposition to apartheid demoralised yet left formal apartheid largely unscathed.)

### THE TOOLS OF LEVERAGE

(1) DEFENSE/DIPLOMACY. Since the arms embargo, external leverage over South Africa's security policy is limited to ad hoc intervention, for instance in detention and passport cases involving prominent citizens and foreigners. Pretoria's defense policy is now autonomous. Washington has supported Pretoria's diplomats against its soldiers in searching for a settlement in Angola/Namibia and in Mozambique. Whether this has helped or hindered the quest for peace is doubtful. President Botha and his senior generals are strongly anti-American. The Nkomati accord, in which Dr. Crocker was involved, was ineffective since America was not in a position to enforce it. Moscow's deployment of SAM missiles and jets in Angola has probably had more impact on the balance of power between hawks and doves on Pretoria's State Security Council than Washington's constructive engagement.

(2) CULTURAL PRESSURE. The sports boycott of ten years ago worked at first (though only on sport, not on politics) but faded when its conditionality was not honoured by overseas sports bodies. Cultural and academic disengagement emphasizes isolation, but mostly hurts English-speaking liberals. Recent changes in petty apartheid are almost entirely the result of internal socio-economic pressures, notably from urbanization, not from external opinion. They have made little impact on the innate segregationism of Afrikaner society. Cultural engagement can claim modest gains, for instance scholarships for South Africans abroad and assistance for black education in the townships. Sponsored schools, law centres and training courses have gone some way to boost black morale, defend blacks against oppressive measures and develop new black leadership.

(3) TRADE SANCTIONS. The familiar "blunt instrument" of international pressure. Recent surveys suggest they "work" only when imposed briskly and intensely and where the victim both must and can concede at once. Left in place too long, they produce antibodies. The 20-year arms embargo against South Africa has drastically restricted defense leverage as self-sufficiency has risen from 40% to 85% (the rest is met through leakage). South Africa needs air defense equipment but is not likely to get it, so there is little scope for leverage here. Similarly in energy supplies, a combination of leakage and import-substitution has brought South Africa within sight of self-sufficiency.

Embargos hurt by increasing the cost of trade, but any future sanctions would be unlikely to hurt more than the past three years of recession and 60% devaluation, from which the economy is recovering. The student of trade sanctions must distinguish a developing country's enjoyment of imports from its dependence on them.

ite living standards may decline as imports become more expensive, assuming value of the rand takes the strain. But it is wishful thinking to see such belt-tightening as leading the white electorate towards radical reform.

The import component of black expenditure is correspondingly less. Trade sanctions may cost some black jobs (and create others with import substitution) but any net rise in unemployment will be mitigated by "third world" effects: a reduction in the pace of urbanization, a decline in the informal economy and an impoverishment of the homelands and remittance country economies. There is no evidence that declining black incomes (were sanctions ever to have such effect) would lead to political advance, peaceful or violent. Trade sanctions would be met by a combination of import substitution, franchising and leasing, exchange controls, the use of front-line states as intermediaries, and the collision of Latin America, Israel and the Far East. At the same time, Afrikanerdom's anti-industrial bias and belief in import substitution and regulation will limit any impact sanctions might have on economic growth. South Africa is an inappropriate victim for this sort of engagement.

(4) DISINVESTMENT. This implies leverage only insofar as it can be manipulated AND insofar as that manipulation can be given political bite. Foreign investment in South Africa (85% from Europe and North America) is mostly immobile and vulnerable to nationalization. Much recent disinvestment (for instance in the motor car industry) has assisted an overdue industrial rationalization. To many African economists, the time has come to "decolonise", repatriate and restructure foreign-owned and fragmented manufacturing businesses, to become more self-sufficient. Though South Africa is short of management and technical skills, an approach has developed that has appeal for Afrikaner politicians and soldiers. They now regard the departure of foreign capital as beneficial to their security in the short and long term. This renders Pretoria largely impervious to the threat of disinvestment.

While the flight of foreign industry would do nothing to erode apartheid (probably the reverse, where Afrikaner bureaucrats are put in to run newly-nationalized "invested" companies), its pressure would appear beneficial. The Sullivan and Acheson policies of employment have played a part in black industrial enfranchisement. Foreign firms have led the way into unionization. This has fed through into black leadership and helped cohere black communities which apartheid would have kept apart and migratory. Though the imposition of Sullivan remains patchy, this is probably the most effective form of external intervention in South Africa, a "sanction of engagement". It must be accepted that its acceptability as a policy is now eroded by organized black opposition to the presence of foreign companies — a position which is not supported by all black unions or their members.

(5) FINANCIAL SANCTIONS. The issue here is not whether limits on borrowing by South African public and private institutions can hurt — they can — but what that hurt can be turned to political account. The 1985 debt repayment crisis was precipitated by private bankers reacting against the rise of township violence and lack of reform, at a time when shareholder pressure for disinvestment was mounting: i.e., both domestic political and sovereign risk elements were involved. South Africa called a moratorium on outstanding capital repayments, which were due in early 1986.

The crisis shocked the South African banking and business community. It has assumed itself to be a "first world, good risk". For a few days it appears to have unnerved President Botha, whose understanding of financial markets is limited (yet it had no apparent longer-term impact on policy-making. Mr. Botha was misled as having overreacted by his cabinet colleagues and the influence of the press/financial community has declined. South Africa's strong current account surplus, including a \$2 billion repayment this year. Total overseas liabilities are about \$16

million, but the debt-service ratio is sound at below 10%. There is no comparison with, for instance, Mexico or Brazil. The debt crisis has apparently passed for the time being.

The case for financial sanctions hinges on South Africa's need for trade service finance and new capital inflows. Limits on the former are costly and inconvenient to traders and would have the same effect as trade sanctions or import controls. New capital inflows have been falling steadily since the recession two years ago, though new loans were being floated in London and Zurich even after the moratorium. A ban on new loan finance would affect those companies which have relied on injections of foreign capital for expansion. But a switch to domestic sources would not seem a serious short-term problem — corporate savings are high — and the chief effect would be on business morale.

This morale has been battered over the past year, and led business to take a more radical political stance. But this is not a sufficient condition for change in South Africa. Radicalized businessmen have in the past made little impact on Nationalist politicians, officials and soldiers. No one in South Africa would welcome a financial siege, but it is wrong to assume that distortions to financial markets would have any dramatic impact on South African politics. We must remember: sanctions must have a dramatic impact to be effective. Siege economies can swiftly adjust to altered circumstances. The case for financial disengagement as a weapon against apartheid is hard to sustain.

### CONCLUDING THOUGHTS

(1) Though disengagement policies have better tunes than engagement ones, they fare worse under scrutiny. The past 18 months have seen unprecedented pressure on Pretoria from as large an international lobby as is likely to be sustainable. It has been more intense than the last "big stick period", under President Carter. President Botha's Durban speech and its aftermath showed an imperviousness to outside pressure. This was reinforced by the attacks on Pik Botha and the resignation of PFP leader, van Zyl Slabbert. Although a ragged reform programme has been on the president's agenda since his 1983 referendum victory (indeed long before it), negotiation on fundamental power-sharing with blacks is still distant. Legal apartheid remains, with segregation, homelands, group areas, and separate electorates. Where there has been reform, such as to the race classification acts, it has been low key, when Mr. Botha has felt strong rather than weak. The abolition of the pass laws in April 1986 was a significant step away from classical apartheid, and one that has been signalled for years. No domestic observer, even those totally opposed to the government, have attributed it to more than domestic pressure.

(2) The engager's approach indicates a more genuine commitment to confronting apartheid than the disengager's washing of hands, yet it can show few publicisable results. Its best ally is the steady erosion of apartheid under the pressure of industrialisation and urbanisation. But the case of engagement is mostly negative: that it does *not* seek further to impoverish an already poor sub-continent nor falsely raise black expectations. It seeks to promote dialogue rather than engender further confrontation and violence. It is the more "moral" policy. Yet in the past, both engager and disengager have suffered from overstating the coercive influence of western governments on events inside South Africa. The American lobbyist, Mr. Randall Robinson, claimed recently: "We have the power to dismantle apartheid". He is cruelly wrong.

(3) South Africa's white politics are entering a period of leadership rivalry and policy turmoil. The far right has yet to show its hand. More substantive concessions to the blacks are unlikely. There will be changes, for instance in influx control, residential rights and revenue sharing with the townships. But these will come in

response to internal events such as boycotts and strikes. The means of concession will be administrative action rather than the formal changes demanded by Congressional "conditionality". External pressure will have little impact on an increasingly ad hoc policy process.

(4) Under these conditions, western governments are likely to keep their sights on the domestic and international fronts. They will probably lean towards further ostracism but with little conviction. Politicians will be content to delegate policy to bodies such as the UN, EC, Commonwealth and pan-Africanist organizations, where it will become less relevant to events within South Africa.

Other questions to consider include:

- Might it be feasible to acknowledge a reduction in government and official engagement with South Africa, yet promote private engagement of all kinds?
- Is there further scope for foreign companies to adopt anti-apartheid programmes, and what are the extra-territorial implications of enforcing this?
- Can the West pursue a more active diplomacy with the frontline states to foster a more integrated southern African economy (rather than the false separatism of the SADCC anti-South African alliance)?
- Could we construct a package of "micro-sticks and micro-carrots" whereby desegregation can be recognised internationally independent of specific legislative changes? Sport might be one area; cultural and academic contact another.

### *Opening Remarks from the Panel, I.*

There is a consensus among our countries on our aversion to the system of apartheid and on the strategic importance of South Africa for the West. Where there is some disagreement is on the role the outside world should play in bringing about peaceful change in South Africa.

The interest of the international community has been sharply focused on South Africa since the constitutional reforms of 1983-84, which granted political rights to the colored and Indian population, but specifically denied them to the black majority. Since that time, events have moved quickly and resistance to apartheid has received a clear impetus. In the United Nations, South Africa has been an issue for 25 years, with various resolutions being passed each year. An arms embargo was adopted by the Security Council in the late 1970's, but then discussion of sanctions subsided until 1983-84.

Only in 1985 did the EEC decide to send an official mission to South Africa to talk to the government, the opposition leaders, unions, journalists, representatives of the business community, and numerous other groups, both black and white. Afterwards, the EEC initiated a common, dual-track approach, combining positive measures, such as assistance to groups working for peaceful change, and restrictive measures, such as an oil embargo, a ban on nuclear cooperation, and the recall of military attaches.

It is wrong to think we are helpless to influence the situation. There is an intermediate possibility between engagement and disengagement. Constructive engagement is not enough. Nor is total disengagement leading to a policy of excluding South Africa a good idea. The sort of engagement we should attempt should not exclude contact with the South African government, whose cooperation for peaceful change is essential. We should make it clear that economic sanctions can't be



avoided unless there is fundamental, timely change.

It is wrong to say economic sanctions are counter-productive. The South African government will always say that sanctions only hurt the black community. But the mere discussion of sanctions has led to some significant moves by the government. The threat of sanctions erodes the political and economic credibility of South Africa and has an effect on the business climate. Sanctions provide an economic pressure to which the government cannot remain indifferent.

The positive signs of movement in South Africa include the dismantling of various discriminatory laws; the proposed restoration of citizenship to inhabitants of the black homelands; abolition of the pass laws and the release of those arrested under them. There has been discussion of more equal opportunities for education and employment. The government has given support to the experimental multiracial government in KwaZulu in Natal. It has been announced that many more laws will be dismantled.

The fundamental question is whether the systematic dismantling of discriminatory laws will continue. It is a race against the clock. What can we do to keep the process going and induce the government to do more? The EEC has called for such things as the lifting of the state of emergency, the release of Mandela and other political prisoners, and the unbanning of the ANC. Without the participation of the banned organizations, there can be no real national dialogue.

The approach of the EEC is to maintain pressure on the South African government, to keep the threat of more severe measures, and to remain in close contact with groups, both black and white, that have an important role to play in a peaceful transition process.

### *Opening Remarks from the Panel, II.*

In trying to understand the nature of the various political problems and crises in southern Africa, and in searching for solutions, it is useful to take a global view of the situation in the region. There is a high degree of interdependence among the countries in southern Africa, resulting from geography, the way in which the means of communication and transportation were established, and unequal economic development.

In political terms, the independence of Namibia is linked to the situation in South Africa and the question of apartheid. It is also linked to the civil war in Angola and SWAPO's presence there. Nor can apartheid be detached from the situation in Mozambique and the armed struggle of the RENAMO rebels. This struggle has resulted in aid to the Maputo government from both Zimbabwe and Tanzania, even as the Maputo government is a co-signatory with the South African government of the Nkomati Accord. There is also an inter-relationship between these problems and developments in Lesotho and Zaire.

South Africa, the strongest regional power, is under internal and external siege. Internally, tensions grow every day and reduce the government's room to maneuver. They threaten the most moderate elements of the black opposition, giving way to radical and extremist elements.

What is going on in Mozambique has a great impact on the collective destiny of the region. Mozambique's present difficulties can be attributed to a number of factors. Among them are the accumulated mistakes of the initial phase of independence; the inability of the political system to address traditional social and cultural values; the heavy political and military pressure exerted, first by Rhodesia,

and then by South Africa; the very negative results of dependence on East Bloc countries; the structural problems indigenous to African societies; and finally the sults of colonization and a long colonial war.

The vast size of the territory is conducive to the activities of various guerrilla groups. The Mozambiquan army is weak and lacks information, means of communication, equipment, training, motivation, and food. Furthermore, the population growing weary, deprived as it is of essential goods. It is more inclined to concentrate on its own survival than on political fidelity.

Thus, there are major clouds in Mozambique's future. It is a closed society, here the war effort is the first priority. The continuing armed struggle aggravates the deep economic crisis. The authority of the state is disrupted, and the lack of an organized structure prevents the implementation of any serious attempt at economic recovery. The effect of foreign aid programs is blunted by the lack of a means to systematically gather and transport products. These same factors inhibit foreign investment.

RENAMO is largely responsible for the present state of affairs. Assisted by support from Malawi and to some extent South Africa, it has been able to consistently maintain the military initiative, and is capable of great mobility. It can operate by means of short engagements and achieves spectacular results from disrupting communications, access routes, and energy supplies. But it lacks the credibility to present itself as a political alternative. Because it was conceived as a tool of alien interests (Rhodesia and South Africa), it has been unable to achieve a political structure parallel to its military potential. It lacks an ethnic base, a consistent program, and leaders with popular appeal.

Nevertheless, presented with the vulnerability of the government, coupled with its own military successes, RENAMO has assumed the role of an opposition movement. It is a force that must be taken into account in any serious attempt to reach a negotiated settlement in the area. If it cannot be defeated, it must be a part of that settlement. Otherwise, Mozambique faces the prospect of being "Uganda-ized."

The survival of the Machel government is primarily due to his own personal and political qualities. It is his leadership that has maintained the cohesion and unity of the regime. His personality is a key factor in holding the government together. He has been able to take advantage of the absence of a qualified political opponent, and to project his authority beyond national boundaries. He has used a flexible and pragmatic foreign policy and the disenchantment with cooperation with the Communists to approach the West, specifically, the U.S., Portugal, Italy, and the U.K. He has done this without doing anything to jeopardize the interests or presence of Eastern countries who naturally do not wish to be excluded from the region.

Machel has also been able to maintain links with the front-line countries and to establish military pacts with Zimbabwe and Tanzania, which gave him the credibility to enter into the Nkomati Accord. That agreement was a heavy blow to the Soviet Union's strategy of siege of South Africa.

For all of this, Machel deserves our support. However, the Nkomati Accord did not yield the political, diplomatic, and economic help that Machel expected. He finds himself increasingly on the defensive, and a feeling of mistrust has surfaced in his government with regard to Pretoria's and Washington's real aims. The failure of the Nkomati Accord is a warning also to other countries in the area. Washington has been unable to act as the guarantor of the agreement, and Machel and the other front-line countries are now doubting the sincerity, and even the power, of South Africa.

### *Opening Remarks from the Panel, III.*

It is true that there is change going on in South Africa, and that the South African government doesn't always get credit for change. But it is also true that some of the change that has occurred has a dynamic of its own and will lead to further changes quite different from those intended by the government.

It is clear that the government has no intention to make structural changes, however much it may talk about dismantling apartheid. The government understands that the language of reform is the language of the day. Its moves constitute a search for a more modern and acceptable way to maintain white dominance. It gives on such points as mixed marriage and mixed politics, which are not much in the way of concessions. There have been reforms whose real significance is questionable. The pass laws have been abolished, but the Group Areas Act, the new identification documents, and the absence of acceptable housing indicate that the effect of the laws remains. The state of emergency was lifted, but new proposed legislation allows a virtually constant state of emergency without its being formally declared. Even the government's calls for negotiation are within the structure of apartheid. It calls for negotiations with designated leaders, but are they the true leaders? The government does not intend to negotiate with Mandela, with the ANC, with Bishop Tutu, or even with Chief Buthelezi.

There is a credibility gap with regard to the South African government's statements about reform. The "double-speak," the reprimand of the foreign minister, and the violation of the Nkomati Accord and Lusaka Agreement all raise questions about the government's intentions.

Meanwhile, there is a profound series of events going on. Opposition to apartheid has moved from the professional, educated middle class to a group of young, impatient, daring blacks who sense that the government is weaker than it appears to be. They feel they are making the sacrifice their parents never made. They have learned to hate. They are anti-West, anti-capitalist, and anti-American, and, particularly, anti-Reagan. They see the U.S. and the West as selfish, if not racist. They cannot understand or accept the rationalizations of the inability of Western countries to influence the situation. They know that we can and do intervene in many places around the world, and that we can and do use sanctions, even while we say they are ineffective.

The South African population, within the black community and to some extent within the white, is becoming increasingly radicalized. The moderates are trying to keep up with the radicals. Violence is increasing and will continue to, the lifting of the state of emergency notwithstanding. Many of the whites feel the government has not been tough enough. Among blacks, there is a tendency to strike out at other blacks — policemen and councilmen, who are seen as symbols of white power — in an effort to make the townships ungovernable. There is also increasing black rivalry, as various groups jockey for position.

The debate about South Africa in the U.S. and Europe is quite "sterile and beside the point." Both sides in the divestment debate tend to overstate their arguments. South Africa is not going to fall or survive over the divestment question. There have been some positive steps, such as the Sullivan principles. But the continued presence of foreign corporations is a contribution to the continuation of apartheid. South Africa gets some advantage, even if it is only psychological, out of being thought to be pro-Western and capitalist.

There is probably more disinvestment going on than meets the eye. Most corporations are ready to cut their losses if it comes to that. The nuisance value of operating in South Africa, especially with low profits, is increasing.

The action in South Africa is inside the black community. At some point the two sides will have to come to some accommodation with one another. Will that happen

at a time when the situation is badly polarized, or will there be an effort to build a political consensus early on? We in the outside world have more influence than we are inclined to admit. It is important that we avoid getting involved in the disputes among blacks. We ought to promote a dialogue, a search for a consensus, and participation of all groups. We should not support black majority rule, necessarily, but rather promote a political consensus growing out of whatever majority might be put together. We should not support those actions of the South African government whose objectives are not clear. It was a mistake for the U.S. to support the new constitution; that contributed toward the negative image of the U.S. in South Africa. We need to stress to the South Africans that the important thing is negotiations, and they can't take place until the government does something credible enough to persuade the blacks to come to the negotiating table. Change in South Africa will come through a multiplicity of forces, including violence.

### *Discussion*

The two fundamental questions that framed the discussion of South Africa were: What was the significance of current developments inside South Africa and what should Western policy be toward South Africa? There was considerable divergence of opinion about whether real progress was being made in South Africa and about what means we ought to use to influence the situation.

A Canadian wondered what the "philosophical attitude" of the South African government was toward apartheid. His contacts with some South African leaders led him to conclude that Botha was convinced apartheid had to go and was dismantling it, virtually by stealth because of pressure from his right wing. A British speaker agreed, saying there seemed to be a "peeling away of the onion of apartheid, layer by layer." Was it not logical to conclude it would get smaller and smaller and ultimately disappear? The situation in South Africa was rapidly evolving, added an American. Even in the minds of the leaders, the end of apartheid was inevitable.

A Briton felt that developments in South Africa over the past three or four years had been "considerably better than anyone dared hope." Various reforms, such as eradication of the pass laws, and references to power sharing represented a "potential sea change" in white attitudes. This was the only way in which we could expect change to begin. It was unrealistic to expect an overnight conversion of whites. But it was clear that the white establishment and the Botha government had lost faith in apartheid. The government was now seriously prepared to contemplate power sharing among the various ethnic groups. South Africa was entering a "realm of negotiation and compromise, or a gradual shift of power away from white domination."

But other participants were less sanguine about the demise of apartheid. A Dutch speaker doubted whether the government was prepared to eradicate it. A Briton pointed out that apartheid and white supremacy were inextricably linked. Apartheid was essential to maintaining white supremacy. The government was deeply committed to white supremacy, and there really was no question of abolishing apartheid. We could demand that another government be installed, but we could not realistically expect the current government to abolish apartheid.

An American conceded that there had been change in South Africa, but the question was what kind of change and was it going fast enough to outrun the growing violence and radicalization. Structural change, in the speaker's view, was not taking

place. Recent developments were not very encouraging.

A number of speakers were concerned that South Africa would soon be consumed by violence, in the manner of Lebanon. Was it reasonable, wondered a Canadian, for the government to set as a condition for the release of Mandela and the un-banning of the ANC that they abjure from violence? It was a British view that the government would only release Mandela if doing so would decrease the violence. A Dutch speaker argued that it was unreasonable to expect Mandela to forswear violence when the government itself was part and parcel of the violence. The way in which the government reacted with its police force was repressive and gave impetus to the spiral of violence. In any event, Mandela was more of a threat in jail than out.

A British participant thought that perhaps the situation in South Africa was qualitatively different in the sense that it was no longer stable and could start to deteriorate quite suddenly. Weren't the townships going to be an increasing problem in this sense, he wondered.

A particular concern brought up by several speakers was Communist involvement in South Africa, in particular in influencing the ANC. It would be easy, said a Portuguese participant, for the Russians to exploit the "explosive situation created by apartheid." The degree of Communist involvement, felt an American, would depend on how fast change took place. In any event, we should not appear to be more concerned about the Soviet Union than about the general situation, lest we make the Africans in the region even more disenchanting with the West and dependent on the Russians. A Briton agreed, warning that if "misperceived strategic interests [led] the West to identify with the whites, the Russians in the end would make the strategic gains."

But, in the opinion of another British participant, the situation in South Africa was not particularly worrying from the point of view of the West's strategic interests. The country was not about to dissolve into anarchy and lawlessness. The situation was not so much like Lebanon as many other countries the West dealt with in Latin American and the Far East. It was not a situation the Russians could expect to make much impact on. The future government of South Africa was likely to be a "shifting military coalition," still dominated by whites, and able to maintain at least a "rudimentary state of law and order." There would be no "one man-one vote," and the system could continue for a long time.

It was ridiculous, continued the speaker, to talk of time running out. That had been said for 25 years and had always been wrong. Nor did it help rational discussion or analysis of what was happening in South Africa. There was no qualitative change in the violence in South Africa. Morale was as low as it had been in the late 1960's and 1970's; it tended to go in cycles. South Africa was not qualitatively different from other societies in crisis that had shown they could sustain conflict for a long time without collapsing into anarchy. The real crisis in South Africa was "in the liberal conscience of the rest of the world."

In trying to determine what Western policy should be toward South Africa, an American said we had to ask what was the "final destination" we visualized. In the name of what were we supposed to bring pressure on South Africa, other than "an abstract statement of abolishing apartheid?" It was the task of the West, answered a countryman, to help the South Africans achieve a sense of certainty about where the process was heading. In the battle against segregation in the U.S., the Constitution had provided the destination; the white community at least knew where the process was going. We ought to help the South Africans "determine what the ultimate allocation of rights and responsibilities would be." We had to work out some fundamental structure which would give both sides confidence.

The policy of the U.S. toward South Africa, as described by an American speaker, was aimed at helping design a political framework so that South Africa's

political future would be congruent with Western interests. The role of the West should be to stimulate dialogue and political negotiation in order to shape the future and determine who would have political power. We had to first insist on basic conditions, such as the release of Mandela, the un-banning of the ANC, and a clear blueprint for the ending of apartheid. But we also had to "find ways to steady the government's nerves and see that power inside South Africa is not undercut." Botha was the only one who could "deliver the white side of the equation." We needed to provide South Africa with incentives for change. Nor should we pick and choose future leaders. It was important to let the ANC know that an increase in their commitment to the Soviet Union and use of violence were antithetical to Western interests and views.

In seeking a solution, continued the speaker, we should not neglect the regional dimension. Southern Africa was a "seamless web." We could not settle the problems of South Africa without involving such countries as Mozambique, Angola, and Namibia. A Portuguese participant agreed, saying we should diplomatically ally ourselves with the front-line states in an effort to obtain settlements to conflicts within them so that a "ring of stability" could be formed around South Africa.

Several speakers observed that domestic political pressure was playing an important role in shaping policies toward South Africa. Political pressure in the U.S., said an American, had brought about an evolution in policy from a sharp dichotomy between the executive and legislative branches to a coordinated policy. The current U.S. approach was an "interim policy" between the constructive engagement advocated by the President and the more extreme measures favored by many in Congress. The elements of U.S. policy were a condemnation of apartheid, the imposition of limited sanctions, the establishment of a list of goals by which to measure progress, and the threat of future sanctions if progress was not achieved.

A Swede agreed with these policy elements, but argued for a much stronger emphasis on economic sanctions. Sweden had prohibited new investment, imposed an arms embargo, banned nuclear cooperation, stopped importing agricultural products from South Africa, and was urging its businesses to cut back on trade. Yet popular sentiment in Sweden demanded more. Tough sanctions, if the Western countries joined forces, could be effective. South Africa should be "cut off from all gold markets and denied access to export markets."

A Briton felt that the private sector sanctions applied in the past 18 months had had an effect on the South African government. A Dutchman agreed, saying that the notion that sanctions would hurt the wrong people was not valid. Even the threat of sanctions had instigated certain moves. And sanctions were one of the only peaceful means left of promoting change.

Indeed, the question of economic sanctions, and disinvestment in particular, presented Western companies with a dilemma. Most speakers who represented companies doing business in South Africa felt they could make a greater contribution to changing the system by remaining in South Africa than by leaving. Yet public sentiment in the West was against staying.

An American reported that his company had a range of policies that assisted blacks, including equal pay, efforts to increase the number of black employees, legal aid, health care, and educational programs. Its current intention to stay was motivated not by profitability, which had deteriorated, but by concern for its employees. The company had never laid off employees anywhere for economic reasons, and the speaker hoped it never would have to for political reasons.

A British speaker reported that whites were "lining up to buy his company's business." It had received no pressure from whites to stay or from blacks to leave. Leaving, he felt, would not help the situation. Another Briton complained that the case for engagement was not being publicly supported. Until it was, there was a danger that major companies would leave South Africa.

An American predicted that his company would likely leave because of pressure at home. The effect on its business in the U.S. would be more of a determining factor than any deterioration in South African business conditions. A measure of public sentiment against South Africa in the U.K., a participant pointed out, was that consumers were increasingly rejecting South African goods.

Yet, for all the gnashing of teeth going on in the West, Botha, said a Briton, was not very worried about sanctions. South Africa was going through a period of "third world-ification." Many Afrikaaners were anxious to see foreign businesses withdraw. They wanted the economy repatriated and Afrikaaners controlling the businesses. It was "ludicrous for the West to pretend that that process would frighten them." We should recognize, when considering economic measures that purported to destabilize the South African government, that apartheid was a labor movement, rather than a capitalist one. The people who ran South Africa were "old-fashioned socialists." They did not care if their businessmen were in revolt. They were "unmoved by the things people in the West [felt] should move them."

There were, at the same time, many courageous people in South Africa, continued the speaker. They were engagers, who were struggling for the cause of black advancement, as much against Europe and the U.S. as against the white government. They had done a great deal of good in South Africa. It was difficult to "see the morality in our just giving up and going home."

Several speakers felt it was a mistake for the West to have excessively high expectations about change in South Africa. Nothing was going to happen quickly. And in the last analysis, said a Briton, the views of the rest of the world were, for all practical purposes, of marginal significance to what happened in South Africa. The future would be decided by the people who lived there.

---

#### CLOSING REMARKS

*Lord Roll closed the 1986 Bilderberg Meeting by expressing, on behalf of all the participants, appreciation to those who had made the conference a success. He noted, in particular, the efforts of John Sainsbury and Andrew Knight, the British members of the Steering Committee, and of the staff of the Bilderberg Secretariat. He also acknowledged the comfortable accommodations and excellent cuisine provided by the management and staff of the Gleneagles Hotel, and the efficient security arrangements carried out by the Tayside police department. Finally, the Chairman thanked the working paper authors, moderators, panelists, participants from the floor, and the interpreters.*