

BILDERBERG
MEETINGS

**LA TOJA
CONFERENCE**

12-14 May 1989

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NOT FOR QUOTATION

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FOREWORD

This booklet is an account of the proceedings of the 1989 Bilderberg Meeting at the Gran Hotel La Toja, Island of La Toja, Spain. Working papers and introductory remarks appear essentially as they were presented, with some minor editing. Comments and interventions made in the discussion sessions, as well as panelists' closing remarks, are organized and reported according to subject matter, not necessarily in the order in which they were made, nor always in their entirety.

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USA	Grant F. Winthrop	Director, Milbank Wilson Winthrop
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IN ATTENDANCE

SPA	Julio C. Abreu	Director General, Central de Congresos; Organizer 1989 Conference
NETH	Saskia ten Asbroek	Executive Secretary, Bilderberg Meetings
USA	Charles W. Muller	President, Murden & Company; Adviser, American Friends of Bilderberg, Inc.

* Member of the Steering Committee
** Member of the Advisory Group

LIST OF ABBREVIATIONS

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

**I. DOMESTIC DEVELOPMENTS IN EASTERN EUROPE:
POLICY IMPLICATIONS FOR THE WEST**

Moderator: Charles McC. Mathias, Jr.

Introductions: Michaela Geiger

William E. Griffith

Background Paper: Timothy J. Garton Ash

**II. CAN THE ALLIANCE BE SUSTAINED BY MILITARY
AND ARMS CONTROL ISSUES ALONE?**

Moderator: Lord Carrington

Introductions: Theo Sommer

Henry A. Kissinger

**III. THE LONG-TERM ECONOMIC DESIGN OF THE E.C.:
EUROPEAN SOVEREIGNTY?**

Moderator: Kenneth W. Dam

Introductions: Giovanni Agnelli

Lloyd M. Bentsen, Jr.

Peter D. Sutherland

IV. CURRENT EVENTS: U.S. - SOVIET RELATIONS

Moderator: Etienne Davignon

Introduction: Rozanne L. Ridgway

**V. GREATER POLITICAL AND MONETARY UNION OF EUROPE:
EUROPEAN SOVEREIGNTY?**

Moderator: Lord Roll of Ipsden

Introductions: Miguel Boyer Salvador

Rupert L. Pennant-Rea

**VI. GLOBAL RELATIONSHIPS: SURPLUSES, DEFICITS, AND
PROTECTIONISM**

Moderator: James D. Wolfensohn

Introductions: Charles H. Dallara

Arthur Dunkel

H. Onno Ruding

VII. ENVIRONMENTAL CONSTRAINTS

Moderator: Costa Carras

Introductions: William K. Reilly

Klaus Töpfer

Background Paper: S. Ichtiaque Rasool

OPENING

The thirty-seventh Bilderberg Meeting was held at the Gran Hotel La Toja, on the Island of La Toja, Spain, on May 11-14, 1989. There were 112 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, not as representatives of their national governments or their organizations. As is usual at Bilderberg Meetings, in order to permit frank and open discussions, no reporting of the conference proceedings took place.

Lord Roll of Ipsden, the Chairman of the Bilderberg Meetings, opened the conference with an expression of good wishes and appreciation to their Majesties the King and Queen of Spain. He then reviewed the procedural rules of the meeting, stressing the need for punctuality and for adhering to the time limits prescribed for participating in the discussions.

Fundamental Dilemmas

1. The countries of Eastern Europe today have greater opportunities but also greater problems than at almost any time in the last forty years.
2. The opportunities lie in the greater room for maneuver which the Soviet Union under Gorbachev is currently allowing these countries' political leaderships. They lie also in the ever richer web of ties with the West, a web spun by the Ostpolitik of the Federal Republic of Germany, the less intensive and consistent Eastern policies of other Western powers, the 'Helsinki process', and, last but not least, by numerous non-governmental and individual initiatives.
3. In discussing these opportunities it is vital always to keep in mind the differences between the interests and aspirations of the political leaderships of these countries, on the one hand, and those of their peoples on the other. Even in the most 'reformist' states—Hungary and Poland—this difference remains deep and crucial. It is too often blurred in Western discussions about policy towards Eastern Europe.
4. The most obvious common problems of the region are economic. Overall, Eastern Europe is again in a position of growing relative backwardness vis-a-vis Western Europe. This growing relative backwardness affects not just industrial production, but transport, schools, leisure facilities, environmental protection (a subject of growing popular concern), housing and health care.
5. The region's more realistic political leaders see this. They look anxiously at the revolution of high technology in the West and Far East and the economic integration of Western Europe under the banner of '1992.' They realize that if their countries are not to fall still further behind they need more radical economic reforms than have so far been attempted, even in Hungary.
6. Apart from the immense theoretical, technical and external economic obstacles to more radical 'marketising' reform there are profound political problems. To oversimplify, one might say that such reforms provoke resistance from both the ruling class and the working class.
7. Such reforms require that numerous members of the ruling class—the nomenklatura and political bureaucracy—sacrifice at least some of their powers and privileges. Besides these individual losses there is a more general concern. The more the market replaces the Plan, the less evident it is what the Party is there to do. Even the most 'reform-minded' leaders are naturally ambivalent about this.
8. Such reforms also generally require that in the short term a large part of the working class—and society at large—will get poorer. New kinds of inequality are added to the old. The 'socialist' state ceases to furnish what it itself has described as the most basic 'social right': full employment. Instead people are promised jam tomorrow. But they have been promised this for forty years. To overcome the credibility gap the authorities therefore have to offer payment in political coin: more popular participation in, or at least oversight of, government. This in turn increases the resistance of the ruling class. Thus, while the society has different interests and aspirations from the political bureaucracy, their resistance can be mutually reinforcing.
9. In addition, there is the problem of raised expectations. Younger people, better educated, remembering neither the fear nor the rural poverty of the forties and fifties, increasingly travelled in the West and measuring their own states by the rising standards of Western Europe, make growing demands on their rulers.

The Role of the Soviet Union

10. These expectations are raised still further by Gorbachev. Gorbachev has given the local elites greater latitude to work out their own domestic solutions. But the 'Gorbachev effect' is far from comfortable even for more reform-minded rulers and profoundly unsettling for the Brezhnevite leaderships of Czechoslovakia and the GDR.

11. The modest conventional troop withdrawals announced by Gorbachev will be welcomed by both states and societies. But these withdrawals may also raise popular expectations still further, while in practice leaving in place a more than reasonable sufficiency for purposes of repression. There is a danger as well as an opportunity in the present Soviet leadership's wholly comprehensible reluctance to spell out (if it knows itself) where the ultimate limits of its tolerance might lie.

12. The countries of Eastern Europe have always been very different, but they are now more different than ever: both from the Soviet Union and from each other. I have written in this context of the 'Ottomanisation' of the Soviet empire, meaning the slow, piecemeal, discontinuous emancipation both of individual states from the imperial center and of societies from states, but in conditions of overall decay rather than systematic reform and competitive modernization.

Opportunities and Risks for the West

13. The less the Soviet Union has to offer, and the less it constrains, the more these states look—as their peoples have never ceased looking—to the West. This growing interest in the West is accompanied by a growing dependency on the West: particularly in those states with a large hard currency debt, Poland, Hungary and the GDR. More than ever before, the politics of Poland, Hungary and (in a special way) the GDR are determined by calculations about the West.

14. For the West, this offers a great opportunity—and a great risk. The great opportunity is that we could assist at ending the Cold War and peacefully overcoming the division of Europe ('Yalta') by helping to remove its political as well as its military root causes.

15. The great risk is that of explosion. Prediction is notoriously difficult, and in Eastern Europe more than anywhere. But on a sober assessment one can see a serious possibility of some kind of an explosion of popular discontent in four out of the six East European states over the next few years: Romania, Poland, Hungary and Czechoslovakia. (Some analysts would add the GDR).

16. No one can predict what course such an explosion would take, nor how the Soviet Union would react to it. A direct military intervention could spell the end of 'perestroika' not just in the country concerned but in the Soviet Union itself. A disguised intervention could split the West far more seriously than did that in Poland in December 1981.

17. One must, however, clearly grasp whence this risk mainly comes. It does not at present come from the process of economic and political reform going too far, too fast. That is not the case anywhere. It comes from the process going too slowly, and not far enough: The longer reform is delayed, the more painful and costly it will be, and the less popular trust the political leadership will have to bank on. Pressure builds up under the sealed lid, not the open one. This is the danger in both Czechoslovakia and the GDR.

Individual Countries

18. The most important countries for Western policy at this moment (spring 1989) are Poland and Hungary, for three related reasons. First, their present leaders have gone furthest in the pursuit of economic and political reform. These countries' politics almost

begin to resemble those of 1945-48, rather than of 'post-Stalinist reform'. In economics, they are speaking almost the same language as the contemporary West, although deeds lag far behind words. Secondly, their highly active civil societies, their intelligentsia and opposition movements, are pushing them in the direction of further and more radical change. As a result, the process of political change in both countries is actually a mixture of reform and revolution. Thirdly, the West's influence here is greatest.

19. These two countries deserve to be discussed in more detail. But one general point might be made in writing. A degree of 'instability' (e.g. unofficial groups, demonstrations, strikes) is an inevitable accompaniment of such fundamental change, and, indeed, a necessary catalyst for it. We should treat it as normal and healthy not as dangerous and sick. Unless the pot is simmering, nothing will get cooked.

20. A change of leadership and a more fundamental change in policy may reasonably be expected in both Czechoslovakia and the GDR over the next one to three years, if only because of the old age of current leaderships (although Erich Honecker has firmly indicated that he will still be there in 1990). The exact timing of the leadership change is, however, important, for at least two reasons. First, it would make a considerable difference to Poland and Hungary to have neighbors moving in the same direction. Secondly, the nature of the reforms then introduced will depend to a significant degree on the progress of perestroika in the Soviet Union. If perestroika in the Soviet Union has in the meantime become entangled and stalled, the new Czechoslovak and GDR leaderships will have one less motive for introducing their own. If it has gone further, they will have one motive more.

21. So close is the engagement of the Federal Republic of Germany in the GDR that the role there of the other Western powers can only be supportive and supplementary. (A special case is, of course, Berlin, whose status is increasingly questioned in and by West German and specifically West Berlin politics. But no better alternative to the status quo of the Quadripartite Agreement will exist, short of radical change in *both* Soviet policy and GDR politics). There is however, a strong case for all the West to pay very close attention to Czechoslovakia at this moment.

22. Romania, with the miserable, repressive and irrational dictatorship of the Ceausescu, cries out for the kind of protest and symbolic politics at which Western official visitors (e.g. to Poland) have sometimes been quite effective in recent years. But until a leadership change—with the accompanying risk of explosion and violence—the possibilities for constructive, peaceful engagement there are very limited. Bulgaria offers modest risks, but equally modest opportunities.

One policy or many?

23. It is customary and comfortable to maintain, as did a recent Foreign and Commonwealth Office memorandum to the Commons Foreign Affairs Committee, that 'most Western countries conduct their policies towards Eastern Europe along broadly similar lines.' An independent analyst is not bound to such diplomatic piety. There have, in fact, been profound differences of approach between the Ostpolitik of the Federal Republic of Germany, on the one hand, and the East European policy(-ies) of the United States of America on the other. The second-rank actors, France, the UK, Italy and Austria, have tended to lie somewhere in between, with the UK closest to the American and Austria closest to the West German approach.

24. Whereas the ideal from the point of view of encouraging desirable change in Eastern Europe would be a coordinated Western approach tailored to each individual (increasingly different) East European country, the reality has tended to be each individual Western country pursuing its own policy towards the whole of Eastern Europe. Some progress in coordination between the major West European powers has been made in recent years, but much more is needed. Seen from Eastern Europe, the differences

between the approaches of Western powers are still very marked.

25. Thanks to its economic might and its new Ostpolitik, Germany (West) is once again a major power in Central Europe. Its trade is three to five times that of other Western states. Its special relationship with the GDR has acquired an extraordinary quality. Whereas security issues were deliberately excluded from the 'first phase' of the new Ostpolitik, in the nineteen seventies, they are now near its heart: a change very much encouraged by Soviet policy over many years. In these circumstances, an active all-Western policy towards Eastern Europe is also part of what one might call the sustainment of West Germany.

26. One should note that leading West German politicians of the right and center say they would positively welcome more active engagement in this field from their West European partners. Their notion of the 'Europeanization of Ostpolitik' merits a serious response. But one response may be to say that it must rather be a *Westernization* of Ostpolitik: that is, unambiguously and explicitly based on Western values, in its theory, and fully involving the United States and Canada in its practice. For 'Europeanization' can also mean de-Americanization.

27. Good policy towards Eastern Europe is a matter of doing many small things consistently rather than a few big things sporadically. It is therefore, by its nature, impossible to summarize. Some useful indications for a positive agenda are to be found in the April 1989 report to the Trilateral Commission by Kissinger, Giscard and Nakasone; in the (British) Commons' Foreign Affairs Committee report on Eastern Europe and the Soviet Union; and, most concretely, in an outstanding short paper by the US Ambassador to Hungary, Mark Palmer. Palmer's paper offers suggestions in three sections: 'economic action,' 'sociopolitical action,' 'security action.' In each section, it has the vital merit of combining elements of previous American and German approaches. [Mark Palmer, 'US and Western policy—new opportunities for action,' in William E. Griffith ed., *Central and Eastern Europe: The Opening Curtain?* (Westview Press).]

28. Rather than review the whole agenda, I offer concluding comments on just two aspects that have recently been controversial.

Not a new Yalta, but . . .

29. Henry Kissinger is said to have (had?) in mind a 'new Yalta': the West negotiating with Moscow over Eastern Europe, Western guarantees of Soviet security in return for Soviet guarantees of East European liberty. No doubt what Henry Kissinger has really had in mind is somewhat more subtle. But the caricature notion of a 'new Yalta' does serve to sharpen the argument.

30. The objections are, firstly, that we should not recognize or legitimate Soviet hegemony over Eastern Europe, and, secondly, that Moscow is already tolerating the unprecedented developments in Poland and Hungary, so why not just let them get on with it? It seems plausible to suggest that the Soviet leadership might tolerate more in its present mode of pragmatic muddling-through or 'benign neglect,' than it would in any systematic, conscious redefinition of its 'security interests,' especially if that was a redefinition urged upon it directly by the United States.

31. To say that Moscow 'holds the key' to developments in Eastern Europe is both true and false. It is true negatively but false positively. What the Soviet Union can offer to Hungary and Poland today are essentially negative goods: non-intervention, benign tolerance of heterodoxy, the removal of past falsifications (e.g. about Katyn), some lightening of economic constraints (terms of trade, energy prices, existing joint projects). Positively, however, it can offer very little: it needs all the technology, know-how and, indeed, hard currency it can get for its own economic reconstruction. It can offer no models for economic and political transformation to these already more advanced countries. These positive goods have to come from within the countries themselves—and

from the West.

32. In any case, what guarantees could we offer in direct conversation with the Soviet Union? Can we really say that we do not want these countries to become liberal democracies with market economies? Can we say that we do not want them to move into ever closer association with the West European Community? Egon Bahr may be prepared to say that, but I am not. Not merely the peoples but even (parts of) the governments of Hungary and Poland would be dismayed if we were to do so. This would indeed be 'Yalta', in the sense that most East Europeans use the term.

33. What we can say is that we do not want these countries to join an anti-Soviet military alliance. For the foreseeable future we see no alternative to these countries staying in the Warsaw Pact, albeit at lower levels of armament all round. But this is hardly news to Moscow. If anyone needs to be told this, to have the arguments explained, patiently and privately, it is some of the new political forces in Poland and Hungary. What the West can and might properly do is to say to them directly: 'yes, we will help you so far as we can along the road to a market economy, to the rule of law, *de jure* pluralism, and to an ever closer association with Western Europe; but no, we will not support you in any attempt to start by changing the fundamental framework of military security in Europe. That is the last step not the first.' But this is a conversation to be had in Warsaw and Budapest, not in Moscow.

34. There is one other private conversation to be had. This is an intra-Western conversation. It concerns the (probable) eventuality of a major crisis on 'explosion' (referred to in Par. 15-17 above) bringing with it the risk of Soviet intervention or Soviet-sponsored domestic repression. The West plainly should have a closely coordinated, indeed united position in presenting to Moscow both the costs of intervening and the benefits of not intervening. Neither the costs nor the benefits should be understated. The time to start preparing such a position is now.

Not a new Marshall Plan, but . . .

35. Others have proposed a new Marshall Plan for Eastern Europe. This is unrealistic. Even if the West were ready to offer a new Marshall Plan, the East is not ready to receive one. The Soviet Union is unready both objectively and subjectively. Poland and Hungary may to some extent be ready subjectively, but their economies are far from ready objectively. In Western Europe forty years ago there was a pump waiting to be primed. In Eastern Europe the pump has first to be built.

36. Yet of the three Western policy areas identified by Palmer, 'economic action' is by far the most urgent for Poland and Hungary in 1989. Economic crisis has driven these countries to radical reform, indeed to an attempted transformation of their whole system. But economic crisis could also defeat that transformation. In the short to medium term, the reforms themselves will worsen things still further: causing dramatic inflation, unemployment, and dramatic new inequalities. It is not at all clear that people will stand for this, whatever the new liberties offered in compensation.

37. As an aspect of policy (rather than business) Western 'economic action' therefore has two goals:

(a) the short-term goal of preventing that explosion of popular desperation which could set back or quite destroy the peaceful transformation, not just in one particular East European country, but possibly in the Soviet Union and in East-West relations as well

(b) the long-term goal of helping the transformation of these economies into ones that can both supply their own consumers and develop a more 'normal' market interaction with the developed economies of the West.

38. Ideally, the instruments used to achieve goal (a) should also contribute to goal (b). The Rockefeller scheme for private agriculture in Poland is a small case in point. But in the present extremity this will not always be possible. Large, untied, government-

guaranteed credits have not in the past been a positive contribution to goal (b). Quite the reverse. They have been used as a substitute for reform, not a means to achieve it. But given the scale of the debt burden, and the depth of the crisis, some government-guaranteed new money may be essential—so long as this emergency panacea is not confused with a proper cure. The package of measures announced by the Bush administration in response to the relegalization of Solidarity is a good beginning. West Germany's response will again be crucial.

40. For Poland, the situation may soon arise when the West will be called upon, and by Lech Walesa as well as Wojciech Jaruzelski, to give straight aid: literally to put some food on the Poles' kitchen tables. One can imagine worse uses for the European Community's butter mountains. And the psychological effect of such immediate gestures should not be underestimated. This would, of course, be little more than 'buying time.' But in the time thus dearly bought, more sophisticated and rigorous proposals could be elaborated.

41. Such proposals might include: debt relief, rescheduling and conversion (whether into local currency for agreed projects or, preferably, into equity); direct incentives for Western investment, in majority-owned joint ventures or special zones; measures designed specifically to encourage the development of the private and co-operative sectors, including perhaps a Western-financed European Development Fund offering small-scale hard currency loans, Western contacts, know-how; management, technical, fiscal and promotional training; a sustained effort to ensure that EC and North American markets are really open to *all* Polish and Hungarian producers, private and co-operative as well as state, with consideration given to preferential treatment, even if not so much as presently accorded to the GDR. The Trilateral Commission's proposal of treaties of association with the EC, under article 238 of the Treaty of Rome, is currently an appropriate overall goal for policy towards Poland and Hungary—and for them only—but direct economic measures must be the immediate priority. Interesting suggestions have been made in this area under the auspices of the Soros, Rockefeller and Bronfman foundations.

42. The West cannot make the difference between success or failure for perestroika in the Soviet Union, and least of all in the economic field. But it can perhaps make the difference between the success and failure of the still more fundamental attempted transformation in Poland and Hungary, and most of all in the economic field. But the case is urgent. It is a matter of months, not years.

Introductory Remarks

I.

The changes that are happening in Poland and Hungary are potentially the most important and momentous in at least 40 years. The central theme of politics in those two countries is nothing less than the dismantling of the Communist system. It is nothing less than the transition to a Western European liberal democracy—to a free market economy, freely elected parliament, and independent judiciary. Poland is already in the throws of its first half-free election in living memory. Hungary already has many political parties, including two or three inside the Communist party.

However, even in Poland and Hungary, the chances of success are small. The internal obstacles, the chances of a backlash are great. These two countries are alone in Eastern Europe in this experiment, surrounded by neighboring states that are hidebound, fearful, and oppressive. Poland's neighbors are the Soviet Union and the German Democratic Republic. Most observers in Poland and Hungary share the prevailing British and American assessment that there is a more than even chance of a check or reversal in the Soviet Union.

Nonetheless, this is an historic moment of opportunity, and we in the West need

to consider the possibilities to facilitate and promote this historic change. Of the various kinds of actions available to us, economic action is much the most important in relation to Poland and Hungary today. This is made more challenging by the political turmoil and transition in these countries, which do not make for clear and consistent economic policy. New thinking is called for.

The Federal Republic of Germany is the crucial player in this respect. It has by far the greatest economic presence of any power in the region. The question is not whether Germany will again be a great power in Central Europe, but what kind of great power it will be, what role it will play.

The Soviet Union is, of course, the other great power in East Central Europe, and we must ask where the limit of Soviet tolerance of these extraordinary changes may lie. It is probable that Gorbachev himself does not know the answer. He is indulging in new thinking and in improvisation—playing it by ear.

A year ago, it could have been said that one essential fact remained—the leading role of the Communist Party in Eastern Europe. That leading role is now being defined away. But there remains one basic minimum condition for the Soviet Union—membership in the Warsaw Pact. However, there is an inner logic in the political developments in Poland and Hungary, in the politics of national emancipation, which will lead these countries, or at least their opposition groups, to challenge membership in the Warsaw Pact fairly soon and fairly directly. This is a development that is at once inevitable and dangerous. Eastern Europe hopes in this direction are inadvertently raised by Soviet unilateral disarmament initiatives aimed at the West.

While it would be absurd for NATO to stand as the last defender of the Warsaw Pact, we could and should say privately to all political forces in Hungary and Poland that to change the basic foundations of military security in Europe is the last step, not the first. Political and economic changes must be put in place first. To be credible in saying that, we must simultaneously be able to say that we are going to take steps to encourage and promote the changes underway.

The window of opportunity opening in Poland and Hungary is a narrow one, and it might soon be blown shut. It would be unforgivable for us in the West to miss this opportunity by squabbling amongst ourselves, to pluck defeat from what is, in the perspective of forty years, an extraordinary victory for Western resolve and values.

Introductory Remarks

II.

Besides those noted in the working paper, the crisis in Eastern Europe is serious for two additional reasons, both of an economic nature. One is the increasing competition with Eastern Europe's ability to export, even to the third world, from Far Eastern powers. The other is because the Soviet Union, since Gorbachev came to power, has been demanding more and better quality goods from Eastern Europe. This means Eastern Europe can export fewer high-quality goods to the West and earn less hard currency to buy Western technology, so they will remain uncompetitive.

It is also true that the chances of success in Eastern Europe are low because the Communist Party *nomenklatura* and most of the working class will suffer, politically and economically, from these reforms. If this obstacle is to be overcome, some charismatic leader is required, and there does not appear to be one on the horizon in Hungary or in Poland.

Moreover, the authority, in the largest sense, of the Soviet Union and its ideology, culture, economy, and military high technology, have collapsed in Eastern Europe. The Eastern European countries are again turning toward the West.

One should distinguish among these countries—between those that are at the core

of Soviet security interests and those which may be becoming peripheral to these interests. The core is Poland and the German Democratic Republic. Russia would cease to be not only a superpower, but a great power, if it were to lose East Germany and Poland, and thereafter almost surely the Ukraine and the Baltic States. This is an internal problem for the Soviet Union.

The Ottomanization of the Soviet Union is a possibility, with the Eastern European countries going the way of the provinces of the Ottoman Empire, which gradually relaxed its grip upon them.

Every day, the non-socialist developed world, above all the United States and Japan, because they compete with each other so much, are rushing ahead of the socialist world in high technology. Thus the situation is, as they used to say in Vienna in 1910, "not only hopeless, but indeed serious."

The Russians might be prepared over the years to grant Hungary and Czechoslovakia the kind of autonomy they had right after World War II. But this is unlikely for Poland and the German Democratic Republic. The Russian fear of a united, powerful Germany is still quite strong.

It is not possible, even if it were desirable, for these problems to be settled either by the United States and the Soviet Union, or by Western Europe and the Soviet Union. If they are to be settled or contained, it will largely be by the forces within these countries. Russian intervention is still a possibility.

These countries badly need short- and long-term economic aid. There should be no disagreement about this in the West. Long-term economic aid should not be given without strings, however. We need cooperation between the United States and Europe on this, and not the kind of squabbling among the countries of the West which sends the message to Eastern European countries that the West will not only not help them, but may indeed not be capable of helping itself.

Yet, while there is some cause for gloom analytically, we must be optimistic in policy. We are seeing the greatest single change in the map of Europe since 1945. Policy should be conducted with prudence, and not with a presumption of ultimate failure.

Introductory Remarks

III.

In the eyes of many people in Eastern Europe, the Communist system is bankrupt. Marxist ideology has lost much of its attraction, and to most Eastern Europeans, has no credibility. The machinery of a centrally-controlled socialist economy has failed because it is an obstacle to innovation and creativity. In the words of Helmut Schmidt, the Soviet Union's development has reversed to make it "an Upper Volta with missiles."

The crisis besetting the socialist system has grown worse since the mid-seventies as a result of slower economic growth and a declining standard of living. The old Soviet instruments of crisis management—propaganda and repression—have lost their effectiveness because the population is generally better educated and because a great deal more information is now coming from the West. The brittle social and political structures forced the Communist rulers to look for methods of reforming or overhauling the system. Gorbachev's arrival on the scene was, therefore, only logical.

In the West, especially in the Federal Republic, the press and the public have "Gorbomania." The West must therefore make clear that the new policies in Eastern Europe are, in fact, a victory for the West, because our democratic, political, and economic system is providing extremely attractive to the Communist bloc countries, whose people want more freedom and a higher standard of living. The Russians, Hungarians, and Poles are trying to make their reforms more realistic than in the past. Reformers, especially in Hungary and Poland, have recognized that this process cannot any longer be confined to

a few improvements in the economic field but has to embrace society as a whole. Most people do not identify themselves with the Communist Party apparatus. This has prompted the Polish Communist Party to conduct a dialogue with old enemies like Solidarity and the Catholic Church.

The credibility gap between the ruled and the rulers in Eastern Europe can only be bridged if the party can make major ideological concessions and relinquish much of its controls. The reformers, most of whom are part of the party apparatus, find themselves in a dilemma. Either the reform process will become bogged down on ideological grounds, or it will increasingly challenge the party monopoly and thus its own power base. This dilemma is driving a wedge between reformers and counter-reformers throughout Eastern Europe.

Party leaders in Romania, Czechoslovakia, and the GDR still adhere to the Stalinist instruments of repression. Each has a different motive. In Romania, it is the primitive urge of a despotic family clique to stay in power. In Czechoslovakia, it is an almost psychopathic fear of another Prague Spring. For the GDR, it is because it is part of a divided Germany; if the citizens of that part were allowed more freedom of movement, they would inevitably move closer to the Federal Republic—something the Communist leaders fear greatly.

Gorbachev's first priority is to keep the balance of power in Eastern Europe stable, but he is not likely to exert much pressure on the anti-reformists among his allies. On the other hand, it has become clear that there will be no peaceful order in Europe as long as Germany remains divided. It is not possible to build a Europe whose nations cooperate with one another and respect the rule of law, where the powers of the state are separated and human rights protected, without the Germans. Similarly, a reunited, neutral Germany isolated from her European neighbors is just as inconceivable. It is not possible to end the division of Europe without ending the division of Germany.

The political stability of Eastern Europe will continue into the nineties. The Soviet Union will devote increasing attention to domestic problems and leave its satellites to themselves as long as they maintain a certain amount of bloc discipline. They would certainly be going beyond the threshold of tolerance if they were to question membership in the Warsaw Pact and Comecon. For the time being, the Soviet Union appears to be tolerating the tendency in some countries to recognize opposition forces.

The outcome of the various experiments with reform in Hungary, Poland, and the Soviet Union remains uncertain. But the process of change will gather momentum. Those Western politicians who are saying the change has become irreversible are being too hasty, and this could be dangerous. The continuing instability in Eastern Europe also holds the risk of sudden turbulence. The pent-up bitterness of the people and their tendency to expect too much from the reform process, especially as regards the economy, could lead to unrest and revolt in some countries. From the Western point of view, that is the worst thing that could happen. An uprising put down by force could mean the end of the reform process and could ruin for decades the chance of creating a peaceful order in Europe. It could also freeze disarmament negotiations. Only if the Soviet Union were prepared in the Vienna negotiations to forego its attack capability would that be a sign that Moscow had abandoned the Brezhnev Doctrine. At the moment such a sign does not exist.

The unstable situation in Eastern Europe and the smoldering crisis in the Communist system still do not permit the West to abandon its dual principles of security and cooperation. It remains essential for the West to maintain its defense capability, even in the face of disarmament negotiations. It is the responsibility of NATO and the European Community to secure the process of change in Europe by creating stable general conditions and offering reliable partnership. The reform process in Eastern Europe means both opportunities and risks for the West. The risks can be limited by Western cohesion.

The question "can we help Gorbachev?" is not the right one. But it would be a

mistake just to wait and see. The arguments that Gorbachev only wants reforms to make the Soviet Union a more efficient, stronger, and more successful superpower, and that thus the West should show restraint, are not conclusive. A Soviet Union and an Eastern Europe that open up both domestically and externally, that modernize their outdated systems, and that offer their people more freedom and prosperity would be far less threatening to us. The Warsaw Pact nations will only master the huge task of becoming internationally competitive if they grant more individual freedom, permit the exercise of human rights, and introduce the rule of law. Such a transformed body politic would no longer constitute a threat to the West. Radical change in Eastern Europe is therefore in the Western interest.

We should take opportunities for cooperation where they present themselves, and especially where, after careful consideration, they promise success. The mistakes of the past, such as indiscriminately granting loans in order to promote detente, must not be repeated. Rather than compete with one another, the Western nations should carefully coordinate their policies. Economic and technological cooperation must go hand in hand with an offensive Western cultural policy designed to bring the people of Eastern Europe out of their long, involuntary cultural isolation. There should be more seminars, scholarships, advanced training courses, exhibitions, cultural forums, and exchange programs. The CSCE process must be used to obtain more basic rights and freedoms for the people of Eastern Europe and to encourage development of a pluralistic society.

Discussion

The political and economic developments in Eastern Europe were, in the opinion of an American speaker, the most important events going on anywhere in the world. Amounting to nothing less than a fragmentation of the Soviet empire, they represented a victory for the West. Poland and Hungary were on the way to becoming Western-style democracies with free market economies. In Czechoslovakia and Bulgaria less evident change was gradually occurring. And while little progress had yet been made in East Germany and Romania, change would ultimately occur there as well.

How should the Western nations react to this process of change in Eastern Europe? One thing they should not do, emphasized the speaker, was to view these changes with caution and fear about their effects on the Soviet Union. The West should not discuss the process of change in Eastern Europe with the Soviets, for such consultations would convey to the Eastern European countries the image of the superpowers getting together to decide their fate.

An Austrian agreed that Western leaders had to be careful about whom they talked with in the East. We had to avoid "legitimizing structures that had been rejected by large sectors of the population in these countries." A Briton added that he was dismayed that some Western leaders visiting Poland and Hungary had had meetings and discussions with groups and individuals that were not part of the reform movement.

Other participants in the discussion urged caution about events going on in Eastern Europe. They expressed concern that the "limits of Soviet tolerance," as an American put it, might be exceeded. This speaker argued that rapid change was not desirable for this reason. There first had to be a "general acceptance of the process of change by the people concerned," or the process might degenerate into violence. A German observed in this regard that many in Hungary, while wanting to adopt a more neutral stance, were fearful of a recurrence of 1956.

A British speaker agreed that gradual, evolutionary change would be desirable, but doubted that it was possible. What was going on in Poland and Hungary was a "dangerous leap" from one form of government to another, and it was inherently impossible to "leap slowly."

There was general agreement that the nations of the West should assist the process of change in Eastern Europe by providing various forms of economic assistance. An American called for development of more East-West trade, greater private sector involvement in Eastern Europe, responsiveness to the goal of full membership of Eastern European countries in GATT, encouragement of IMF agreements and World Bank financings, and rescheduling of the heavy debt burdens of these countries. Others advocated such things as vocational training and technical exchanges.

In the view of a British participant, the most important thing the West could do to assist Eastern Europe economically would be to keep our markets open, including our labor markets, even though this might well cause us economic hardship. The importance of this was illustrated by the fact that, in 1988 hard currency transfers from Poles working abroad exceeded the total hard currency surplus of the state sector in Poland.

Some speakers were cautious about the appropriate extent and manner of Western economic assistance. An Austrian speaker pointed out that Eastern European countries had serious economic problems. Hungary, for example, had a huge external debt, and faced great difficulty in restructuring it. The abolition of price controls there was resulting in the loss of purchasing power of the population, and this could be the basis of future social tensions. It would be a mistake to invest a great deal of money in Eastern Europe without regard to the possible structural effects. A Greek warned that we should not repeat the same mistakes we had made in providing assistance to Third World countries.

In a British speaker's opinion, the West, especially Western Europe, had to "think more constructively about new instruments for economic action." In particular, there was a need for a new instrument to aid directly in the growth of the private sectors of Eastern European economies. An Austrian said Western Europe ought to "think in an institutional framework" about how to use existing European institutions as agents of change. A Spaniard wondered if Western European institutions, such as the Council of Europe, could be opened to Eastern European countries. In the case of other organizations, such as the EC, perhaps they could be offered some kind of associate or observer status.

There was a consensus that, whatever the West did, it had to act together and act carefully. Particularly in Europe, there had to be cooperative effort in which the burdens of economic assistance were shared.

The suggestion in the working paper that the Federal Republic of Germany should play a dominant role in shaping future relations between Western and Eastern Europe prompted a discussion of what that role ought to be. A West German speaker said he "recognized and accepted" that his country had an important role to play, but said that it should not be overestimated. For historical reasons, neither Poland nor the Soviet Union would be likely to tolerate a dominant German role, nor would the German Democratic Republic, whose interest in good relations with West Germany was mainly for hard-currency income. The Federal Republic should play an important role, but only as part of a larger, European effort.

An American agreed that West Germany should not, "consciously try to dominate events in Eastern Europe." Relations with Eastern Europe should be carried on in the context of a united Europe. Europe had to become more united than it currently was. Only in the reunification of the European continent did the possibility of real stability exist, and only in the context of a unified Europe was it possible to envisage a reunified Germany. German reunification was not against U.S. interests, but was intolerable to the Soviet Union, unless reunited Germany was in a weakened state.

Regarding German reunification, a British speaker said he could imagine Poland, Hungary, or Czechoslovakia "muddling through" to something close to democracy and a free market economy while remaining sovereign independent states. But this would be difficult for the GDR. If the GDR ceased to be Communist, it would cease to be the

GDR; there would no longer be an argument against reunification. This was a major reason for developing a very active Western European policy of ever closer association with East Central Europe. Only in such an association could one imagine a peaceful, evolutionary convergence of the GDR back into a larger, democratic Germany.

Several speakers stressed the importance of political contacts between Western and Eastern Europe. An Austrian felt that a "political Marshall Plan" was called for. A countryman called for exchanges of political information about the organization of parties, the running and financing of political campaigns, etc. A Belgian speaker noted that this was particularly appropriate for Poland and Hungary, which now spoke the "same political language" as the West.

A Spanish speaker commented that his country was carrying on extensive political exchanges with Hungary and Poland, trying to explain to these countries Spain's experience in developing democracy. Indeed, as a British speaker noted, leaders in the democratic reform movements in Hungary and Poland looked particularly to Spain as an example.

II. CAN THE ALLIANCE BE SUSTAINED BY MILITARY AND ARMS CONTROL ISSUES ALONE?

Introductory Remarks

I.

The answer to the question under consideration is obvious: the Alliance can't be sustained by military and arms control issues alone. Arms control is one avenue toward a more acceptable order in Europe and the world; but it is not the only one. There must be political approaches as well, and there must, above all, be a political concept of where we want to go, what kind of order we would like to see emerge, and how to get there.

Arms control is not everything, but without arms control, everything else is nothing. It is inconceivable for us to hold fruitful talks with the Russians on fundamental political issues dividing us while eschewing negotiations with them about every category of nuclear and conventional weapons. It is almost unimaginably crude to place the two Eastern countries that have gone farthest in their political and economic reform—Poland and Hungary—under a new military threat at the same time we are thinking of ways and means of supporting them.

There is a conflict here between military means and political goals, quite apart from the fact that the whole modernization issue is overtaxing the psyche of one important Alliance member—West Germany. The combination of pressure for modernization and the refusal to negotiate with the Russians on SNF lie at the heart of NATO's present crisis. While one may argue that NATO has weathered similar crises before, this one is more dangerous and potentially more disruptive than all the previous ones.

The one element is no longer there that used to cement the alliance in those earlier crises—the sense of clear and present danger, imminent threat, and an undisputable enemy image. Gorbachev has changed the givens. He may falter, fail or fall, and we must insure against those contingencies by prudence. But prudence becomes counter-productive if it leads to do-nothing policies, if it fails to explore the opportunities at hand for fear of the risks connected with them, and if an arms build-up is the only reaction to the new range of possibilities. This is what the quarrel in NATO is all about: do we muster the courage to grasp the new opportunities, or do we hang on to our old risk assessment as though Stalin and Brezhnev still resided in the Kremlin? Do we acknowledge that the threat is diminishing and therefore tailor our defense efforts and military strategies to the diminished threat? Or do we cling to our familiar concepts, making our defense efforts and our strategy independent of the threat? Do we restrict our actions to arms measures, or do we become active diplomatically?

Here is the German position on short-range nuclear forces, given in the knowledge that some believe the Germans are being weak and vacillating on this issue. First, modernization is a misnomer. Replacing a four-cylinder engine with an eight-cylinder engine is modernization. But NATO is replacing a beetle with a tank by extending the range of the Lance from 120 to 480 kilometers—just under the intermediate-range nuclear force limit, and by doubling the number of launchers to around 200. This is an arms build-up in a field which had been lying fallow heretofore. Indeed, the old Lance has already been modernized with new engines and electronic parts.

NATO is considering this arms build-up in the face of no increased threat in that range band on the other side. The numbers game is somewhat suspect. Some say there is a ten- or a sixteenfold superiority in the East in this area, whereas the number is closer to fourfold. Whatever it is, it should be negotiated down. Some say the Russians have modernized the Frog, but what they did was to increase its range to 120 kilometers—roughly the same as that of the Lance. This time we do not need to arm to bring the Russians to the negotiating table. They are offering to negotiate.

Denuclearization is also a misnomer. It is a distortion to say that Western Europe would be denuclearized if all the land-based short-range weapons were eliminated. (The Bonn government is not seeking the third zero, anyway. Even the Social Democrats are prepared to settle for the time being for parity at a much lower number.) There would still be about 4,000 American nuclear warheads in Europe. There would be several hundred on American submarines at the disposal of SACEUR. And there would still be the British and French nuclear forces.

It is wrong to imagine that the German government sprung on its allies the demand to negotiate about weapons in this range band. The Germans did not change their minds. Ever since the INF negotiations and the imposition of the second zero, the Germans have been asking that Russian superiority in SNF be negotiated away. There is ample evidence of this on the public record.

Another factor influencing German opinion on this matter is the impact of the recent Wintex exercise which politicians observed first hand. That this exercise hypothesized a scenario in which the use of nuclear weapons occurred after just a few days was disturbing to the politicians observing it. The analysis of it dropped like a bombshell right in the middle of the coalition talks about the compromise. It raised all the old fears, and the question "how flexible is flexible response?"

It is not disloyal to ask for negotiations on SNF. The argument that parallel negotiations on SNF will hamper or undercut the conventional talks is not valid. It ought to be possible to link the implementation of reductions in SNF to meaningful conventional arms reductions.

Underlying the whole issue is the suspicion that perhaps the Germans are drifting away from NATO and the West, perhaps even trying to get out of the European Community as soon as there is a chance for reunification. This is unfair. Germany has made its choice. It will be loyal to NATO as long as NATO exists. Germany has become part and parcel of the European Community. Even if Eastern Europe opens up, West Germany will not be pushing for reunification in the foreseeable future. What matters is to end the separation of the people, not necessarily the division of the country. Once reunification becomes possible in a freer Europe with freer communication, it will become superfluous. The argument about SNF modernization should be viewed on the basis of that assumption.

Introductory Remarks

II.

While it is certainly true that arms control has become a central component of East-West relations, it is doubtful that there is a clear-cut objective to arms control. When the process started in the Nixon Administration, there were certain imperatives, including a peace movement that had to be placated, and a Congress that would not increase defense spending, so that putting in a ceiling met certain needs. Every arms control agreement became the subject of vicious debate on issues like verification and selling out to the Soviets and justified in terms of arms control being desirable in itself. We lost a sense of direction, and arms control agreements have become an end in themselves. It has become difficult to explain what they are supposed to do.

It was predictable that the INF agreement would produce exactly the situation we see today in the political structure of Europe without producing a corresponding military benefit. It became its own end. The attraction of being able to say that a class of weapons had been reduced to zero was so overwhelming that the political implications of putting a German government that had been dedicated to the Alliance through the agony of deploying these weapons and then pulling them out were ignored. This has contributed to the extraordinary German unanimity we are now seeing. It is essential to bring arms

control into some relation to the political objectives we are trying to serve.

The timing of the proposal to modernize short-range weapons was a mistake. It was extraordinarily insensitive to propose, in the year that we withdrew strategic weapons, the modernization of weapons that would kill primarily the victims of aggression. It was also wrong that, once the issue had been raised, to resist so fiercely the modernization of weapons that were already there.

The SNF debate raises all the issues of nuclear deterrence that we have avoided studiously for twenty years—ever since it became apparent that some parity in strategic forces was on the horizon. The West German Foreign Minister's statement that he has a responsibility to spare the East German population from the horrors of war has practical consequences not just for short-range weapons, but for the use of any nuclear weapons. It will lead logically to a position of no-first-use of nuclear weapons. If such a position means NATO is saying it would rather be defeated by conventional weapons than resort to nuclear weapons, it may change all the premises of the security policy on which NATO has been based.

It is a mistake to compare the short-range weapons on both sides. We made that mistake with the INF. The INF was not an answer to the SS-20, but rather an attempt to couple the defense of Europe to the strategic defense of the United States. It was irrelevant how many SS-20's there were; and it is irrelevant how many short-range weapons the Soviets have. The utility of the short-range weapons in Europe, as with any nuclear weapons in Europe, is to threaten the Soviets with getting into a realm of warfare that is essentially unpredictable and perhaps uncontrollable. Giving this up would amount to a huge change in all the perceptions.

There is nothing in European history to suggest that conventional equivalence produces deterrence. We are talking about conventional arms control and equal numbers in conventional weapons when all of European history shows that victories have almost always been achieved by equal forces and have frequently been achieved by inferior forces.

Fundamentally, we have four sets of relationships that we need to think through: the relationship of unified Western Europe to the United States; the relationship of Germany to Europe and to the United States; the relationship of Western Europe to Eastern Europe; and the relationship of both sides of the Atlantic community to the Soviet Union. We need a concept of what we are trying to do. We have escaped into psychoanalysis of Gorbachev, and we cannot gear our policy to one man, whose life is bound to be transitory. It is a fact that every Soviet leader has disavowed his predecessor. It has been said the Communist systems, and especially the Soviet system, are the only systems in the world that have an unpredictable past.

On the relationship of Western Europe to the United States, it would be highly desirable for Western Europe to organize its own defense arrangements within NATO. Such an act would not divide the Alliance. If we can stand a European Economic Community where there is no penalty for competitiveness, we ought to be able to stand a European defense community in a situation in which any threat to European survival would find any sensible European better off with American assistance than without it.

It is undoubtedly true that tremendous changes are taking place in Eastern Europe. But it would be a fatal mistake to assume that a great empire will disintegrate by itself, while the United States and Western Europe simply sit there and observe this disintegration and harvest its fruits without any action on their parts. There is nothing in Russian history or Soviet perceptions that would make this likely.

What we have to do is separate the economic and political liberalization of Eastern Europe from the Soviet military security problem. We need to see that the first part moves faster than the second part. The issue of membership in the Warsaw Pact should arise later than the issue of whether these countries can join the European Community as associate members on an individual basis. We cannot tell them they must stay in the Warsaw Pact, but a direct challenge to the Soviet system in that respect should not be

encouraged.

This is not a second Yalta. It is a means of eliminating the consequences of Yalta without creating an excessive danger of conflict. There are now two forums in which issues of this kind are being discussed. One is the European Community and its relations to Eastern Europe. The E.C. can determine conditions of association in the economic field. Second, arms control negotiations are going on in the conventional field in Vienna. Rather than turn them into the usual numbers game, they ought to be related to our desire to reduce the Soviet capacity for repression in Eastern Europe while at the same time continuing to try to achieve a degree of balance. If these countries challenge their membership in the Warsaw Pact, it would be much better if they did it after Soviet forces had been substantially reduced as the result of arms control negotiations.

With respect to the position of West Germany, it must be admitted that there is a growing concern among its allies. This has little to do with the tactics that produced the current SNF situation. When one looks at German history, one can say that the tragedy of Germany is its central location and its late unification. Throughout its history, Germany has been either too weak or too strong for the peace of Europe. When it was too weak, it invited constant foreign intervention. When it was too strong and sought to defend itself against all its neighbors, it threatened each neighbor individually. Pre-World War I German foreign policy was an extraordinary achievement in bringing about every nightmare that it sought to avoid.

The problem is that German national energies have been so absorbed in achieving unification that there has never been developed a clear statement of the national interest which would explain its foreign policy. With the best interests in the world, Germany, assaulted by all its conflicting temptations, will tend to follow them all, and will thereby create an uncertainty that one of its leaders intend. The danger is not that Germany will stampede out of the Alliance, but that, under the pressure of public opinion, policies will be pursued whose objective result will be to undermine European unity and the NATO Alliance.

It was a tremendous achievement of Germany policy to integrate itself into the West. Germany has every right to seek reunification, but it should be sought in a European framework. But the European Community and the United States owe it to the Germans to come up with a concept that is rational and sustainable. Germany owes it to itself and to its allies to be willing to pursue its goals in such a framework. For this reason, arms control is not enough.

Discussion

An International speaker opened the discussion by responding to some of the points made in the panelists' introductory remarks. Regarding the need to modernize the Lance missile, the speaker said that the service life of the Lance would end in 1995, after which it might not function reliably if it was not modernized. As to Soviet superiority over the West in the SNF category, a factor of 16 was accurate if applied to launchers; the Russians had approximately 1400 against our 88. And the Russians had modernized their SNF arsenal by doubling the range of the SCUD and bringing in new missile systems such as the SS-21, SS-N21, and AS-15. As to the question of whether Western submarine-based weapons could replace ground-based weapon systems, the speaker said they could not because they were not based on European soil.

With regard to the unsettling effect that the Wintex exercise had had on German politicians, this was unfortunate, but understandable. But such a procedural exercise, in which both military and political leaders participated in a simulated crisis, escalating to the use of nuclear weapons, was still valuable.

To deal with the larger arms control issues facing the West, the International

speaker proscribed a five-point course of action to be taken at the summit level.

First, we should indicate that we planned to move ahead with conventional arms negotiations. We needed to indicate our determination to make progress by adopting a "better spirit of give and take."

Second, we should "stay generalized" on the question of a follow-on system to Lance. Such a system should not be discussed in detail before being created. The proper question to address should be that of budgeting for research and development of a follow-on system. We ought not to "overload the German circuits" by pressuring Germany about the issue of deployment.

Third, we should negotiate on SNF only after progress had been made on the conventional side. This was important because of the seriousness of the conventional threat and because it would provide the Russians with an incentive to agree to cuts.

Fourth, we should recognize the importance of unilateral moves in arms control negotiations; they were as important as negotiated reductions. The West had in fact made, and should take credit for, significant unilateral reductions over the past ten years, both in terms of reducing the number of nuclear weapons and in defense-budget reductions.

Fifth, we needed to reaffirm our adherence to the Alliance and to our defensive strategy, and we had to commit budgetary resources sufficient for our defense.

It was a French participant's view that the current controversy over SNF was largely the result of the INF agreement—a mistake we should try to avoid repeating. We needed to avoid the "slippery slope toward denuclearization." We should continue the arms control process, but do it in sequence, and not start too rapidly with SNF. It was important that we think about how to "relegitimize" nuclear deterrence and how to avoid irreversible moves.

An International speaker doubted that a "go slow" approach on SNF would be possible. In his view, a negotiation on SNF was "irresistible," and any link with conventional talks would probably be loose. It would be hard to avoid a third zero on ground-based nuclear weapons, given the "broad rejection" in West Germany of artillery nuclear weapons and the follow-on to Lance.

A Canadian argued that the idea that NATO could rely on a conventional defense alone had to be discarded because no NATO country was prepared to pay the costs of its share of such a strategy. The INF agreement had indeed caused a gap in the strategy of flexible response, and, if we adopted the third zero, flexible response would not longer be valid. What strategy could replace it? Clearly a strategy of massive retaliation would not be acceptable. We had, therefore, to find a variation of flexible response which relied on whatever nuclear weapons remained. To some extent the independent French nuclear arsenal could be seen as a deterrent because of the uncertainty of its use. Submarine-launched nuclear weapons could not be relied on as tactical weapons because they were destabilizing. And aircraft-delivered nuclear weapons posed the problem of being increasingly unreliable and also not survivable. If all ground-based weapons were removed, NATO security would be left to the "good will of the Soviets," and this went against the fundamental concept of the Alliance.

Another Canadian warned that, though it was up to the West Germans to decide whether or not to allow nuclear weapons on their soil, Britain, the U.S., and Canada had the right to choose to not maintain their ground forces in Germany without the protection of the nuclear umbrella. Thus, burden-sharing had to be considered part of the SNF issue.

Several speakers questioned whether flexible response was still a valid strategy. An American doubted that there could be such a thing as gradual escalation, or that a controlled war was possible. A Briton agreed, saying that, in Europe, there was a growing concern about the doctrine of flexible response. For many Europeans, the concept of a limited war made little sense. In this respect, there was a growing divergence between the two pillars of the Alliance. A West German raised the question of the viability of flexible

response, given the changes in Eastern Europe. Would flexible response allow the destruction of Prague or Warsaw?

Other participants strongly defended the Alliance's reliance on nuclear deterrence. A Briton argued that nuclear weapons were essential for deterring war. They had done so successfully for more than 40 years, while conventional weapons had never done so. An American found it "odd" that all arms control agreements so far had focused on the nuclear side, while it was the conventional side that had produced the threat in Europe. If we gave up nuclear weapons, he warned, we would be in a new world that "we had better analyze prayerfully."

There was an extensive discussion of the importance of public opinion in sustaining the Alliance and its policies. In the view of a British speaker, the Alliance could be sustained by military and arms control issues as long as people were frightened. What now confronted us was the perception by our publics of a diminished threat.

Such perception, said a Canadian, combined with Gorbachev's great public relations successes, made it vital for Western leaders to maintain a long-term, consistent approach to Western security. For that, we needed the support of our publics. This was especially important in relation to the problem of the psychological decoupling of Europe from North America. At a time when our values were triumphant, when we were winning the cold war, we found ourselves divided and thus in a weakened position. Arms control went to the heart of public opinion, and our failure to address arms control in a united way would undercut public support for the Alliance. This could lead, in turn, to a decoupling and weakening of the Alliance. One way to counter Gorbachev's public relations success was to be united and to develop arms control proposals that captured public opinion.

An American agreed, saying that the revival of West-West tensions had to be avoided. Keeping NATO together had to be the foremost objective. An Alliance weakened by internal squabbles would have a "dismal" effect on Eastern Europe and on the Soviet Union.

It was, in a Belgian participant's view, a paradox that, "at the moment of our greatest success" we were "in real trouble." The responsibility of Western leaders was to quiet the dissension in our ranks, and to restore unity. "NATO must be a choice, not a habit," he said.

It was a widely held view among participants in the discussion that the Alliance had to formulate a new comprehensive concept. The best way to accomplish that, in the opinion of many speakers, was to conduct a Harmel-type exercise. We had, in the view of an International participant, locked ourselves into an agenda out of which we urgently had to move. We had to stop allocating blame. And we had to move away from the focus on nuclear issues in the Alliance. If we could not resolve the problem of ground-based nuclear weapons, then we should attempt to address the problem of defining "first principles." The best way to do that would be a new Harmel exercise.

Another International speaker agreed, saying that the West had to address some basic questions. Could we "live with success" and maintain unity and cohesion at the same time? Was the Atlantic link still important? Was nuclear deterrence still valid? We had to confront the question of how to reduce East-West confrontation and move toward a more peaceful Europe while maintaining our security.

It was a German's view that the strategic, theoretical problems we faced were insoluble. There was no strategy that would satisfy both sides of the Atlantic. The most promising course was to work to create "a more benign security environment." At that point, it would be time to talk about nuclear strategy, flexible response, the Atlantic link, etc. If there was going to be a fundamental change in the political environment, then these issues would have to be addressed anew. We could not "railroad a definition of our national interest past our public opinions." Our governments had to have a concept of what they wanted, and it was up to the leaders to mold public opinion.

An American felt the underlying question was what leaders should tell their publics. The average person could not understand the complex technical issues involved in arms control, nor the rationale of negotiating levels and ceilings of various weapons and forces. There had to be a discussion of what it was we wished to achieve in terms of an ultimate result.

In terms of the Soviet threat, the speaker continued, we had to ask whether the Russians wanted to remove the cause of our fear or the perception of it. It could be argued that the Russians knew that the perception of a threat was what held the Western Alliance together; remove that perception, and the West would fall apart. If the Soviet goal was simply to remove the perception of the threat, then the West was indeed in trouble. We had to have a definition of what we considered to be the nature of Soviet threat. We had to stop putting all our focus on the character of the current Soviet leader and start looking at the reality of 400 years of Russian expansionism. Could the "Russian Empire" live in equilibrium with its neighbors? And how did the West define equilibrium?

We also had to have a clear concept of what we meant by Europe. The Soviet idea of a Europe from the Urals to the Atlantic was absurd. If the Soviet Union was part of Europe, it was from Vladivostok to the Atlantic. There were three possible concepts of Europe: today's concept, which included both the Soviet Union and the U.S.; a Europe that included the Soviet Union but not the U.S.—a prescription for Soviet hegemony; a Europe from the Soviet-Polish frontier to the Atlantic. If the West were to base its arms control and economic concepts upon this last idea of a Europe, then that would constitute the vision of the future that we so sorely needed.

III. THE LONG-TERM ECONOMIC DESIGN OF THE E.C.: EUROPEAN SOVEREIGNTY?

Introductory Remarks I.

One finds, in discussions such as those that have taken place on developments in Eastern Europe and on military and arms control issues, frequent references to the European Community as an entity, as opposed to a more general reference to Europe as a place, and to its role in the world. Such references would probably not have been so common in similar discussions four years ago.

The metamorphosis which has taken place in the significance of the European Community has been stimulated by the event symbolized by 1992. That 1992 has become a symbol of something has obscured some of the essential issues that underpin it. 1992 is not an isolated event, but one which will take place in the context of a process that has been developing over several decades. Only in that context can 1992 be examined.

The issue of national sovereignty in relation to 1992 cannot be avoided. If national sovereignty means the untrammelled right to order one's own economic destiny, then the European Community has gradually reduced in one sense, but increased in another, the power of the member states of the Community to develop economic strategies.

In the context of discussions about Europe and where it is going, one sometimes hears the expression of European union as being a goal. That certainly reflects the evolutionary process that began in the fifties and moved gradually through the sixties with the development of independent and autonomous institutions, to a point where we had formed an entirely new structure which cannot be compared with any other regional grouping in any part of the world that has existed before or has come into existence since. The difference between what the Community is and what it aspires to be is related to the fact that it is, in its essence, supranational, rather than intergovernmental. It is not merely a matter of ongoing agreements between sovereign independent states, but it also necessarily involves the institutions of the Community playing an independent, autonomous role in developing a new type of economic space with important political implications. All the member states have agreed to this, and the essence of it is now secure, defined by basic concepts, such as the supremacy of Community law. Time-honored formulae about the sovereignty of national parliaments has now to be taken in this context.

During the 1970's, the Community went through a period of economic stagnation, which was the result of the post-Bretton Woods world, the economic upheavals of the seventies and early eighties, and the internal protectionism that it gave rise to. We are now faced with a startling change. Back in late 1984, Europe was considered to be the sick man in economic terms in the world economy. Terms like Eurosclerosis and Europessimism were in vogue. There was a certain palpable negativism about the Community. 1992 has regenerated something that was already there in substance and structure, but has now begun to develop.

What are the implications of 1992 in terms of economic sovereignty? First, by the adoption of the Single European Act in 1986 and the agreement of all of the governments of the Community that we should have, in a defined list of economic measures, majority voting, as opposed to unanimity, everyone agreed to reduce their own sovereignty. They did this by accepting that they could not stop something simply by voting against it. Second, the Community was founded, and still rests, upon the principle that a free market economy and competition stimulate and create efficiency, growth, and prosperity. 1992 has always been viewed, in Community terms, as being a liberalization of trade, both internal and external. Therefore, the debate about fortress Europe is somewhat incongruous and essentially denies the real purpose of 1992, which is merely the fulfillment of objectives

that were in the original Treaty of Rome and should have been fulfilled long before.

Thus, when one talks of the economic implications of 1992, one talks of a common external trade policy. It will no longer be possible for national governments to maintain separate rules in regard to the importation of certain types of goods. National quotas are inconsistent and will be totally outlawed in terms of the creation and maintenance of one economic space. There must be common dumping procedures, rules on local content, a similar position on liberalization of services—in short, one Community policy and one Community voice in the development of that policy. The national power to grant-aid industry through state subsidies must be subservient to overall rules. This is a real infringement of national sovereignty, but is inherent in and necessary for the development of one economic space.

Such areas as merger policies and regulation of sectors like air transport or telecommunications will also be affected.

The gradual development of the strategy of 1992 has involved not merely passing legislation necessary to remove national borders and facilitate movement between different parts of Europe, but has also involved the assertion of a certain European Community power in itself. The point is not to seek to intervene anywhere and everywhere on a Community basis, but rather to enforce the principle of subsidiarity. Policy making should—and must—only take place at a Community level when it is necessary to do so to maintain a common market. Otherwise, the matter should be left to national governments. The effectiveness of certain economic functions at the national level is reduced by market integration. This means enormous changes in the balance of administrative and political power within the European Community.

The option of an inward-looking Community does not exist. The integration of the world economy through technology and communication, supplemented by the integration of industrial society through investment across oceans, is such that the idea of a fortress Europe simply does not hold water. Apart from the fact that 20.9 percent of world trade is generated within the Community and therefore that the Community has an enormous vested interest in free trade rather than protectionism, it is entirely inconsistent with the situation which involves the degree of cross investment, for example, that arises between North America and the European Community.

Prime Minister Thatcher's statement that the European Community should not seek to regulate or divest national governments of their powers or to impose excessive regulation is correct. But the paradox of 1992 is that Community regulation is intended to deregulate by removing the national barriers which inhibit trade. The European Community is, and will be, an open trading bloc which will stimulate an open world trading area.

Introductory Remarks II.

The automobile industry is an example of what can happen in European industry after 1992. It is much more important in Europe than it is anywhere else. Europe produces 12 million cars, while the U.S. and Japan each produce eight million. There are 1.8 million workers employed in the European auto industry, and another 1.8 in the automotive component industry. The value added in industrial turnover is over 12 percent, which is half again what it is in the U.S. Research and development in the motor car industry in Europe represent 20 percent of all research and development in Europe, and is very important in terms of its fallout to other industries.

European motor cars are sold in Europe, the U.S., Japan, and the Third World. The industry has a negative balance with Japan and a positive balance with the U.S. and the rest of the world. But the positive balance with the U.S. and the rest of the world is

shrinking in favor of the Japanese. There is a ten percent import of Japanese cars into Europe, which is more or less stable, with varying quotas.

What about the future? The Japanese will not import more cars into the U.S., but will produce more cars there. They are likely to go up to two million cars by the end of the decade. At that point, they will import into Europe from the United States. The Japanese will also increase production of cars in Europe. So Europe is looking at diminishing exports to the U.S. and to the Third World and resulting negative balances.

Europe cannot afford to accept this state of affairs. It must therefore negotiate with the Japanese an interim, transition period that could last for up to seven years. In the meantime, Europe will have to negotiate voluntary quotas. The Japanese industry is only 35 years old, and when it started, it asked for quotas on cars from Europe. So the motor car industry, like the other industries in Europe, must have the objective of being able to be competitive and not protected. In the meantime, it must have some kind of transition period.

Introductory Remarks *III.*

American opinions about 1992 run the gamut from Europhoria to Europhobia. There are those in the U.S. who believe that 1992 represents a great opportunity to develop markets and expand trade. And there are those who say that 1992 will bring about the destruction of GATT. But there is an American consensus developing about 1992 as we become better informed about it and better understand the changing institutions of Europe.

There has been a rich record of trade between the U.S. and Europe since the end of World War II. Since then, Europe has had widespread support from the U.S. for the fulfillment of its dream of a Europe without frontiers. We have seen the fulfillment of that dream as a Europe united by peace and by prosperity. We have also seen that vision as an antidote to military conflict among Europeans and as a bulwark against Russian expansion.

On the other hand, the U.S. is concerned about some of the specifics of E.C. policy. For example, it is important to understand what is meant by domestic content. At what level does this become industrial policy? At what level does it become emulated by less-developed countries trying to protect their industries?

Then there is the question of Europe's Common Agricultural Policy. It is destructive to free trade, and the U.S. has replied in kind. This is costing both Europe and the U.S. We need to stop the oversubsidization of agriculture, which is a great waste. It has damaging effects on other parts of the world, like Central America. It is a subject that is important to the relationship between Europe and the U.S. and must be addressed.

We are concerned about protectionism toward Japan and what effects it may have on the U.S. At what point might Japanese cars built in the U.S. be precluded from being exported to Europe?

We worry about some of the details, such as standards. It is fine to have E.C.-wide minimum standards. But small- and medium-sized American companies that can't afford to build a plant within Europe are excluded from the standard-making bodies. The detail standards are at least partially designed to be protectionist.

As Europe brings down 12 different barriers, it is the concern of the U.S. that it does not erect one big barrier. This is not the intent or objective of Europe 1992, but there are competing interests within the U.S. that want protectionism. The Europeans and the Japanese lobbied hard in Congress during the writing of the trade bill, and we tried to be responsive to their concerns, particularly on protectionist measures. We would like to have that kind of communication to advise Europeans about our concerns.

Collectively, Europe will be the U.S.'s largest trading partner, and vice versa. If we continue to build on that relationship and encourage a free exchange of our products and goods, then we will all benefit. It is essential that Europe and the U.S. come to terms at the Uruguay Round and bring it to a successful conclusion by the end of next year.

Discussion

There was a general consensus among participants in the discussion that the political dimension of the economic unification of Europe presented the most significant challenge to its successful completion.

A speaker from Luxembourg felt that the business community had gone ahead of the politicians in the E.C. member states in adapting to 1992. What was lacking was a long-term political concept of the Community, and this created a problem in terms of political cohesion. The European Parliament did not have the full powers of national parliaments, yet the national parliaments felt they were being divested of traditional powers. This could lead to a disaffection in public opinion about the Community.

A Briton agreed that "supranational consciousness" was not yet very fully developed within the E.C. countries, and thus it was important to avoid the supranational ambitions of the E.C. institutions going too far too fast. A major difference between the E.C. Commissioners and members of national governments was that the latter had to respond more directly to public opinion. We had to decide whether to strengthen the Community's institutions or to seek more effective liaison between them and national parliaments. In order to build a supranational consciousness and gain the support of public opinion for the E.C., we had to create not just a "businessman's Europe," but a "people's Europe," with higher social standards in terms of such things as welfare and wage levels.

A Belgian participant observed that the authority of last resort, except in legal matters, in the Community was the Council of Ministers, and it was not directly responsible to anyone. This did create a political problem, and was a void that had to be filled. A Canadian wondered how European political institutions might evolve, and whether a new form of political organization might develop that could be described as "United States of Europe."

Another major challenge that the Community faced, in the opinion of a Spaniard, was the question of how the efficiency, growth, and prosperity of an economically unified Europe would be distributed among different countries and regions. Countries such as Spain, Portugal, Greece, and Ireland had not converged with the other countries of the Community in terms of per capita income levels. Indeed, the divergence in income levels in these four countries was greater in 1988 than in 1975. This could lead to a major conflict in 1992 in terms of approaches to economic growth. The richer countries in the E.C. were more prepared to sacrifice growth in order to maintain economic equilibrium; but the poorer countries needed to grow faster in order to catch up with the average of the Community. In addition, there were problems with the EMS arising from the fact that the monetary policies of the stronger countries were imposed on the weaker ones. Another problem was that the current high level of E.C. budgetary expenses on agriculture made difficult the transfer of structural funds to poorer countries. Thus, in order to achieve the upward convergence of incomes that would be necessary to successfully achieve economic integration, there would have to be budgetary adjustments and changes in the EMS.

The Common Agricultural Policy was a subject of concern to several speakers. In the opinion of a British participant, it could no longer be defended, and the Community had moved too slowly in dealing with it. It was wrong to preach free trade in the industrial sphere and not apply it to agriculture. An American observed that agriculture was a "sore point" from his country's point of view. While in many European nations,

agriculture was a "social policy," in the U.S. it was a business. A Belgian agreed that a change in agricultural policy in the Community would require a change in the social structure, and would take a long time. But it was a "complete misconception" to believe that the European Commission did not want to reform agricultural policy while national governments did.

Other trade-related concerns expressed by speakers included such things as standard-setting, anti-dumping measures, labor standards, and subsidies or other forms of protection for companies not able to compete in the post-1992 environment. An Italian felt it was a paradox of 1992 that it might stimulate an over-reaction in the form of a more aggressive attitude on the part of the E.C.'s trading partners.

It was an International speaker's view that what was happening in the E.C. was not just a matter for transatlantic discussion, but concerned the rest of the world, too. The best place to address trade policy was at the Uruguay Round, where the Community was the only trading bloc to speak with one voice. It was here that the fears of a fortress Europe should be dealt with.

A Greek speaker expressed the hope that, with respect to environmental standards, the Community would not adopt weaker measures than its trading partners in order to achieve growth.

Members of the panel concluded the discussion by addressing themselves to some of the questions and comments raised therein. The following points were made.

It was not envisaged that a European entity comparable to the U.S. be created. This would create more problems than it solved. The goal, rather, was gradually increasing integration as necessary to achieve the agreed upon goal of the single market. There was indeed a requirement for political cooperation and cohesion, particularly in formulating a response to such developments as those in Eastern Europe.

Policy making in the Community had to take place at the lowest level consistent with its proper functioning. It was not correct to say that unelected bureaucrats were making decisions. The European Commission could only propose laws, while the Council of Ministers had the power to make them. They, in turn, had to be answerable to their parliaments.

As to public opinion, while there was some negativism toward the European Parliament, there was an increasing positivism toward the goal of economic integration.

In answer to a question raised about the supremacy of Community law over national law, it was unambiguously true that Community law overrode national constitutional law.

As to labor standards, there would be decisions as to joint standards in subjects like safety and welfare, but not minimum wages. Minimum wage standards would inhibit growth prospects of poorer E.C. countries.

It was recognized that further widening of the gap between the richer and poorer countries in the Community would be a problem for the Community, and policies had been developed to deal with it.

Reforming the Common Agricultural Policy did present a major social problem. There were 13 million farmers in the Community, many of them at the subsistence level. They could not simply be wiped away. But progress was being made.

Finally, the subject of trade should be dealt with multilaterally, not bilaterally.

IV. CURRENT EVENTS: U.S. - SOVIET RELATIONS

Introductory Remarks

In the view of the American government, the overriding goal of Soviet leaders in the next decade is to arrest internal decline and modernize Soviet political and economic systems. They seek to lay the basis for the Soviet Union becoming a stronger, more competitive superpower politically, economically, and militarily in the next century. Gorbachev himself has admitted that this is his objective.

In pursuing this objective, the Soviets face formidable problems: slow economic growth, an increasingly dissatisfied public, lagging technological development, resistance to change, and looming nationality strife. The restructuring process that is now in motion will take years, if not decades, to take root. But there does exist a widespread consensus that a return to the policies of the past is out of the question.

The U.S. sees Soviet foreign policy objectives flowing from these internal imperatives. Gorbachev is clearly impatient for progress and sees international stability as a *sine qua non* for domestic reform. It is not possible to say with certainty the extent to which the new Soviet attitude is either genuine or lasting. But, since the impetus for reform is likely to last into the next decade, if what we are looking at is tactical now, it is possible that if it is pursued for a period of time, it could become fundamental change.

The basic conclusion of what all this means for the West is not surprising. There are many new opportunities that could not be imagined a decade ago for achieving long-standing Western objectives in the security, political, and economic fields. It is in our interests to try to encourage the kind of systemic changes that will help to ensure the durability of reform. Given the length of the road that is still to be travelled by the Soviets, we must also be prudent. The Soviet Union is opening, but is not open. Some good things are happening, but we don't know what the final result will be.

Meanwhile, Soviet military forces remain formidable and continue to modernize. They will be a threat to Western security for years to come. As a result, as we navigate this period of possible transition to a more cooperative relationship, one of the most difficult tasks is going to be to balance realism with forward-looking policies that seek to exploit real opportunities for change.

The U.S. has three broad sets of objectives *vis a vis* the Soviet Union over the next ten years. They reflect the new opportunity that is apparent to reintegrate the Soviet Union into the world system. The basic thrust of the objectives is to encourage the institutionalization of favorable military, political, and economic change so as to build a more lasting and predictable relationship in the future.

The first set of objectives come under the category of strategic/military. The objective there is to maintain strong, modern defenses, strengthen deterrence, and enhance the security of the U.S., and its allies and friends. In this category is the search for ways to encourage the transformation into reality of all of this Soviet rhetoric we hear about restructuring the Soviet military toward lower force levels and a truly defensive posture. Arms control is one of the ways to accomplish that.

The second category is political/diplomatic. There, the objective is to encourage further Soviet retrenchment in the Third World and greater autonomy in Eastern Europe. We would challenge Moscow to subordinate its client relationships to the goal of finding peaceful resolution to regional conflicts and, over the longer term, to removing the competitive East-West dynamic. We would like to take advantage of opportunities that arise as the Soviet Union becomes more interested in being a player globally, and to expand cooperation in dealing with global issues such as terrorism and the environment.

Finally, perhaps the greatest challenge is in the area of democratization—genuine reform within the Soviet Union. The starting point has to be an understanding that our

ability to influence Soviet internal developments rests largely in the difficult area of ideas and in mechanisms like the CSCE process. Over the long term it is in the West's interest to encourage the Soviets to reach their own conclusions and to build a society that increasingly talks of its values and priorities in terms of the quality of life of its people rather than in terms of expansion abroad, or the power of the Soviet leadership and Communist Party. Over the longer term, many of the things that are in this category—economic, social, cultural contacts—are private, and not governmental. But governments can encourage this.

Looking at these sets of goals, the Administration has confirmed a five-part agenda: human rights, arms control, regional issues, bilateral issues, and global issues. The purpose of Secretary Baker's recent trip to Moscow was to share with the Soviets this broad set of conclusions from the American policy review, to re-engage with the Soviets in all of these five parts of the agenda in various forums, and to begin work again in the various negotiations in which there had been a pause for several months.

Dates for the resumption of all the arms control negotiations and related talks have been set, and dates will be set for bilateral consultations on the edges of the Geneva conference on disarmament dealing with chemical weapons. Substantive negotiations on conventional arms have begun again in Vienna. We are looking to find forums for consultation with respect to missile and chemical weapon proliferation in the world beyond our own bilateral relationship. In the regional area, we have agreed to reinstitute all of the experts' meetings, and much time was spent discussing central America and the Middle East.

The human rights part of the agenda is being followed and progress is being made. We are finding that the Soviet Union is searching for Western experience in the area of developing democratic institutions.

The bilateral category includes active cultural exchange and such lesser but real topics as making television available to the staffs of the embassies in the two capitals. This is the kind of thing that can cause problems.

On global issues, it will take time to decide where the appropriate areas of cooperation lie, but a start has been made.

During his meeting with Secretary Baker's delegation, Gorbachev made the following remarks about perestroika. Perestroika is no longer a policy, but a reality. In a large and complex country like the Soviet Union, the results are not immediate, particularly in a period of revolutionary change. But perestroika will succeed. In terms of the economy, of political developments, in the intellectual sphere, in the nationalities question, and even in the party, it has turned out that the process has been more difficult than was first thought. But a process is underway that will change the Soviet Union in a very profound fashion. The Soviet Union has set out to radically reform its economy by changing the role of the individual in economic affairs. This main purpose of perestroika affects both the role of the individual and the forms of socialist ownership. The problem is not just the bureaucrats, it is the impact of 70 years of egalitarianism in the economy and its effect on people. It is not easy to change how people approach work. One has to break up the old managerial attitudes and defeat the old administrative system. To do this, it has been necessary to move to political reform. In this area, there have been some startling changes. The recent elections were a lesson for everyone. It is now necessary to form the kind of Supreme Soviet and the kind of government that can shoulder new responsibilities.

Gorbachev said mistakes had been made in past years, but no one could be expected to carry out this kind of profound change without making mistakes. He seemed concerned that people were always comparing progress in the Soviet Union with progress in China. He said that China may have had some success in the beginning of its reform but was currently stumbling because there had not been enough technological progress.

The Soviet Union is trying to learn from this and move forward with not only new forms of management and ownership, but, efforts to keep up with technologies.

Gorbachev spoke of the switch from the military sector to the consumer sector, and seemed amazed to learn that the Soviet space program is producing technologies, ideas, and materials which are suitable for the consumer sector. He said the Soviet Union was trying to break down the barriers between the military and consumer sides of its economy in order to apply some of these technologies to the consumer side.

He said there was much debate about the tactics of perestroika. Many people wanted an overnight fix. He said of the great Soviet breakthroughs of the 1930s and the Chinese "Great Leap Forward" of the 1960s that these were really leaps backwards. He said that extremes had to be avoided. He sees the need to stay the course. His major challenge is dealing with the contradictions between the great expectations of perestroika and the real results.

In the area of pricing and, convertibility of the ruble as indications of a real commitment to economic reform, Gorbachev said he believed the people would not have let perestroika continue if the leadership had moved into the area of price reform immediately because one could not pursue for very long policies that take money out of peoples' pockets.

With respect to arms control, Gorbachev has said the Soviet Union has decided to unilaterally withdraw 500 warheads from tactical nuclear systems from the territory of its allies in Eastern Europe. Of these, 284 will be from tactical missiles, 166 from aircraft bombs, and 50 from artillery weapons. This program resembles more NATO's periodic restructuring of its warhead supply than the removal of missiles.

The next proposal that is likely to emerge will be for the removal, between 1989 and 1991, of all tactical nuclear weapons, including dual-capable systems, back to national territory. Thus, a zero on all short-range weapons will be proposed.

On the conventional side, the Warsaw Pact will table a new proposal in Vienna very soon. It calls for the Warsaw Pact and NATO to reduce the numbers of their armed forces and armaments in Europe by 1996-1997 to the following equal, residual levels: 1.35 million men, 1,700 combat helicopters, 20,000 tanks, 24,000 artillery weapons, 28,000 infantry fighting vehicles, and 1,500 "frontal" aircraft. The Soviets will likely propose that each military alliance reduce its armed forces by more than one million men; that NATO reduce its combat aircraft and helicopters by 2500 each while the Warsaw Pact reduces such systems by smaller amounts; that the Warsaw Pact reduce tanks by 40,000, artillery by 46,000, and infantry fighting vehicles by 42,000, while NATO reduces such systems by lesser amounts. All of these things are under study.

The U.S. has noticed that the Warsaw Pact figures on tanks, artillery, and infantry fighting vehicles are very similar to the numbers tabled by the West in March in Vienna. It appears we are about to have a very serious negotiation in this area.

Discussion

An Austrian speaker began the discussion with the observation that the developments in the Soviet Union signified a "totally new East-West relationship." It was up to the West to promote change in the Soviet Union by economic, political, and cultural means. We had to determine what mechanisms, frameworks, and institutions we could use to reintegrate the Soviet Union into the global system. And we had to decide whether to base our hopes on one man—Gorbachev—or to identify other agents of change in Soviet society.

But, warned an American, we should be careful not to overestimate our potential influence upon events in the Soviet Union. Western influence could only be marginal. It

was beyond our capability to be the deciding factor in the transformation of the Soviet Union. We could render technical assistance in some fundamental areas, such as helping the Soviets create a national income accounting system, which they lacked. But we should be careful about jumping in and saying we had all the answers. The danger was that we might find ourselves associated with policies of reform and austerity that could lead to domestic turmoil.

This warning was endorsed by a Frenchman, who felt that there could well be serious upheavals and disorders in the Soviet Union in the next few years. The economy was in total disarray, far worse than Gorbachev admitted. Soviet leaders were discovering the problem of inflation and were frightened by the social consequences of price liberalization. They seemed not to know where they were going.

Another American agreed that the Soviet economy was in serious trouble. We should be cautious about believing Gorbachev could succeed; it was doubtful that his country would ever catch up with the West. A more realistic prospect was the "Ottomanization" of the Soviet Union—a slow, regulated, fairly peaceful decline. The best course for the West to follow was to do nothing that would cause Gorbachev any more difficulties than necessary.

As for the goal of reintegrating the Soviet Union into the global system, a Briton wondered when it had ever been integrated in the first place, except perhaps in the period 1941-1945. An American responded that U.S. policy makers had purposely chosen to use the concept of reintegration in deference to the wartime relationship between the two nations.

The Soviet Union, said an International speaker, was showing very clear signs of wanting to become part of the multilateral economic system. It had indicated its desire to join GATT, and it appeared to be laying the groundwork for membership in the IMF and World Bank. An American speaker advised that any such steps toward including the Soviets in the multilateral system be careful and tentative.

A Briton suggested that we should ask ourselves which Soviet Union we wanted to reintegrate into the global system. We had to address the question of the nationalities. The problems of the Soviet internal and external empires could not be separated from each other. An American disagreed with this, saying that the internal empire involved more than the forces of sovereignty and nationalism. There were issues of language, religion, and borders at work also.

The limits of perestroika might lie in the issue of the internal and external empire, said a Spaniard. The Soviet Union could not tolerate any change in its security scheme. An American agreed, saying that the Soviet Union would be "more relaxed" if it was not worried about its security interests. For the West to challenge these interests would be "the height of folly."

A British participant cautioned that, when speaking of the irreversibility of change in the Soviet Union, we should be clear about the distinction between irreversibility in domestic political and economic change versus change in foreign policy. Foreign policy was much more easily reversed—an important point to get across to our publics.

In this context, an American said that we had to keep in mind that the drastic nature of Soviet economic reforms did not have to be paralleled by equally drastic change in its long-term strategy. Gorbachev might well be using foreign policy as a counterweight to balance progress in the international area against the domestic difficulties of economic restructuring.

A French participant suggested that the degree to which there was "new thinking" in Soviet foreign policy could be tested in terms of Soviet behavior toward out-of-area conflicts such as those in the Middle East. This notion was rejected by an American on the grounds that it implied we in the West necessarily had the answers.

Several speakers supported the concept of linkage in the West's dealings with the Soviet Union. Economic assistance, for example, could be linked to progress in the

military area. There was a difference of opinion between two American speakers over whether this was appropriate. One argued that linkage never worked because the U.S. was not prepared to sustain it, particularly on the economic side of the equation. While the elements of the Soviet-American relationship were interrelated, the basic issues had to be addressed separately.

The other American felt that it was dangerous to segment all negotiations into "sets of technical negotiations conducted by experts." He worried that there would be a return to the "traditional agenda" of separate negotiations on such issues as conventional arms, chemical weapons, testing, and regional conflicts. Each negotiation would become an end in itself. It would be a pity if the opportunity we now had was "swamped by endless technical discussion." We needed some unifying sense of what kind of world order we were trying to achieve.

A number of speakers wondered what effect Gorbachev's recent conventional arms control proposals might have on the issue of SNF modernization. It seemed to a British participant that, if the rationale for modernization was the conventional imbalance, and that imbalance disappeared, then the rationale for modernization was undermined. An American responded that, if a mixture of conventional and nuclear forces was deemed to be necessary for the defense of the Alliance for the foreseeable future, then these systems, no matter their number, had to be up-to-date. Thus the new Soviet proposals did not alter the need to modernize SNF.

An International speaker added that, apart from Soviet conventional superiority, nuclear weapons were based in Europe to deter war. This was NATO's strategy. This prompted an American to question the effectiveness of deterrence based upon weapons that the West "constantly proclaimed it could not use." There was a danger that any agreement we reached with the Soviets, even if perfectly balanced, could produce a form of unilateral Western disarmament.

One aspect of what was happening in the Soviet Union that particularly worried a British speaker was that the West "was losing the propaganda battle." The Alliance was in danger of losing the support of its publics. The perception of most people was that the West made general proposals while the Soviets made specific ones. It was imperative for the NATO heads of government to address the need to coordinate information policies.

V. GREATER POLITICAL AND MONETARY UNION OF EUROPE: EUROPEAN SOVEREIGNTY?

Introductory Remarks

I.

The Delors Committee took on the responsibility of studying and proposing concrete steps toward the objective of a progressive realization of monetary union of the member states of the E.C. Such a union is desirable because it will enable us to take advantage of all the potential of the single market, to deal with uncertainties of rates of exchange, and to reduce costs. The Delors Committee did not set out to do an academic study but to respond to the very precise terms of reference of the Council of Ministers.

The definition of monetary union chosen by the committee was the definition of the Werner Report of 1970, which said that monetary union was characterized by the total convertibility of the currencies, by free movement of capital, and by certain exchange rates that are irreversibly fixed.

At the time the Delors Committee was created, the British government seemed to think that, in order to liberalize the movement of capital, it was better to have flexible exchange rates. But Great Britain seems now to accept that semi-fixed exchange rates will be convenient in due course.

Monetary union implies that the inflation levels in the various countries must be practically the same, or the fixed rate of exchange cannot be maintained. With similar levels of inflation and free movement of capital, interest rates will also be the same. The public deficit must have some limits, and taxation on capital income must probably be the same in all countries.

Regarding the economic union, which is more difficult to define, the Delors Report synthesizes this in the total freedom of movement of goods, services, workers, and capital. There must also be a certain level of transfer from rich countries to poor countries in order to make up for the fact that exchange rates cannot be used to adjust the economies of the poorer countries. And there must be a coordination of economic policies, most of all budgetary policies.

The report does not go into the reasons that all the constraints of this union are accepted, but, the evolution of the thinking in the last few years is such that we reject inflationary growth models. We have seen it is possible to grow with relatively low inflation rates. Therefore, monetary policy must be aimed at combatting inflation, and not, as we believed in the 50s and 60s, at stimulating growth through very low interest rates.

Variations in exchange rates have proved to be less useful than was thought a decade ago, and they have very obvious inconveniences. Exchange rate variations are inefficient and they serve only to reduce speculation against a given currency. But this can be achieved as well with a disciplined system of rates of exchange without having to resort to other procedures. Devaluation can help buy time while other adjustments are made, but the effect of devaluation lasts only a short time. Many think the single market cannot be achieved without eliminating the possibility of competitive devaluations. This would destroy the rules of the single market.

The Delors Committee delineated three stages of development. The first is a better coordination and a convergence of the economic policies within the existing institutions. During this stage, all the countries are to observe the discipline of the exchange mechanism of the European Monetary System. This means all countries would submit to the predominance of the Bundesbank for a period of time until a broader institution may collectivize the decisions in monetary policy. In this first stage, the committee advises that a new treaty be prepared and negotiated to enable all the member

governments to give up their sovereignty in the field of monetary policy, which the existing legislation does not do. The report also talks about the eventual creation of a European monetary fund.

The second stage starts when the new treaty enters into force and a European system of central banks is created according to the model of the U.S. system. This would dictate the limits of budgetary deficits and their financing. But the responsibility would lie with the national authorities.

The third stage would start when the exchange rates are irreversibly fixed and the ECU is adopted as the single currency in place of the national currencies. While there are national currencies there will always be doubts about the irreversibility and the fixation of parities. In this stage, there is no autonomy in monetary policies. The objectives will be set by the European system of central banks, which will also set the maximum deficits and how they can be financed. The national central banks will only be branches of a supranational system which will have a pool of foreign reserves.

The report only set one date—that the first stage should start before July 1990, when the complete liberalization in capital movement is due to start in France, Italy, and several other E.C. countries. The report says it is necessary to go from one to the other, but it does not specify when or define the conditions to go from one to the other. The report does not give any role to the ECU until the final stage. But the report says that to embark on the first stage must be a commitment to go through all three stages.

The findings of the report have been accepted by all of the governments, except the British. Even the countries of southern Europe, which have a harder time observing the disciplines prescribed, have been enthusiastic. On the other hand, the northern countries fear that their monetary orthodoxy will be destroyed.

The transfer of sovereignty is an important issue and has been met with some resistance by the United Kingdom. But the fears of loss of sovereignty are greatly exaggerated. This is in part due to the report, which overemphasized the creation of limitations for national budgets. It is not necessary to insist on this, because it will come about anyway. If the ideas put forward are accepted, monetary sovereignty is not very important any more, and the function of monetary policy is to avoid inflation and not to stimulate growth. It is less serious to submit monetary policy to a collective decision than to give up other types of sovereignty. Monetary sovereignty is already very much reduced and will be even more in 1990 with the free movement of capital. The Bundesbank is the only bank with monetary sovereignty in Europe, and it is better to share it with others in a more collective system of decision making.

Finally, it is not likely that the socialism the British government worries about is going to occur through the Brussels commission. The Commission applies the principle of subsidiarity to reduce to a minimum the regulations. This should liberalize our economies, not create more interventionism. If the British rejection cripples the progress toward monetary union it will be very serious. Great Britain's remaining on the margin will deprive Europe of many benefits, not the least London as a financial center.

Introductory Remarks

II.

When governments talk about the loss of sovereignty implied by European monetary arrangements, they are talking about three sorts of freedom: to set monetary policy, to set their exchange rate, and to set their own fiscal policies.

Regarding monetary policy, if you look at the eight countries that are full members of the EMS and at their latest 12-month inflation figures, you see that they range from about one percent in the Netherlands to the average of just over three percent up to the high of just over six percent in the Italian case. In those countries that are not full

participants in the EMS, the lowest (Spain) starts at about six percent, with the U.K. at eight percent, Portugal at 12 percent, and Greece at 15 percent. This seems to indicate a conclusion that a country that has access to the printing press cannot be trusted with it.

What about the freedom of setting interest rates? What is this freedom intended to be for? Historically, it has been to bring a country's domestic costs into line with those of its trading partners. The essence of a devaluation is that it should cut domestic costs, and, if it doesn't, it will have only created higher inflation. The delusion that somehow the exchange rate can be used as a painless way to cut costs, and particularly to cut wages, can surely not be in doubt today. The most extreme case of countries trying to use exchange rate devaluation in order to bring costs into line with other countries is that of the Latin American countries, with their hyperinflation.

In the case of fiscal policy, the Delors Report argues that monetary integration has to go hand-in-hand with fiscal integration. This is analytically wrong and ignores important historical evidence. Take the example of the gold standard when exchange rates really were fixed against each other, between 1870 and 1913. The inflation rates in all the countries participating in the gold standard were almost identical. There was no talk then that they were losing their rights to set their own fiscal policy. There was no worry that they could not set their own tax rates, the scale of government borrowing, or repayment of national debt. Above all, none of them complained that this was going to force them into some sort of political union where some centralized body was going to be setting things they regarded as most dear to their national sovereignty. On the contrary, during most of this period, there was a great deal of national political independence.

A more recent, European example, is the entirely fixed exchange rate that existed between Ireland and Britain for more than 50 years after Irish independence. One might think the Irish would have been very conscious of any loss of fiscal sovereignty as the result of that direct link with the British pound; but they never complained.

The British government is wrong in refusing to put sterling into the EMS now and in portraying the prospect of a fully fixed exchange rate of a monetary union as somehow being a dagger at the heart of political and national sovereignty. But the Delors approach, too, is wrong in some ways, including the tactics. It was wrong, knowing the position of the British government, to insist that any government that signed on for the first stage of the three stages of the report, had to accept the final stage at the outset. It was also an error to argue that fiscal integration is a necessary accompaniment to monetary integration. And it was an analytical mistake to assume that the ECU could only emerge as an important component at the end of the process. It would have been better to say the ECU could start to develop if and when ordinary people want it to. Gradually, a parallel currency in Europe could be developed that would prove itself on its convenience and its relative stability compared to national currencies. It would seem the most natural thing in the world to say that a European currency had evolved by choice. If we proceeded from that starting point, we would have a far better choice of getting to the end without any of the political friction that is now going to be involved in this process.

Discussion

The discussion of this topic began with a British speaker's explanation of his country's position on economic and monetary union and on the recommendations of the Delors Report.

The United Kingdom had, for some time, been acting as a surrogate member of the EMS, tracking the Deutsche mark, staying in an "imaginary band." Many in Britain believed that it was this that gave rise to the current burst in inflation, and that full membership in the EMS would not have prevented it.

By proposing to create a central economic policy-making body with the power to

impose its will, the Delors proposals embodied a "huge transfer of sovereignty" that the U.K. found unacceptable. Taking control of a nation's monetary and fiscal policy and putting a central bank in charge of its currency did imply a substantial loss of sovereignty and amounted to a "quantum leap," bigger than anything suggested in the E.C. so far.

Britain was not opposed to change, and had in fact been leading the way in Europe in removing barriers and restrictions and opening all markets. Britain totally supported the single market concept. But the British government objected to monetary union in that it went against the way Europe ought to be moving in the sense that it involved more centralization of power. Furthermore, there was no democratic machinery to which those in control would be responsible, and nothing to suggest that the Community had the machinery to undertake such a large task. The logic behind the Delors proposals was an unacceptable move toward the kind of interventionism that Britain had been trying to get rid of. The focus in working to achieve the single market should instead be concentrated on the major task of removing barriers.

Several participants felt that the recommendations of the Delors Report were too ambitious. An American opined that fiscal policy was "very much a domestic area of responsibility." He questioned the necessity of accepting all the stages of the Delors plan before taking the first step. That step, he said, ought to be the creation of a central bank of European central banks, modeled after the Federal Reserve System in the U.S. The Federal Reserve had managed to do a good job in the U.S. without the requirement of fiscal coordination.

Another American agreed with this approach, calling for the creation of a bank of issue of the ECU. This would get the process going and would lead to semi-fixed, if not fixed, exchange rates. It would be a force for the convergence of fiscal and tax policies within the Community. The preordaining of subsequent steps was wrong, and could delay the realization of this first step. A speaker from the Netherlands agreed, and warned that, although it made sense, the requirement that all three stages of the process be pre-accepted was "politically dangerous."

A number of speakers expressed concern about the powers of the Brussels bureaucracy that would oversee economic and monetary union. Said a Dutchman, it must not be an over-regulated, interventionist type of system.

This speaker voiced another problem with the report—the "overemphasis" on the southern countries and Ireland, which was, he felt, a "kind of bribe." Why should the other countries provide to these countries, for the second time, a transfer of resources? They had already "paid" by doubling structural funds. There was no case why an additional transfer of monies to the "so-called weaker countries" was an essential element of European monetary union.

An American raised two concerns about the report, one about the role of the Bundesbank and the other about labor mobility. He wondered what convinced the other countries of the E.C. that the Bundesbank would have the capacity to take into account their interests. Given the record of the Bundesbank, might not its interests and those of the rest of Europe diverge? As for the question of labor mobility, the speaker felt that the problem of unemployment had become increasingly difficult for Europe. Increases in subsidies would increase the labor problem, and economic prospects were not going to be enhanced without a major effort on labor mobility.

A speaker from Switzerland worried about the assumption that monetary union would be achieved in stages "by doing what has been done in past years." He observed that what had been done so far had not been terribly difficult because it had occurred during a period of "unexpectedly high economic activity." If there was a recession, things would be much more difficult, and a very clear decision to give up monetary sovereignty would be necessary.

To many speakers, the issue of loss of sovereignty in monetary and fiscal affairs

was greatly overblown. A Dutchman said that the fiscal policy aspect of the Delors report did imply a loss of sovereignty, but, in practice, there was not really much sovereignty left. A countryman agreed that it was better to lose sovereignty to international cooperation than to the "straightjacket" of locked exchange rates, which would "do irreparable damage to monetary union." A Spanish participant felt that we should be talking about shared sovereignty. Historically, sovereignty was defined by a nation's capacity for self-defense. Today, no European nation worried about shared sovereignty in this regard, and the same should be true with respect to economic sovereignty.

A Belgian pointed out that the Single European Act listed economic and monetary union as a basic policy to be followed to achieve European union. There was, therefore, a legal basis for it. Moreover, a commitment had been made not only to bring about economic and monetary union but to charge a committee with making recommendations on how to achieve it. The resulting Delors Report provided an excellent guide for action, with clear objectives. Member states had to undertake an act of political will to achieve economic and monetary union. Already, many important decisions were being made at the Community level, and autonomous decision-making was being eroded. This should not be lamented, but rather should be considered a recovery, or strengthening, of sovereignty at a different level.

On the specific subject of fiscal policy, a Dutch speaker argued that fiscal harmonization was a crucial component of monetary union, which would be impossible without it. An Italian agreed, and pointed out that giving up fiscal autonomy applied also to hidden taxation through financial regulation. This sort of "non-explicit taxation" which did not require parliamentary approval and was used by some E.C. countries as a way of making transfers to the government, would be harder under economic and monetary union. In addition, with the removal of capital controls, governments would no longer be able to finance themselves at interest rates kept artificially low in domestic markets. And with the liberalization of financial services, it would become impossible for certain countries to require banks to have much higher reserve requirements.

It was very positive to force governments to give up these highly distortionary forms of "taxation without representation," even though, as a result, there might be higher budget deficits, particularly in the countries of southern Europe, which would face a demanding exercise in fiscal discipline.

The subject of the British government's position on economic and monetary union was of particular concern to many participants in the discussion. A speaker from the U.K., while agreeing with his countryman's earlier remarks about the Thatcher government's steps toward opening markets and lowering barriers, worried nonetheless about Britain's "low reputation as a European." Mrs. Thatcher, he continued, still had the potential to be the great leader in Europe, but she was "throwing away that chance on the language, not the practice, of parochialism." She was "boxing the U.K. inside a wall of noncooperation from her partners on E.C. issues." Rather than dispersing the socialist tendency she complained of in Europe, she was in danger of entrenching it. And she was interpreting the E.C. to the U.S. as a "misguided socialist club." She was also allowing other countries that were skeptical about the Delors Report to "hide behind her skirts." Finally, she was destroying her own ability to influence West Germany in terms of the future of the E.C.

A Dutch speaker warned that a "showdown" over the problem of sovereignty must be avoided at any price. If, for example, the French were to put the British to a test on the subject of Sterling in the ECU basket, this could lead to British withdrawal. What Denmark's position might be was also problematical. This raised the question of "Europe at two speeds," something that should be avoided, but not at all costs. We had to be prepared to move ahead with the faster group. A Spaniard, who felt that the U.K. was vital "for the construction of Europe," rejected this idea of two speeds.

A British and a Spanish speaker responded to some of the points and questions that had been raised in the course of the discussion. The British speaker defended the role of the Bundesbank in the process of economic and monetary union, saying that it was able to deliver low inflation and low interest rates. As to subsidies, it was not correct to suggest they were being increased in Europe; rather, one of the purposes of 1992 was to reduce them. And while it was true that international cooperation was preferable to a gold standard, political control of monetary policy built an inflationary bias into the whole system.

The Spanish speaker remarked that, in his opinion, the emphasis of the Delors Report on constraints on fiscal policy was a mistake. It was in the report because the governors of the central banks wanted to impose limits on deficits, but their concern was exaggerated. Regarding the requirement that countries sign on to all three stages before undertaking the first stage, this arose as a way of dealing with the risk that countries might remain at the first stage permanently. As to the subject of fixed exchange rates, this must indeed be done very carefully, and it was envisaged that the second stage, in which exchange rates were not irreversibly fixed, would last quite a long time. Responding to the concern expressed about the transfer of resources to the weaker countries, the speaker said that this was not intended to be a subsidy, but rather was aimed at infrastructure improvements and other state-administered functions.

Finally, the Spanish speaker emphasized that the criticism that had been made in some quarters that the report bore the stamp of the personal opinion of Delors was not valid. The conclusions of the report had unanimous support of all the committee members, and, indeed, Delors took great pains to steer a neutral course and not to influence the results. A Briton added here that the tendency of some to depict Delors as "a fanatical idealogue" were quite unjustified.

VI. GLOBAL RELATIONSHIPS: SURPLUSES, DEFICITS AND PROTECTIONISM

Introductory Remarks

I.

In spite of its persistence, the U.S. fiscal deficit is half the size it was just a few years ago as a percent of the total economy. It is still a problem, but it is about in the middle with respect to the deficits of other major industrial countries. Unfortunately, the U.S. savings performance is at the lower end of the spectrum, and that is one reason why this deficit is such a problem for the U.S. economy and the world economy.

The American body politic is struggling to come to grips with this deficit. The recent bipartisan budget agreement, while not a final solution to the problem, is an important step forward as a sign of the new administration's ability to work with Congress and agree on a framework that should provide for significant further reduction of the deficit during the next fiscal year. But another round of budget negotiations will have to occur before long, and these may well be more difficult. It is true that there is a good deal more that can be cut from the spending side of the U.S. budget.

The other U.S. deficit, the trade deficit, is, in part, a function of the fiscal deficit. It is somewhat more frightening because it seems that the country, having now understood the gravity of the fiscal deficit, is more complacent about the potential threat posed by the trade deficit. The inexorable accumulation of liabilities to the rest of the world—living off the rest of the world's savings, in effect—could have a major affect on the global balance of power in the next decade.

The global imbalances we face today, which consist significantly of a U.S. trade and current-account deficit and major German and Japanese surpluses along with growing surpluses in some of the Asian economies, represent a complex set of factors that underscore the interdependence of the global community. The factors which led to the U.S. trade deficit include the strong U.S. growth in the early 1980s, the attractiveness of investment in the U.S. which contributed to a rise in the dollar, the structural rigidities in Europe which reduced demand for European currencies, and the international debt problem, which had a major negative affect on the exports of the U.S. and other major industrial countries.

Such a complex set of factors could only be usefully addressed within a broad framework, and, in 1985, such an effort was initiated, calling for both the surplus and deficit countries to tackle their domestic problems. This signalled a recognition that the interdependence of our global economic relationships required us all to formulate national policies within a more closely constructed set of international relationships. The blessing of this process at the economic summit in Tokyo in early 1986 was an important element of political support that has carried the process forward. Substantial progress has been made, but there are signs today that it is losing some steam. Reports of continuing growth in German surpluses and some stagnation in the American trade position are matters of concern and should cause a reinforcement of efforts by the leading countries.

The Brady Initiative is also an important part of the effort to reduce global imbalances. The debt problem is an economic problem for all of us. Secretary Brady's initial statement was one of concepts and not of details because of the international dimension of the problem. It is not up to the United States to lay out the details and to specify every part of a solution to the problem in which American banks only hold 30 percent of the claims. In spite of the dominant political interest the U.S. has in the solution of this problem, it is not within its capacity to solve it alone. Intense international collaboration is needed. The IMF and the World Bank are moving quickly to put into place the necessary measures, and individual negotiations are underway between the

banking community and the debtor countries. These will not be easy negotiations, because, when the U.S. Treasury speaks of debt reduction, the commercial banks see a loss of capital. When the Treasury speaks of debt service reduction, the banks see a loss of quarterly earnings. A great deal of skill and considerable luck will be needed for a successful effort. But the problem is urgent and must be tackled quickly, particularly with respect to Latin America.

Introductory Remarks

II.

Deficits or surpluses in the current account, or in the overall account of balance of payments, are no reason for concern as such. But they become dangerous if they are unsustainable. Looking at the balance of payments patterns in the world, there is reason for concern. There are prolonged imbalances, especially among the U.S., Japan, and West Germany, that require action.

There are basically three causes of external imbalances. First, there are the imbalances in the overall national relationship between savings and investment. Excessively large public sector deficits frequently play a role in external imbalances. But, in some countries, a large budget deficit may be offset by substantial private savings. This is the case in the Netherlands.

Another cause is lack of competitiveness, to which wage increases are a major contributor.

Thirdly, rigidities in economic structures—improper functioning of markets—are a cause.

These unsustainable current account deficits should be reduced because they lead to exchange rate instability, inflationary pressures, and, ultimately, unsustainable external debt positions. They also feed protectionist measures, especially where there is unemployment at the same time.

International imbalances should be reduced by eliminating their causes. In most cases, this requires correction of domestic policy deficiencies rather than using protectionist measures. In the case of the U.S., there is a budget deficit which implies too large domestic demand and insufficient private savings. In the U.K., the causes are too large money growth, lack of clarity in monetary policy with confusing impacts on exchange rates and interest rates, leading ultimately to rising inflation. Italy is a classic case of excessive budget deficits. The Federal Republic of Germany, according to the IMF, is a case of structural policies, of rigidities and disincentives affecting many areas of the economy.

Beyond correcting domestic policy deficiencies, it is necessary to improve consistency and predictability of policies and international policy coordination. This must be done on the basis of preparedness to adjust national policies within the framework of the existing multilateral international financial organizations. For example, the surveillance task of the IMF is important. It uses a number of macroeconomic indicators to promote international convergence of policies.

There is a danger that the existing multilateral institutions are weakening as the result of the growing importance of small groups of large industrial countries, such as the Group of Five, or the Group of Seven. The multilateral organizations play virtually no role in these groups, and this is a matter of concern. Ultimately, it is in the self-interest of the U.S. to continue to support these multilateral financial institutions. The G-5 and the G-7 are not bad as such. They function successfully by coordinating exchange rate and interest rate policies among their member countries. But they should not try to become the main forums worldwide for negotiations about the world monetary system. The policies of the G-5 and G-7 have a major impact upon other countries, industrial and

developing alike, which have no influence in these groups.

International inter-relationships in the areas of exchange rates, balance of payments, interest rates, and macroeconomic policies are nowadays not based on a global system. There is cooperation, but no longer a system, since the collapse of Bretton Woods. Most of the international inter-relationships are rather loose, and not binding. The IMF no longer controls the international monetary system, nor does it control exchange rates. It has largely become a credit institution for LDCs only. It would be good if some industrial countries with persistent balance of payments disequilibria would apply, as was the case in the past, for IMF standby credit arrangements.

On the European regional scale, the situation is not so bad. The Common Market and European Monetary System have been largely successful and provide for a higher degree of exchange rate stability than exist worldwide.

But the prospects for exchange rate stability globally are not so bright. This is because, first, there is a tension between a growing volume of international transactions and consequent growing interdependence among countries on one hand, and, on the other, insufficient willingness to give priority to international external economic policy objectives as opposed to domestic economic policy objectives. This leads unavoidably to insufficient coordination and convergence of national economic policies.

The second underlying reason is that the U.S.—and hence the dollar—is no longer able to play the central role in the international monetary world. This is due to three factors: (1) the growing role of others—Japan, Europe, the newly industrialized countries; (2) the weakened position of the U.S. because of its twin deficits; and (3) the fact that American economic policies are still mainly determined by domestic considerations rather than by external considerations.

Regarding the international debt issue, it is important to recognize that a number of highly indebted middle-income countries have very large interest burdens. The U.S. would contribute more to the third-world debt problem by correcting its budget deficits and thereby allowing the dollar interest rates to fall. This would be more productive than the Brady Initiative.

Introductory Remarks *III.*

No trade or finance minister has ever said he, or she, is either in favor of protectionism, or practices it. However, all of them have complained about the protectionism of their colleagues. One must conclude that there is no agreed upon definition of what protectionism is.

The Uruguay Round of trade negotiations, now back on track, is leading governments and economic operators to reconsider their traditional and classical approach to trade policy and to consider a number of substantial changes.

Developed countries in GATT have been successful in bringing down the level of their tariffs. They have fallen, on average, from 15 percent in 1962 to five percent in 1987 for manufactured products. The target of the present round is to reduce present levels by a further 30 percent. These reductions have been accompanied by significant simplification or elimination of all sorts of formalities at the border. As a result of such policies, as well as through the harmonization of standards and norms, trade in goods has grown to the point that it now contributes an average of 20 percent to the GNP of GATT members, compared to 14 percent as recently as 1970. This percentage would be substantially higher if trade in services, which is one of the main areas of negotiation in the present round, were included.

Some significant conclusions must be drawn from these developments. First, external trade in goods and services is no longer a relatively marginal part of the economic

activity of national economies. This is true for all countries across the board. In other words, the notions of interdependence and globalization of the world economy are now part of the real world. Trade policies now must focus increasingly on the conditions of competition. A series of practices and policies which have always existed require very serious attention if the full benefits of the market-opening process of the last few decades are to be realized.

A review of some of the things being considered at the Uruguay Round will indicate what some of these practices are. The Uruguay Round is looking at production subsidies, not just export subsidies; at price supports, not just for export goods, but for domestic goods competing with imported goods; at state trading; at local content; at trade-related investment; at norms and standards; at different forms of safeguard clauses. In other words, it is looking into all the elements that relate to public policies and have an impact on competition. This means that trade policy is no more just an activity of customs administration. It has turned into one of the major elements of any national economic policy.

Trade in services is also a very important area. Protectionism in the field of services—banking, insurance, etc.—is not implemented through tariffs or quotas, but through the national legislations in these areas which often have a very protectionist element. Here again, trade policy will go into areas that were considered areas of national sovereignty.

Negotiations in the Uruguay Round are of course influenced by the serious imbalances among the major trading nations. The negotiators are also very aware of the negative impact of the debt situation on trade policy. This is because the countries that are trying to service their debt are not importing, and thus, those who could export are not exporting. The negotiators are also very much aware that the process leading to 1992 has an agenda that interfaces with the Uruguay Round.

Finally, there is a very clear contradiction between the position of the industrialized world and the developing world in the negotiations. The industrialized world is seeking open markets for services, protection of intellectual property and to bring the world trading system into all the new areas where the industrialized world has a competitive edge. But in areas where the developing areas have a competitive edge—agriculture, textiles, etc.—they are very reluctant. This is a challenging aspect of this round.

Discussion

A considerable portion of the discussion of this agenda item was devoted to the twin deficits of the United States. An American began the discussion by giving his views on the current prospects of effective U.S. government action on the budget deficit. The recent bipartisan agreement on the budget did not signify much in the way of progress, based as it was, in the speaker's view, upon "a number of rosy economic assumptions and some bookkeeping legerdemain." But it was significant insofar as there was a bipartisan effort and it did lead to an agreement.

Doing something about the budget deficit was a political problem in the U.S. With power divided between a Republican White House and a Democratic Congress, it was difficult for an administration to govern effectively without creating and maintaining an overall political consensus. This was particularly true on a specific, controversial issue like the deficit. Reagan had had this kind of political consensus for cutting taxes and increasing military expenditures. But Bush's campaign for the Presidency created no such consensus on the budget. Bush ran on a promise of no new taxes, and, politically, he had to keep that promise at least for the first year.

But, the speaker said, the Bush Administration knew that the budget deficit had to be reduced over a reasonable period of time, and it was likely that, by late summer or early fall, there would be a successful effort by the Administration and Congress to

develop a political consensus in support of doing something about the deficit.

Another American agreed with this analysis. But he regretted that the Administration had missed its first opportunity to really accomplish something. The bipartisan agreement was based upon contradictory assumptions about GNP and interest rates; it represented little more than a "muddling through" approach.

As for the trade deficit, the speaker continued, it was more serious than the budget deficit. In part, it was the fault of the U.S. for not sufficiently increasing productivity. But trade barriers comprised a major factor in the U.S. trade deficit. In addition, it was worth noting that, if the U.S. were to decrease its military expenditures to the level of Japan's, it would have a surplus. So the matter of burden-sharing had also to be addressed.

A third American speaker commented that in the steel industry, for example, the U.S. had increased productivity and could compete effectively given "a level playing field," which there was not.

The degree to which many in Europe held U.S. fiscal policy accountable for much of the world's economic imbalance was illustrated by the comments of a Dutch participant, who said it was "an absurd economic world in which the richest country sucks in the world's savings and whose policy mix is such that it imposes much of the burden on poorer countries." The U.S. trade deficit could not be corrected by exchange rate adjustments, less protectionism, or increased spending by its trading partners. The solution had to be found in its internal policies.

The point was made by two Americans that, while the twin deficits were indeed a problem that had to be dealt with, there was a growing sensitivity in the U.S. to criticisms from other countries that had done little to correct their internal problems. Cases in point were European countries with structural rigidities that inhibited growth, and the Japanese failure to address their agricultural problems. All countries and regions were subject to political constraints, and constant criticism of the ability of the U.S. to bear its responsibilities in the international area were not helpful.

Responding to the point raised in the Dutch intervention, one of the Americans said it was incorrect to suggest that the U.S. was forcing the world's savings to invest there. Investment in the U.S. was voluntary, based upon the high rates of return there as compared to other countries.

A Canadian, speaking in defense of the U.S., opined that those elements that were the most critical of the American trade imbalance were also the "most addicted" to the three to five million jobs in Europe, Canada, and Japan that were dependent on the large portion of the world's exports that went to the U.S. market. It was worth noting that a correction in the U.S. trade imbalance would be painful for these countries.

Another aspect of the global relationship focused upon in the discussion was third-world debt. This problem was, in the view of a Swiss speaker, more urgently in need of a solution than ever before. Recent events in Venezuela were an example of how dangerous the situation could become. Pressure was building in the indebted countries on the political and social level.

The Brady Initiative was "highly inadequate," and raised unrealistic hopes among both bankers and debtor countries: the former that they could be bailed out of a bad situation by the taxpayers, and the latter that there was a relatively painless way to solve the problem. The Brady Initiative seemed destined to be a disappointment, as the Baker Plan was before it.

Defending the Brady Initiative's approach of linking debt relief with economic reforms in the debtor countries, an American argued that no amount of debt relief would sustain the kind of economic growth needed in debtor countries in the absence of comprehensive economic reforms. Some debt reduction might be useful to foster the will to undertake reforms, but it was not really a matter of quantity. What was needed was a three-part strategy of debt reduction, reforms, and new lending. It was important not

to undermine the long-term creditworthiness of the debtor countries and the banks' interest in long-term relationships.

Another American agreed that, without performance, no initiative on debt restructuring would be successful. He cited the experience of his bank, which had been involved in restructuring Third World debt since 1974. The countries that had successfully worked out their problems had, for the most part, adopted sound economic and financial policies. Many of today's most heavily indebted nations had yet to show an ability to pursue such policies.

A third American speaker worried that we might find ourselves in a situation where the short-term benefits of debt forgiveness had been exchanged for the long-term availability of credit to the third world. To encourage permanent debt forgiveness, as opposed to temporary debt relief, risked legitimizing debt repudiation, especially in countries with large trade surpluses. This was a danger that went beyond Latin America.

A Dutch speaker stressed that debt repudiation or forgiveness was not under consideration for middle-income countries, which had to do more for themselves in the way of adjustments, particularly in such areas as capital flight, which the speaker called "morally unacceptable." It was also his view that official creditors should not substitute for private lenders, which would have the effect of transferring the burden to the taxpayers.

A Finnish participant noted that Poland and Hungary had serious debt problems, and wondered if the Brady Initiative or other actions should apply to them. A German added that indebtedness in Eastern European, as well as the Soviet Union, was a particular problem for his country. A Dutchman said that Poland, in particular, while a member of the IMF, was unwilling or unable to honor the standard conditions of the IMF program. It was simply unable to perform, and new credits would not solve the problem.

Addressing himself to the need for a strong multilateral trading system, a Canadian expressed concern about conflict in international trade relations. He observed that trade disputes had come to occupy "center stage around the world." Feelings of unfairness were becoming politicized. It seemed also that the world was being organized into large trading blocs, and negotiations were occurring bloc to bloc. The only way out of this situation was to strengthen the multilateral trading system. It was necessary to define international rules to be accepted by all participating nations. It would help governments deal with their publics and with pressure groups if it could be shown that these rules applied universally. Also needed was a better system of dispute settlement. The problem of conflict in the international trading system was not just caused by imbalances, but by "profound, rapid economic and social change."

An International participant agreed that it was necessary to address these issues on the basis of multilateralism and to define universal rules of the game. The negotiations in the Uruguay Round were moving in this direction. It was encouraging that governments were increasingly bringing smaller disputes to GATT; but it was important that they bring the large ones as well.

Several speakers voiced the opinion that the Uruguay Round should take up the issue of labor standards and trade union rights. It was an American's view that, instead of being in a "race to lower standards," the participants in the world trading system should be attempting to raise living standards around the world. An International speaker said that there had been some resistance to dealing with this issue in trade negotiations because it might be used as an argument for protectionism. But there was now going on in Geneva a process which was bringing into GATT an objective analysis of labor standards. On this subject, a Dutch speaker pointed out that trade unions in his country had given priority to increasing employment over wage increases, and this had led to a substantial recovery of competitiveness.

Finally, an American stressed the importance of completing the Uruguay Round by 1990. An International speaker agreed that this was important for political and

psychological reasons. There had to be a deadline. But the round could not come to a successful conclusion until the concerns of all the participating nations had been dealt with. The speaker noted that, in a number of areas, there had already been results that were being implemented. There had also been adopted a new trade-policy review in which the major trading nations' trade policies would be reviewed every two years. This would force governments to define what their trade policy was on a continuing basis.

VII. ENVIRONMENTAL CONSTRAINTS

Background Paper

"You could not step twice
in the same river, for
other and yet other waters
are ever flowing on."

- Heraclitus, 6th Century B.C.

The state of the planet Earth is not static; it is ever changing on time scales ranging from seconds and hours to thousands and millions of years. The daily cycle of the solar heating, the seasonal changes in vegetation, the eddies in the ocean currents, the slow meanderings of the gulf stream and the waxing and waning of the polar ice caps all testify to the dynamic nature of the environments. This concept of an ever changing earth has been pondered since the beginning of human thought.

What is new today is that changes brought about by human activities in the character of land surface, the chemistry of rivers and oceans and the composition of the atmosphere may have reached a proportion such that they might not only change the equilibrium of the global ecosystem but alter its course. It is also becoming clear that subtle and relatively small changes in the characteristics of Earth's surface or atmosphere in one region of the world can produce substantial social and economic impact on people far away in another part of the globe.

Evidence of these changes varies from discovery of the ozone hole and the potential greenhouse warming effect to the accelerating rate of land use and rapidly changing ocean productivity. The important question these planetary scale changes have raised in Earth sciences is why despite rapid advances in space and computer technologies in the last 20 years are we still unable to forecast these events or predict their consequences with any confidence?

The greenhouse warming is an interesting example. There is a tendency to think about the problem in the most simple way (Figure 1). The radiation comes in. The greenhouse gases increase the atmospheric opacity to the infrared radiation emitted by the Earth and thus heat is trapped and the climate warms. However, the problem is much more complex than that (Figure 2) and in fact depends entirely on our ability to probe simultaneously into three completely different areas of research in the Earth sciences: how are vegetation cover and soils around the globe changing with time, and how exactly do those changes influence the build-up of greenhouse gases in the atmosphere? How does the deep ocean circulation regulate the exchange of gases at the ocean/atmosphere interface? And what are the processes of chemical exchanges in the atmosphere and how are they being perturbed by human interventions.

Advances in space based systems and improved computational techniques are of course assisting in resolving these questions. With these new tools scientists have begun to find compelling observational evidence that the chemical composition of the atmosphere is changing at a rapid rate on a global scale. Scientists have also begun to compile a list of potential problems for the global environment which may result from this change (Figure 3). This list grows larger with each new investigation.

Although the changes are being brought about through both natural and manmade causes it is clear that we as humans are responsible for many of the problems. While the automation and increased productivity of the post-industrial age has reached full stride it has barely kept pace with the growth in world population which continues to increase. In the process the by-products of civilization continue to be spewed into our atmosphere and oceans at a rate unprecedented in the history of mankind.

The reality of these circumstances is that there will be changes in our global climate. Whether these changes will be large or small and whether or not they will be irreversible is the question which is being hotly debated by the scientific community around the world.

The Facts

An examination of the facts finds that the atmospheric concentrations of key greenhouse gases; CO_2 , CH_4 , N_2O and man made CFC's is higher today than during any period in the last 160,000 years (Figures 4, 5, 6).

These gases alter the Earth's radiative balance through the greenhouse effect as previously shown in Figures 1 and 2.

There is evidence that the global mean temperature has increased by about 0.5 degrees centigrade since the late 1800s (Figure 7). This overall increase in global mean temperature is consistent with that expected from the increase in greenhouse gases.

These are the only facts of any consequence to the global warming issue which today are unambiguously accepted by the scientific community. Beyond them all projections related to the impact of the greenhouse effect on the planet Earth are fraught with uncertainties.

The Uncertainties

The observed increase in global mean temperature has been neither monotonic with time nor uniform over the globe as has been the increase of greenhouse gases. This situation calls into question the validity of isolating the greenhouse effect as the only cause of the recent temperature increase.

A second uncertainty stems from the knowledge that the Earth has gone through major perturbations in temperature and climate in the past and continues to go through seasonal and cyclical changes (Figures 8, 9). How much if any of the recent changes then are just part of a long term trend is not known.

In addition what if the temperature does rise, what will be the role of increased humidity and the associated enhancement of cloud cover in modulating the climate? Low clouds reflect sunlight and thus reduce the tendency to warm the climate. High clouds let sunlight through but trap radiations increasing the tendency for the Earth to warm.

Then, what about the role of vegetation on the land and nutrients in the oceans which regulate the carbon cycle.

Finally, regional and temporal effects must be better understood. The ability to differentiate between natural and human induced changes in temperatures in specific regions, especially those regions which are important to the world's food production is critically important.

To answer these questions, however, requires significant improvement in our data base and in our understanding of the global Earth system.

Adding to the list of uncertainties is the fact that no model that exists today is capable of predicting with any accuracy the exact magnitude of the greenhouse warming effect, the time scale over which it will occur or its specific regional and temporal effects. While all general circulation models (GCMs) predict an increase in the global mean temperature of between approximately two and five degrees centigrade for an effective doubling of atmospheric carbon dioxide there are wide differences in the magnitudes of the predicted regional and seasonal temperature changes and in the patterns and intensity of global rainfall (Figures 10, 11). Most of these differences attest to the complexity of the problem and reflect our poor understanding of the physical, chemical, and dynamical processes involved.

Even with this background of uncertainty it is important to recognize that human activities are changing the global environment and there is a finite possibility that these

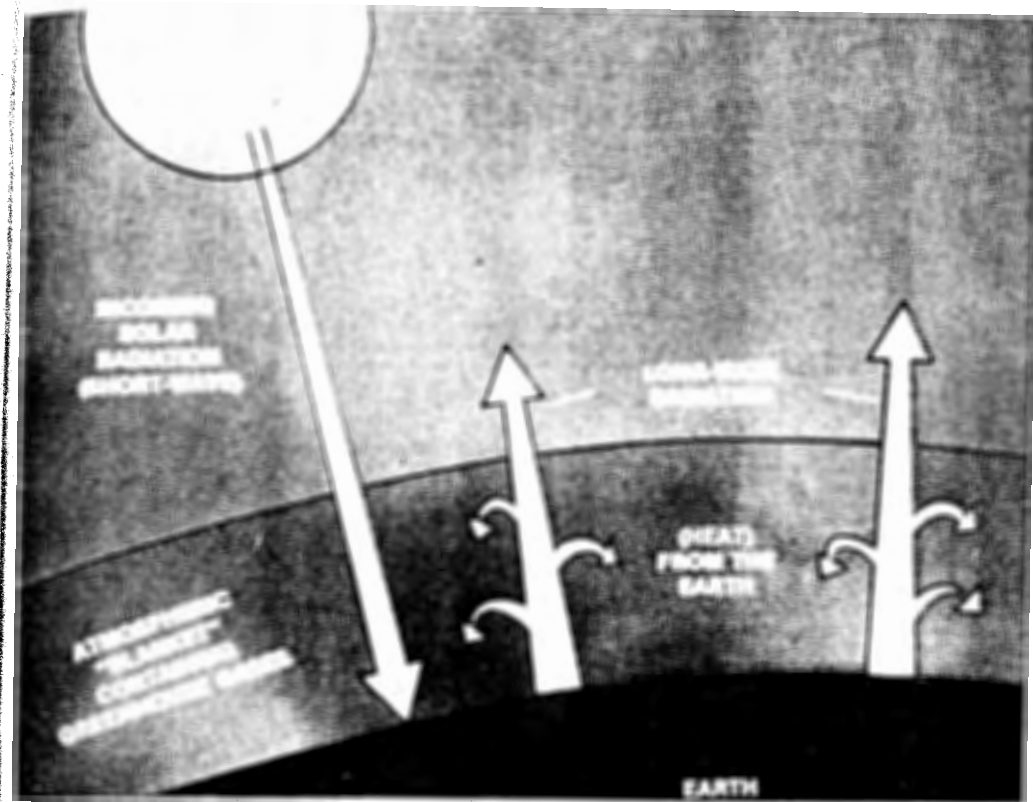


FIG. 1

THE BIOGEOCHEMICAL CYCLES. Movements of key elements (carbon, nitrogen, sulfur, phosphorus, and others) through the Earth system are critical to the maintenance of life.

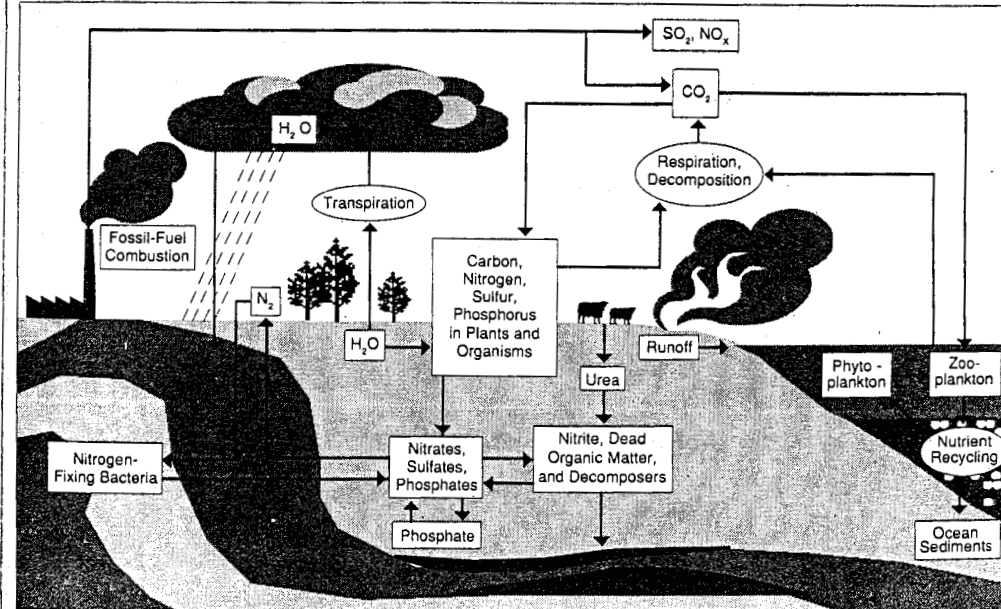


FIG. 2

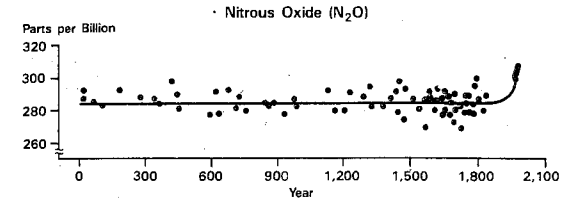
GLOBAL CHANGE

Key Global Change Issues:

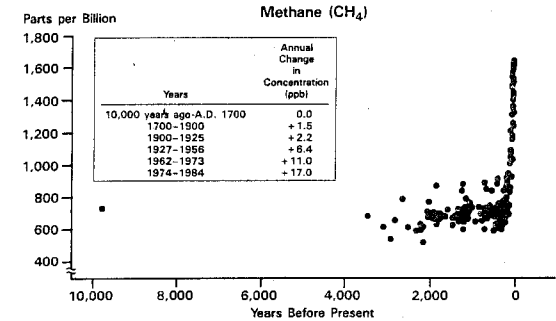
- Ozone Depletion
- Greenhouse Warming
- Deforestation
- Desertification
- Soil Erosion
- Ocean Productivity
- Atmospheric Dust
- Fresh Water Supply

FIG. 3

Long-Term Trends in Concentrations of Greenhouse and Ozone-Depleting Gases



Source: M.A.K. Khalil and R.A. Rasmussen, "Nitrous Oxide: Trends and Global Mass Balance Over the Last 3,000 Years," *Annals of Glaciology*, Vol. 10, 1988.



Source: M.A.K. Khalil and R.A. Rasmussen, "Atmospheric Methane: Trends Over the Last 10,000 Years," *Atmospheric Environment*.

FIG. 5

HISTORICAL CHANGES

ATMOSPHERIC CARBON DIOXIDE & METHANE

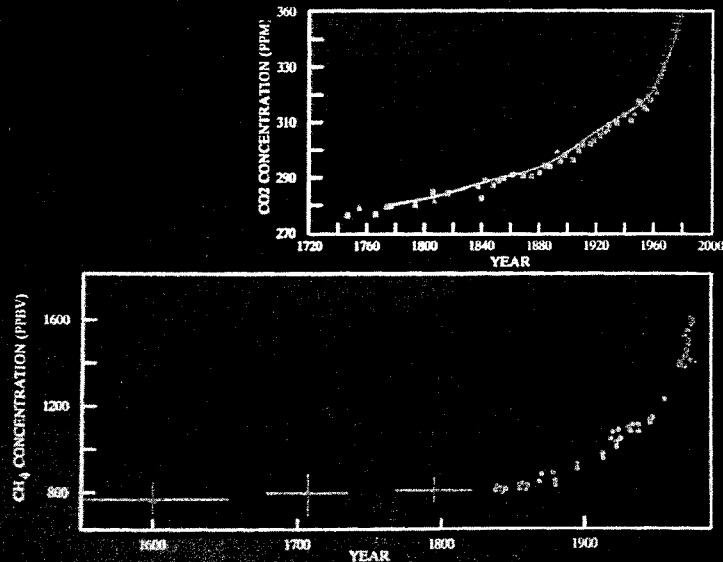
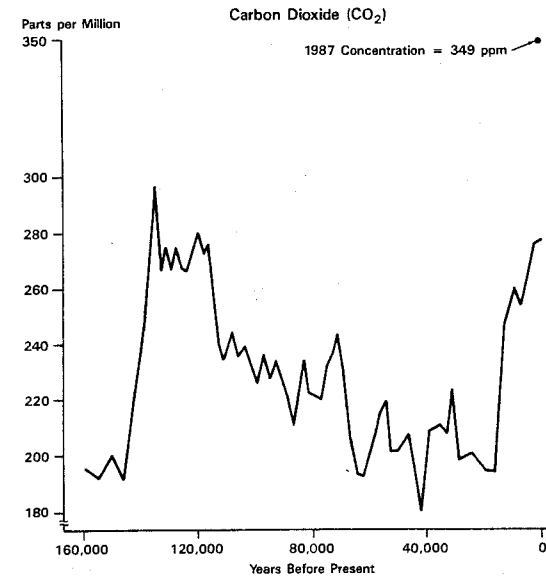


FIG. 4

Long-Term Trends in Concentrations of Greenhouse and Ozone-Depleting Gases



Source: J.M. Barnola, et al., "Vostok Ice Core Provides 160,000-year Record of Atmospheric CO₂," *Nature*, Vol. 329, p. 410.

FIG. 6

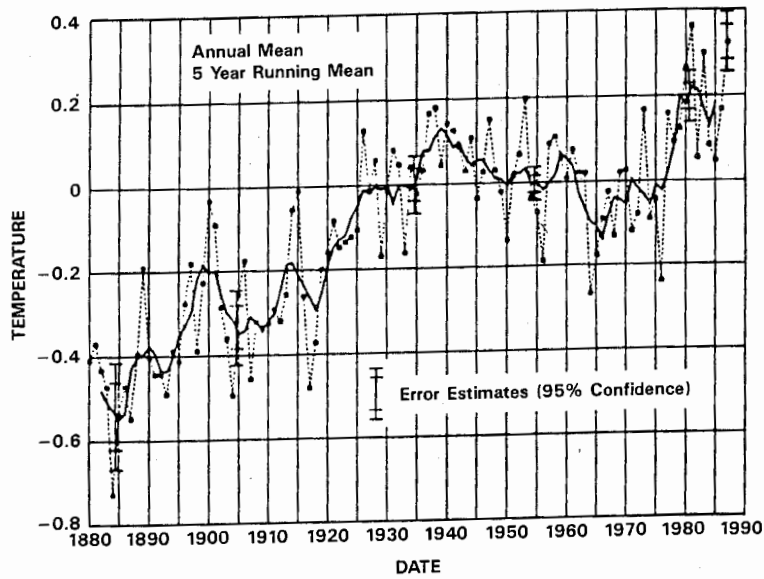


FIGURE 10-1 Departure of mean global temperatures from their 1951 to 1980 period mean value for individual years (dots connected with dashed lines) and for 5-year running mean values (solid curve). Error estimates for both individual and running mean values are shown for selected years. Period of record is 1880 through 1987. (Reprinted from Hansen and Lebedeff, 1988. Copyright © 1988 by the American Geophysical Union.)

FIG. 7

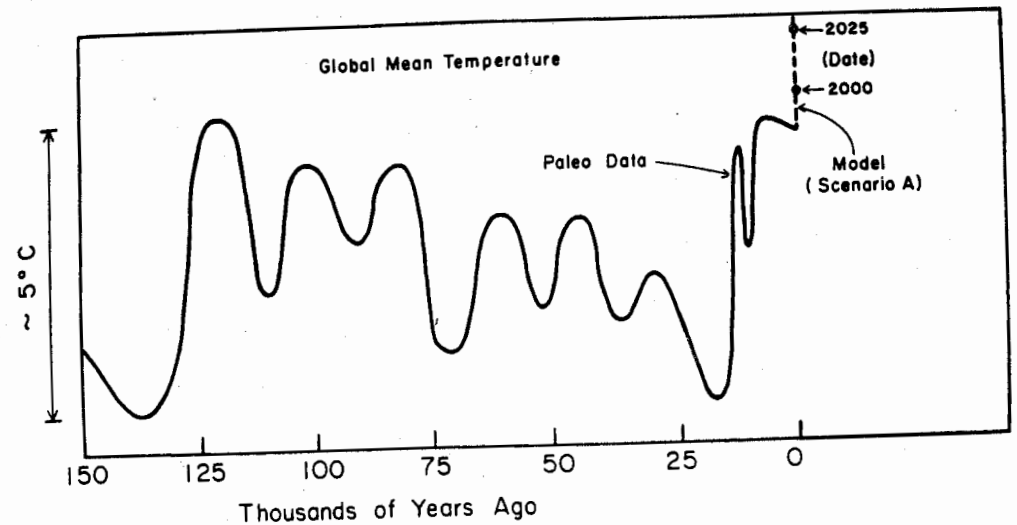
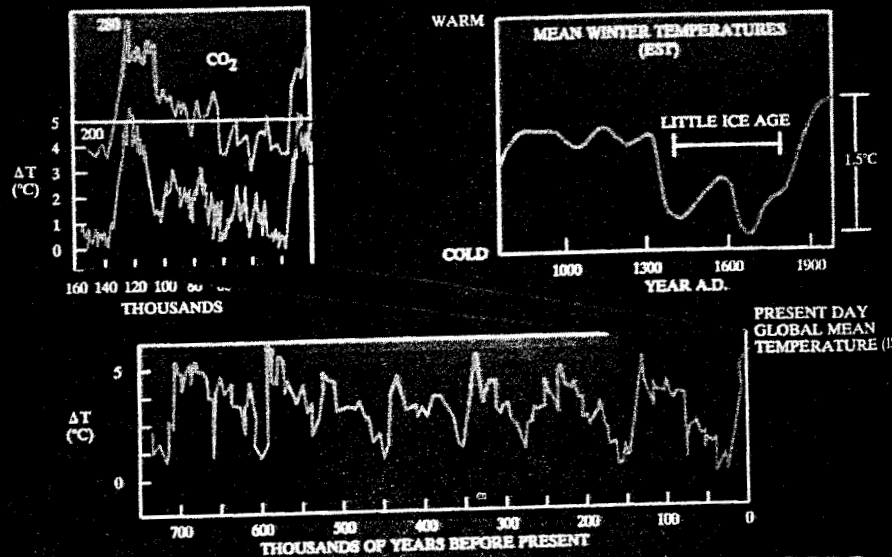


FIG. 9

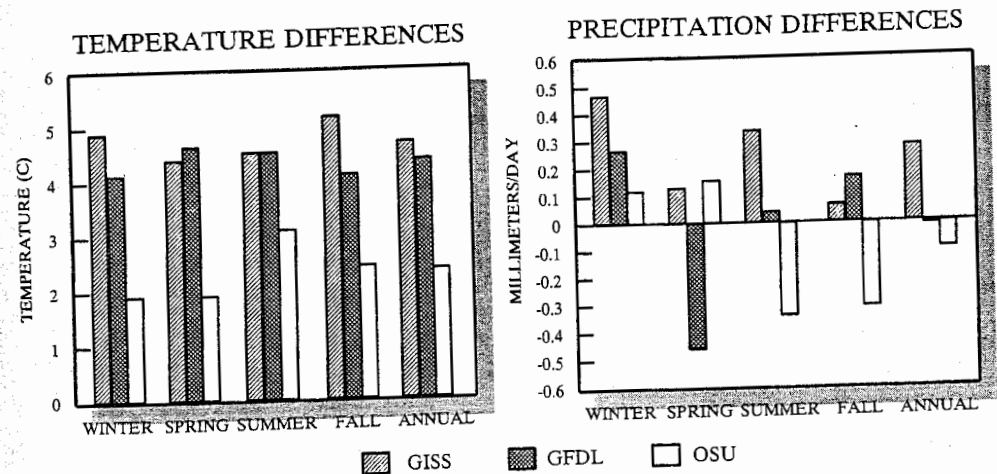
VALIDATING GLOBAL CLIMATE MODELS: LONG-TERM CLIMATE CHANGE RECORD



- MODELS SHOULD REPRODUCE HISTORICAL RECORD

FIG. 8

FORECASTING THE GREENHOUSE EFFECT: SEASONAL PREDICTIONS



LARGE DIFFERENCES, PARTICULARLY FOR PRECIPITATION

F110.004

FIG. 10

SOIL WATER DIFFERENCES FOR JJA

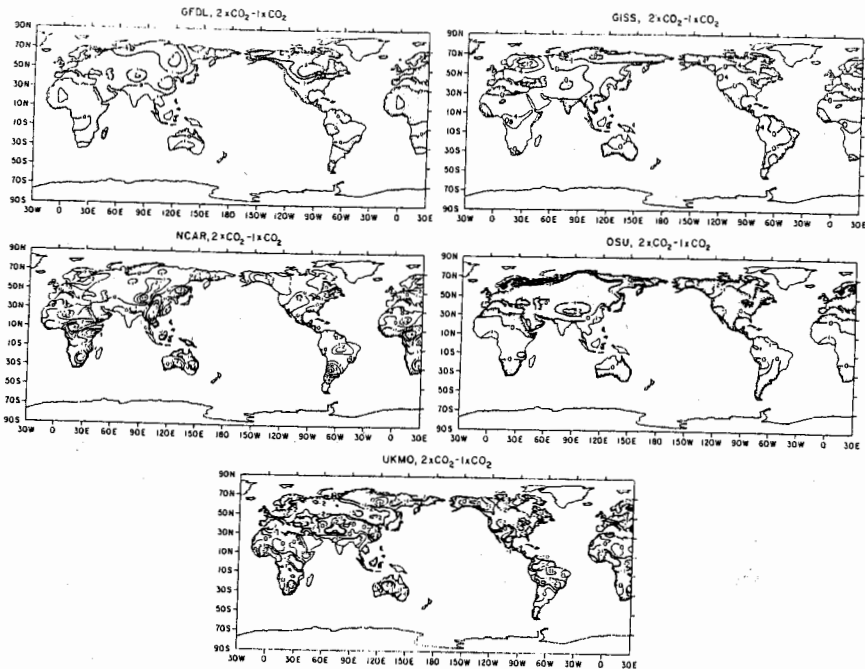
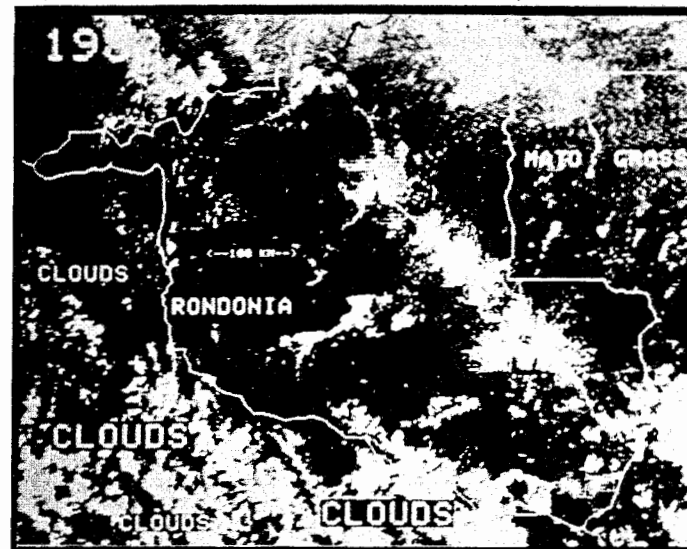
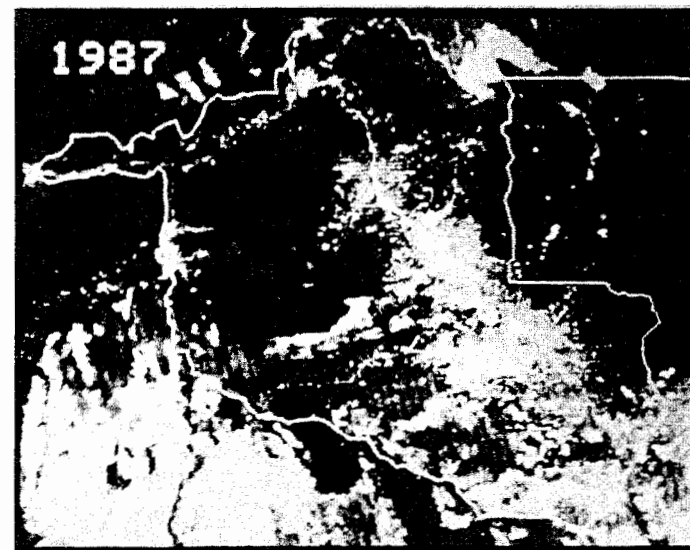


FIG. 11

SATELLITE MONITORING OF DEFORESTATION RONDONIA, BRAZIL



1982



1987
FIG. 13

MISSION TO PLANET EARTH

A GLOBAL SCALE EXAMINATION OF OUR PLANET

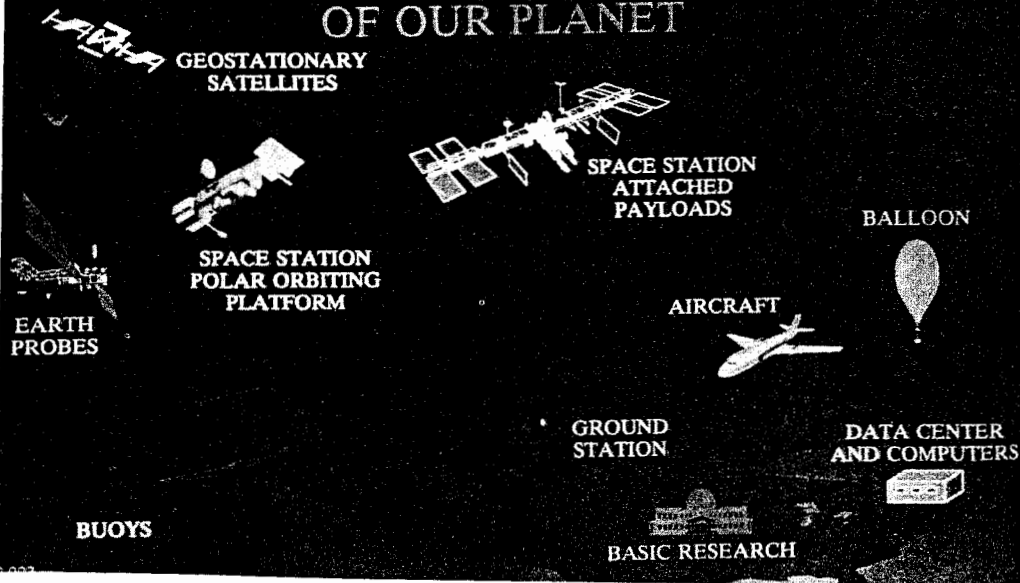


FIG. 12

changes may be irreversible.

The issues are not only global in nature but their solutions are linked directly to the world economy and the standard of living of all the world's peoples. A course of action is required which will improve our understanding of the global Earth system, provide the basis for predicting changes and form a solid basis for the policy decisions that will secure our future.

The Solutions

The first steps can begin immediately. There are currently available data records from the last 10 to 20 years that can be analyzed to determine whether there is a clear and unambiguous greenhouse warming "signal" that will stand out above the current "noise" of climate change. It is possible with today's technology to define an integrated approach to this problem that could yield the complete "fingerprint" that increasing concentrations of radiatively active gases are leaving on the global climate.

Also within the reach of today's technology is our ability to improve our predictive models. This can be done by incorporating the role of clouds, the recycling of "greenhouse" gases through the biosphere, the changes in oceanic current and the effect of changing vegetation cover on regional and global climates.

These efforts to search existing data for a clear greenhouse warming signature and to improve our predictive models are important to do but we also need to recognize that understanding the global environment requires new and innovative approaches to studying the Earth and its climate system.

It is necessary to initiate a long-term program of integrated comprehensive monitoring of the Earth on a global scale. Such a global perspective can only come from space observations but they must be made in conjunction with measurements from surface networks. Together they will provide direct measurements of a changing world and will also serve to test models and verify predictions.

A full scale mission to planet Earth (Figure 12) must be launched to start a long term study of the atmosphere, ocean and land that will tell us how they evolve and interact on a time scale of 2 to 3 decades.

The United States must take the lead in this effort not by doing it alone but by making the issue of global change a permanent and prominent part of our scientific, political and foreign policy agendas. We can lead by our example. It is not necessary to wait 10 or 20 years to begin to make adjustments in the way we live that will have immediate positive effects on our environment.

We know, for example, that global warming and acid deposition are linked to heavy reliance on fossil fuels. We should therefore enhance both energy efficiency and conservation of these limited resources while continuing our search for alternative non-fossil fuel energy sources.

It is also known that stratospheric ozone depletion is linked to ozone destroying chemicals such as chlorofluorocarbon products. While the Montreal Protocol was an important step, we can take steps to totally stop emissions of these chemicals on a reasonable time scale.

And finally, we can take action to preserve and protect our agricultural, forestry and water resource systems by considering strategies that consider the economic and social forces which are currently driving their destruction. It should be made clear for example that deforestation in Indonesia or in the Brazilian Amazon basin (Figure 13) could have devastating local and regional impacts as well as potential global effects. Unequivocal evidence of this type could provide incentives for conservation efforts that would benefit the local economy and the entire world community.

The Summary

The problems are complex but the solutions although elusive appear attainable. Each country must seek their brightest individuals from science, academia, industry and government and have them turn their attention to the solution of these problems. They must have the depth of knowledge, breath of experience and global perspective necessary to provide the leadership to unite the nations of the world in a common effort to secure the future of planet Earth.

Gloom and doom should not despair us; scientific research and sound policy design should proceed hand in hand. The areas where immediate advances are required are:

- Rapid progress in the capability to accurately forecast the regional effects (i.e. temperature and precipitation) of global warming for the next decade. This will provide the basis for conservation movements in critical areas of the world that can have both regional and global benefits.
- Environmental issues must become an integral part of national policies, economic developments and international affairs.
- The harnessing of our most precious resource, man himself must be improved. The right people must be identified, motivated and placed in various strategic positions in industry, government and academia.
- The educational system must be adjusted to focus on strong interdisciplinary topics that will produce a new generation of scientists and engineers that will be the infrastructure upon which future advances will be made.

Introductory Remarks

I.

We know that the planet Earth is changing, at a more rapid pace than ever in recorded history, not only in terms of speed but also of magnitude of change. Deforestation is occurring at a rate of 11 million hectares a year in the tropical forests; there are indications that the ozone hole is not only in the Antarctic but is in the northern hemisphere as well; moisture on the surface of the earth appears to be decreasing at a rapid rate. At the same time, the population of the Earth is increasing by 84 million people a year. In order to keep pace with this increasing population and to maintain a level of prosperity, industry keeps producing material which stays in the atmosphere.

These are the observable facts. The scientific community is dealing with the complex question of the future impact of this changing atmospheric composition and changing chemistry of the land and water. There is no consensus on this. Scientists do not all agree, for example, that the greenhouse effect is upon us today, but they do agree that the changes are so imminent that in one to three decades we are bound to see some major perturbations in the global climate. Whether they are just perturbations or a long-term trend toward disequilibrium is not clear. We don't know whether the greenhouse warming will come in five or fifty years, or how much the oceans will rise in the next decade. But, if it does happen, we have to begin to think about how to deal with it. We don't know if the ozone hole will go towards the equator or stay at the poles and disappear in a few years, but we need to start thinking about how to slow the process.

The deforestation in the tropics is a very critical problem. It will not only change the global carbon cycle, which will impact the global climate, but it may also desertify the tropics themselves, and change the biodiversity that is unique to earth. We must find a way to explain to those who depend on the forests to slow down on the use of what we call the lungs of the planet Earth. There are some indications that the deforestation of the Brazilian forests is affecting the climate of North America.

These are some of the problems the scientific community is trying to deal with by

taking measurements from ground and space. We need to begin to think how to deal with these global changes to the betterment, rather than the detriment, of mankind.

Introductory Remarks

II.

The emissions into the air and the water from the economic activities of a dramatically increasing population are neither bound to national or continental boundaries nor to ideological differences. We must learn to see the Earth as one single ecosystem. We must therefore increasingly steer our policies away from mere national interests. A global environmental partnership must be our answer to the environmental community. We need integrated, international action.

There is no longer any doubt that the greenhouse effect and its consequences for the warming of the Earth's atmosphere, together with the depletion of the ozone layer, constitute one of the main threats to the preservation of our environment and the conditions of life on our planet. Scientists will never give us 100 percent security. But the evidence in this case is so dramatically clear-cut that we are forced to act now, and not wait for scientific proof, lest the patient die in the meantime.

We need more and better coordinated research, but not as an excuse of inaction. It is up to us to restore the balance of our common creation. We have an obligation to future generations. We must take precautionary measures instead of react to damages already done. What is needed is a full cost accounting of our economic activities in the prices we pay now; we must not burden coming generations or other regions of the world with these costs.

Scientists now consider CFC emissions to be the main culprit behind the threat to the ozone layer. These substances are responsible for some 20 percent of the greenhouse effect as well. It is important that the production and consumption of these substances throughout the world be ended as quickly as possible. Substitutes and alternative production techniques are already available or will become so in the near future if science and industry is forced to develop them.

The United Nations environmental program is aware of the seriousness of the present situation, and it deserves the credit for the Montreal Protocol. This protocol should be amended as soon as possible. The main targets of negotiation must be a reduction in the period specified in the protocol with regard to protection measures. A 50 percent reduction in consumption and production by the end of the century is not enough; these substances should be completely phased out by the end of the century. The industrialized countries should phase them out by 1995. Also the protocol should be amended to include additional substances, such as carbon tetrachloride.

Uniform action will only be safeguarded if the developing nations cooperate as our partners. We should help them to avoid using ozone-depleting substances and technologies. Nothing can be achieved without assistance to these developing countries. This was emphasized in the declaration adopted in March of this year in The Hague. It called for the development of a mechanism to assist the developing countries, and the establishment of new institutions.

Further action is needed with regard to the greenhouse effect as well. The greenhouse effect is much more complicated and the task greater because there are several substances involved. Parallel to the Vienna convention on protection of the ozone layer, it is important that a convention on combatting the greenhouse effect be established soon. This convention would have to be supplemented by individual protocols on the individual contributory factors, like CO₂. And it must incorporate an action plan to preserve the tropical rain forests as well. Such means as debt-for-nature swaps should be used.

There also needs to be better strategies to decrease CO₂ emissions in industrialized countries. Technical progress on energy consumption must be speeded up in order to achieve a more efficient use of fossil fuels. Energy prices are an important factor in saving energy. There is too much use of fossil fuels today. We need to look to new energies and new fuels. Research and development of solar energy, as well as other sources, should be intensified.

It is also important to deal with the future role of nuclear energy. We need an internationalization of security standards on the highest possible level and a solution to the problem of nuclear waste. Without it, we cannot convince our populations that nuclear energy is one answer, at least during a transition period while other sources are researched.

Introductory Remarks

III.

As the Twentieth Century comes to a close, we are witnessing two great social phenomena. The first is the collapse of Communism as an ideology. With this collapse comes the recognition that economic growth requires free markets and that economic freedom implies some political freedom as well. We are moving quickly toward a global, consumer-based society. The other trend, interrelated with the first, is the increasing global awareness that mankind faces terrible environmental problems. These problems are receiving unprecedented attention within developed countries.

It used to be that concern about environmental problems was a leading indicator that a society had a healthy economy. Even today, many political leaders believe that, were a serious recession or economic dislocation to arise, this environmental concern might evaporate. But even countries with stagnating economies are showing increasing concern about the environment. It is clear that people who are starving do not have time to worry about ozone depletion in the upper atmosphere, but it is also clear that more and more people around the world understand the connection between the use of resources and impacts on the environment. The perspectives may differ from nation to nation depending on economic circumstances, but, as the planet shrinks, public concern over basic and woeful environmental issues is going to continue to grow. But issues like the stability of the planet and the continued productivity of natural systems like agriculture and forestry are, thus far, primarily the concerns of people in developed nations.

The question is how can we harmonize the growth of free-market consumer societies and the growing awareness that our economic activities are wrecking great cities and risk crippling the planet. How can we recognize these trends without polarizing them between north and south, east and west, or in more subtle ways, between high-waste societies, like the U.S. and Canada, and more efficient energy users like Japan? And how can we do it fast?

The greenhouse effect is the paradigm, and there is a growing consensus that significant global warming due to greenhouse gas emissions is probable over the next century and that rapid climatic change is possible. The magnitude is subject to debate, but a conservative baseline model indicates that the doubling of carbon dioxide concentrations from pre-industrial levels would create an increase in global temperature in the range of two to four degrees centigrade. We have already seen a 25 percent increase in carbon dioxide in the atmosphere in the last 100 years. Two to four degrees might not seem like much, but small temperature changes have very dramatic consequences. When you consider that the total global warming since the peak of the last ice age, 18,000 years ago, was only about five degrees centigrade, it is clear that the climate shift is dramatically rapid. What can be done? Two months ago, the U.S. Environmental Protection Agency published the first study looking at what policy options

might be available for stabilizing global climate. It was found that a model based on vigorous global economic development, without any serious attempt to limit greenhouse gas emissions, would result in realized warming of two to three degrees centigrade by 2050, and four to six degrees by the year 2100. The most optimistic scenario in terms of addressing greenhouse gas emissions could lower global warming by the year 2025 by only one-fourth, and the rate of climatic change in the next century could be reduced by only 60 percent.

The optimistic scenario did not take into account any limitations of cost or political feasibility. Political leaders have to ask what is reasonable, what is politically plausible, what is a realistic time frame for action. These questions illustrate the unreality of even the most optimistic scenarios.

It will have taken us 26 years if we are successful in phasing out CFC's by the end of this century—26 years since the science began to emerge about the effects of these chemicals on the upper atmosphere.

In order to slow down the global heating process in any significant way, the scale of economic and societal intervention will have to be enormous. The EPA scenarios show that the most effective forms of intervention involve such things as massive reforestation, large-scale conversion to biomass energy sources, radical shifts in the cost structure of fossil fuels to reflect their true environmental impacts, and the emergence of solar and nuclear power as far more significant sources.

Any serious attempt to implement even a few of these proposals would generate enormous political controversy within the United States and elsewhere. The world is not yet ready. Yet unilateral action by any nation would have only a minimal impact. Today the U.S. and the OECD countries account for 40 percent of all greenhouse emissions, and these proportions will decrease as the emerging economies continue to grow.

The controversy from a geopolitical perspective is going to be even more heated. How can the Atlantic Alliance credibly suggest to China that increased exploitation of its reserves of coal is counter-productive? China plans to double its production of coal by the end of the century, and India to triple its coal production. How can those of us in the West tell the emerging countries that the creation of a consumer economy based heavily on fossil fuels and on the personal use of automobiles has become unacceptable?

Even among ourselves, how can we develop a framework for discussion that has even a remote chance of success? The Japanese have said that any across-the-globe attempts to penalize CO₂ emissions would penalize energy-efficient nations like Japan. The U.S. has plenty of waste to cut, but Japan would be very quickly cutting down to the bone. Japan has serious anxieties about moving to a convention on global climate. By the same token, some U.S. officials are concerned that efforts to address global warming will lead to demands that the U.S. cut back its own output of CO₂ severely and disproportionately, given that we generate so much of it per capita. There is also anxiety in the U.S. that a movement to negotiate a framework convention on global climate could lead to a repeat of a Law of the Sea negotiations, which the U.S. found it necessary to repudiate.

Trying to develop a sense of what's fair, let alone workable, is a daunting task. Yet the fact is that, not only do we have to address these issues, we have to do it very quickly. The cost of inaction is heavy. The greenhouse effect is cumulative in nature. The EPA study concluded that if industrialized countries delay implementation of any response to global warming until 2010, and developing countries delay until 2025, the equilibrium warming commitment in 2050 could increase by 30 to 40 percent. President Bush recently called for a process laying the foundations for a global climate convention. He did so with a careful regard for the growing anxieties found among the developing countries about where this process might lead. These countries are very concerned about where the developed world might try to take them in this sense.

There is good reason for prudence and for taking seriously these anxieties. If our

understanding of the greenhouse phenomenon is limited, as it is, our understanding of the social and economic consequences of trying to deal with the problem is really primitive. There is much more at stake here than just lifestyles. The very values of economic and political freedom that are emerging in the Communist world and elsewhere may very well collide with the imperatives of planetary restabilization. The severity of the problem we face suggests that, when we do begin a process of negotiation, we have laid a groundwork for success. And that groundwork requires a considerable degree of consultation, among those of us in the Alliance and with the developing world. We must find a way to address this problem inclusively and thoughtfully.

We are at a point of significant correction in the field of environmental policy, as in East-West relations. The environment is moving from the margins of governmental policy-making toward the mainstream. Public-opinion polls in the United States show that concern for the environment has never before been higher.

Discussion

There was general agreement among participants in the discussion that one of the great challenges in effectively dealing with the environment was generating a public consensus about the seriousness of the problem and public support for remedial efforts.

An American said that it was a troubling fact that, in his country, citizens groups, often led by individuals with suspect scientific credentials, tended to oppose measures designed to deal with environmental problems, such as the building of resource recovery plants. It was the "not in my back yard" syndrome. What was needed was new leadership from the scientific community in helping to establish the basic credibility of the politicians' efforts to deal with the environment. Leadership was needed to inject a sense of urgency and clarity. A countryman agreed that the scientific community, through its research, testing, and search for solutions, should endeavor to narrow the uncertainties and give public officials a range of choices.

Several speakers worried that the public was not yet persuaded of the seriousness of the environmental problem. A Canadian observed that concern about the environment seemed to go in and out of fashion, and somehow it was necessary to sustain public interest in the problem. An American believed that a public perception of the seriousness of the problem could be sustained as long as the public was directly impacted in unavoidable ways, as it had been by the drought and heat wave in the United States last summer.

Of greater concern, continued the speaker, was the question of the public's willingness to make sacrifices for the sake of the environment. In the U.S., people were willing to make inconsequential sacrifices over such relatively minor risks as trace elements of pesticides in fruits. But their perception of the risks of global warming was not yet at a point that they were prepared to make major lifestyle adjustments to deal with it.

Without the support of public opinion, it would be difficult to overcome the immense political obstacles in the way of effectively dealing with the environment. National budgets had little money to pay for the kinds of efforts that had to be undertaken. A Dutch speaker reported that public-opinion polls in his country indicated that people were willing to pay a bit more to protect the environment, but not very much. The recent attempt by the Dutch government to adopt an ambitious environmental program was a case in point. While there was widespread support for the specific measures, a disagreement on how to pay for them ultimately brought the government down.

To effectively deal with the greenhouse effect, caused in part by the emission of CO₂ into the atmosphere, a number of speakers stressed the importance of reducing the

world's reliance on fossil fuels. This meant, in the opinion of some participants, an increased reliance on nuclear power. A Briton said there was no other alternative for the production of baseline power. But nuclear power was extremely controversial, and its increased use faced considerable public opposition. This point was underlined by an American, who reported that, in the northeastern part of the U.S., which suffered from serious undercapacity, there were two fully-loaded, on-line nuclear plants that were not being used. And, nationwide, not a single nuclear plant was under construction.

To overcome public opposition to nuclear power, a German called for "concerted worldwide action" to increase security standards and to deal with the problem of nuclear waste.

Other speakers cautioned against an overemphasis on nuclear power. A Greek pointed out that, under the most optimistic scenario, nuclear energy could only replace fossil fuel-generated electricity accounting for a third of the world's CO₂ emissions. A Briton suggested that pursuing energy efficiency was more cost-effective than spending money on nuclear development. A number of participants stressed the need for developing other energy sources, such as solar.

The developed world faced a significant problem in impressing upon the developing world the seriousness of the global environmental problems. A British speaker observed that, while the developed world was talking about ways to cut down on CO₂ emissions, developing countries were planning to augment their power-generating capacity. China, for example, planned to greatly increase its use of coal, of which it had an abundance. The developed world had to find a way to help developing countries attain their economic goals without nullifying any efforts to correct environmental problems.

In the view of an American, the nature of our problem with the developing world was this: having exploited the environment for economic gain, we now presumed to "lecture" the developing world on the dangers of environmental degradation. Perhaps what was needed to help foster an understanding in the developing world of the seriousness of the environmental problem was an admission of guilt and a demonstrable sacrifice on the part of the developed countries.

A Canadian observed that there seemed to be an underlying assumption that the current path of development was unsustainable and perhaps unacceptable. Could there be a shift to a different path of development that was sustainable? This could only be determined by addressing the criteria by which sustainability was to be judged. In this context, an American wondered what the international multilateral economic organizations should do. Should environmental analysis and assessment be included in their operations? Perhaps the real issue was not environmental analysis of individual projects, but whether the development strategies being pursued by these organizations properly took into account the externalities.

A response to this question by another American was that the multilateral institutions had to foster a different model of development with new priorities. Foreign assistance should be reconfigured to place a higher priority on the environment. Practical theories of sustainable development were needed. The approach of the Montreal Protocol, which applied a less stringent standard to the developing world with respect to the elimination of CFCs, was a practical approach to encouraging action on the part of the developing countries. It could equally well be used for CO₂ and greenhouse gases. Another opportunity to stimulate action lay in the linking of debt repatriation to environmental action. It was also necessary to involve the developing world in the science of the environment. Brazilians, for example, had to be shown that deforestation of the Amazon rain forest would affect the level of rainfall and, therefore, Brazil's agriculture.

A matter of concern to several speakers was the adequacy of existing political institutions to the task of dealing with the environment. It was an American's conviction that there was a need to define the fora to prepare a global convention on environmental problems. An Austrian felt that, to address this "massive problem of social engineering,"

might require "imaginative new institutions" to address the current inadequacy of leadership. A stronger international authority was needed.

But a German speaker felt that existing institutions, particularly the United Nations and its environmental agency, was up to the job and should be relied upon. It should be strengthened with a higher level of funding. The search for new institutions would be time-consuming, and could be used as an excuse for inaction.

The problem we now faced in the environment was due to uncontrolled growth and pace of economic development which took place with little regard for the consequences for the planet as a whole. This proposition was generally agreed to, and thus, in the opinion of many participants, industry had to play a role in the solution. A Swiss speaker regretted that industry had been defensive on this issue in the past, but it was encouraging that more and more business leaders were becoming aware that the way they dealt with environmental issues would impact the success or failure of their companies. It was important that business leaders recognize that their social responsibilities went beyond creating jobs and income. But it was also important that there not be a governmental response that would "bind industry into a straitjacket of rules and regulations." There should instead be a legal framework that allowed industry the freedom of action to be innovative and come up with new, environmentally sound technologies, processes, and products. There should be an approach that made environmental innovation economically attractive.

A Greek speaker stressed that business must be allowed to remain competitive. No business could afford to sustain substantial cost increases unless these were shouldered by competitors the world over. A global commitment to action was therefore necessary. A Belgian participant agreed that there had to be an in-depth dialogue among the developed countries to deal with this question of competition. But, a German warned, concern about competition should not hinder action.

Several participants expressed optimism that the necessary technological developments would take place, probably faster than we imagined. A German pointed out that industry had come up relatively quickly with substitutes for CFC's. In the area of energy, it was worth noting that Germany had achieved great economic growth since 1973 without any increase in energy consumption. An American agreed that technology could be pushed harder than most people thought possible.

In some cases, observed another American, certain technologies already existed that could make a significant contribution to the environment. There were a billion gallons of ethanol in the U.S. which could be used as an alternative fuel source. There was enough cornstarch and the technology needed to make all plastics used in the U.S. biodegradable. And there were boilers, made in Finland, that could burn the dirtiest coal without causing acid rain. What was needed was the incentive to use these technologies.

A Greek speaker ended the discussion on a note of encouragement, saying that at last the environment was being taken seriously on a global level.

CLOSING

In closing the conference, Lord Roll first recognized the contributions to Bilderberg of Tage Andersen and Franz Lütolf, who were retiring from the Steering Committee.

Speaking on behalf of all the participants, he thanked all those whose efforts had made the conference a success: the Spanish hosts, led by Jaime Carvajal; the session chairmen, working paper authors, and panelists; the conference organizer, Julio Abreu; the Bilderberg Secretariat; the interpreters; the management and staff of the Gran Hotel La Toja; and the security staff.