A FOREIGN ECONOMIC PERSPECTIVE

Peter G. Peterson

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In February 1971, the President asked that I prepare a review and analysis of the changing world economy -- as background for the formulation of U.S. international economic policy in the seventies. Following the presentation of the review to the President and the Council on International Economic Policy in early April, the President directed that it be given in briefing form to selected officials in the Administration, Members of Congress, and to groups outside the Government. Subsequently, the President approved a series of specific work programs of the Council on International Economic Policy aimed at developing new policies and new legislative programs.

Following these presentations, Members of Congress, as well as others in Government and in the private sector, have requested that some of this material be made available in printed form. In response to those requests, this material is presented in two sections. The first, "A Foreign Economic Perspective," is a personal overview of the origins and possible policy implications of the new world economy. The second, "The United States in the Changing World Economy," is largely statistical background material that provided the basis for briefings to the President and the Council on International Economic Policy during 1971. The first major briefing was presented on April 8.

This personal view and analysis is presented in the hope that it will serve as a basis for constructive dialogue on alternative future directions of U.S. international economic policy and programs.

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SUMMARY

President Nixon's New Economic Policy announced August 15, 1971 marked the beginning of a new era in postwar international trade and finance. Though the past era had been a success in its own time, it was based on a system which had finally been overtaken by the demands of a changing world. The new era -- based on the modern reality of shared power and responsibility -- should lead to a new age of prosperity and peace.

The purpose of this briefing is to show how and why the old era and system had to end, and to outline the tasks ahead -- for the United States and the world -- in facing up to the challenges and opportunities which the new era offers.

We begin with the premise that the formulation of sound policy must start by asking the right questions. The old policies were based partly on early postwar realities, and sometimes reflected lags between changes in these realities and the world's perception of those changes. The central fact of the past twenty-five years had been the conviction -- ours as much as that of other countries -- that the U.S. was dominant, both in size and competitiveness, in the international economy and that the practices, institutions and rules governing international trade and payments were structured to fit that fact. We as a nation and the world as a whole were too slow to realize that basic structural and competitive changes were occurring; as a result, international policies and practices were too slow in responding.

Some of the changes are discussed here. They relate to the increasing competitiveness of various economies -- notably those of the European Community and Japan -- and their role in world trade and finance which grew while ours declined. We see that, while the American economy has remained basically strong during this process, our international competitive position has been weakening for a variety of reasons: changes in international trading practices and patterns; developing inequities in both agricultural trade and the proliferation of preferential arrangements for industrial products; basic changes in the U.S. economy; and a monetary system whose lack of flexibility resulted in intolerable burdens being thrust upon the United States as we continued to meet our international economic and security obligations.

These problems were brought to a head as a result of inadequate increases in productivity, excessive domestic inflation over the last half of the sixties, a breakdown in the classic international monetary and domestic adjustment mechanism -- and, of course, massive short-term capital flows. The international institutions created after World War II were simply not equipped to deal with these changes, and governments were either disinclined or thought themselves unable to cope effectively with the rapidly changing realities.

The changed circumstances were manifested in a variety of interrelated problem areas. They include:

Trade with Developed Countries

Support for the creation and enlargement of the European Community continues to be a cornerstone of American foreign policy. However, the tendency for the Community to conclude a host of special preferential arrangements with countries not willing to enter fully into the unification process has steadily changed the character of the world's trading system -- from one ruled by the principle of nondiscrimination to one in which trade flowing under special preferential systems may be even as great as that subject to nondiscriminatory treatment. Second, the process has further compounded the problems of the world's system of trade in agriculture, to the point where market forces are seriously compromised and inequities abound.

As Japan has come to be a major trading nation, the structure of Japanese foreign trade, the practices which regulate it and its asymmetrical distribution have contributed to major imbalances in Japanese international economic relations. These imbalances are frustrating to the United States (which holds a disproportionately large place in Japan's trade pattern), to Japan and to others.

With Canada, our economic interaction is great and complex. The interaction of our two economies is so extensive that productive and harmonious relationships with Canada in the future require considerably greater joint action to anticipate and solve mutual problems, while at the same time maintaining each country's economic identity.

Less Developed Countries

Our relations with the 100 or so less developed countries (LDCs) involve complex and interrelated problems of trade and aid. Coherent trade and investment policies are essential. For example, to grow, LDCs must export more, but this implies that the industrial world must open its markets on an equitable and realistic basis.

Communist Countries

As a result of a variety of Presidential initiatives, our relations are now opening up, but financing and other international arrangements concerning trade leave much to be desired. Here too, a new era requires new arrangements.

Multinational Corporations (MNCs) and Investment Policy

The growth of MNCs poses both new challenges and new opportunities. There has been a tendency to say more than is known about these new and extraordinarily important enterprises. We need new policies to ensure that the full potential inherent in this phenomenon for improving the utilization of the world's and our nation's resources is realized, and that problems that can arise in international investment are dealt with fairly and effectively. These policies will be concerned with, among other things, investment controls, taxation, competition, extraterritoriality, expropriation and treatment of investors, effects on employment, and the promotion of foreign investment in the United States.

US Trade Policy -- and a More Competitive, Employed and Confident America

In seeking a new, more open and fair environment for American exports, we have two basic options. We could choose the route advocated by some of erecting a variety of new restrictions, and intensifying the long and growing list we already maintain against the products of our trade partners. However, I believe this to be a prescription for defeat and an admission of failure. Our preferred alternative is to meet head-on the essential -- if demanding -- task of improving our productivity and our competitiveness in an increasingly competitive world, to seize the initiative in designing a new, comprehensive program designed to build on America's strengths, and to encourage a competitive world trading system with the confidence that comes from having a sense of our future.

The basis for this confidence must be a strong domestic economy, characterized by increased investment in our economic future -- particularly in new plant and equipment -- and stimulated by new programs directed toward drawing forth the technological advances which will both increase our international competitiveness and help our society fulfill its promise of a better life and productive work for its citizens.

These programs will build from our strengths, but will not and cannot be indifferent to the social problems caused by rapid change and readaptation. We need a comprehensive, new approach to the problem of adjustment -- for industries, workers and communities. We will also need a genuinely comprehensive, national manpower program to ensure that the skills of our labor force meet the increasingly sophisticated needs of our economy.

To assure that we realize fully the international benefits of these new policies, we will also need new programs to help promote export opportunities, as they arise. Such a program may include elements of tax policy, export financing techniques, and

new organizational concepts -- designed to make America more competitive in export promotion.

Of critical importance in our efforts will be the new legislation needed to equip American negotiators with the tools for constructing a new, open and fair world trading system. Defining the negotiating authority we need will require close collaboration with the Congress. In the international negotiations undertaken with this authority, our intention will be to construct a new trading system to take the place of the old.

There is a final matter of fundamental importance -- reform of the international monetary system. We have been trying to live with what in many ways is an anomaly -- a system presuming that in a world of increasingly rapid economic change, exchange rates should not change. In the new monetary system that must now be designed, that presumption must be modified.

This new system must be characterized by shared leadership shared responsibility and shared burdens, to which at least all the free world's strongest nations commit themselves. It will be a system which fully recognizes, and is solidly rooted in, the growing reality of a genuinely interdependent and increasingly competitive world economy whose goal is mutual, shared prosperity -- not artificial, temporary advantage.

Such is the perspective which the President's actions of August 15 have opened for us and for the world. It is a perspective which a strong, confident nation can dedicate itself and its best efforts to realizing for coming generations.

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INTRODUCTION

President Nixon's New Economic Policy announced August 15, 1971, marked the beginning of a new era in international economic relationships; it was not a one-shot reaction to a one-time crisis. The New Economic Policy marked the beginning of a new era of more flexible, enduring and viable economic relationships among nations. The years behind us were by and large an era of success, but an era based upon a system which had become outgrown, outworn -- and increasingly crisis-prone.

The central assumptions on which our policies had been based had ceased to fit the facts well before August 15. The international measures taken on August 15 marked the first phase of our adjustment to current realities. Had the President chosen to solve the crisis only in terms of its immediate symptoms, he might have acted differently. But then we would have faced yet more crises in the future, and the world economy would have been left in a continuing state of avoidable uncertainty.

Instead, he chose measures which, while protecting our short-term international position, were also designed to encourage the initiation of basic reforms in the international monetary and trading system, and in the distribution of the burdens of leadership among the economically stronger nations.

The emergency features of the New Economic Policy, notably the suspension of gold convertibility and the surcharge on U.S. imports, have been the subject of international negotiations. This paper represents my personal view, not of these immediate negotiations, but of Stage Two of our adjustment to the new realities -- the definition of objectives and strategies that will guide us through and beyond present negotiations.

The paper begins by examining some of the reasons why the old system, though in its time serving the world well over the last quarter century, had finally reached the stage where fundamental changes were required. These included real changes in the structure and competitiveness of national economies and the international economy as a whole and, equally important, the lag between the real changes and the perception of them.

The second section ("The International System: Theory and Practice") discusses the international trade and monetary system within which these changes were occurring. It reviews the theory upon which the system was built and discusses some of the ways that practice diverged from theory, both in response to change and as a generator of change.

The third section ("Some Issues: Agenda for International Action") examines some of the major issues which have arisen as a result of the changes we have perceived and which stand clearly forth on our present agenda for resolution. These are identified for each of our major international economic partners (Europe, Japan, Canada, the Less Developed Countries and the Communist countries) as regards trade. It also discusses some issues rising up around the emergence of the Multinational Corporation and investment policy in general. Finally, it calls attention to the fact that we, too, engage in certain practices which also call for reevaluation as we embark on a new era.

The fourth section ("A Strong Domestic Economy - Requisite for a Strong and Outward-Looking Foreign Economic Policy") offers some observations about what is needed domestically in order to help our own economy face up to the challenge of the era which lies ahead. It tries to show the meaning of "competitiveness" for the American economy in a more open world, and outlines some of the major areas where leadership on the part of the Federal Government is required; new plant and equipment, technological opportunities, manpower training needs, raw materials for the future, and a conscious effort to shape our country's future rather than resign ourselves to whatever it may bring.

Section V ("A Work Program for International Economic Policy") discusses the work program on which the Council on International Economic Policy has been actively engaged. The objective of this program is to identify, for the President, a range of program initiatives which may be needed for a forward-looking foreign economic policy in the years ahead. These include possible new programs related to domestic adjustment to external competition; to help us seize new export opportunities; to form coherent and equitable policies and create an appropriate international environment for foreign investment; and an agenda of items to consider for proposal to Congress concerning new legislative negotiating authorities.

The final section ("Negotiating a New Era") discusses the negotiating requirements ahead of us and the spirit which should command our negotiating posture. It concludes by defining the objective we would seek through these negotiations: new trade and monetary arrangements and a system characterized, in the new era ahead, by shared international leadership, shared responsibility and shared burdens.

SECTION I - The Changing Tide in International Economic Relations

Some New Questions

The formulation of sound policy must start with the right questions -- questions rooted in present realities, and aimed at the future.

As our country moves into the post-Vietnam era in a vastly changed world, important questions must be asked, and answered, about the future role of the United States. Much of our thinking and most of our rhetoric about international economic policy have been carried over from another era. As a result, we continuously risk coming up with old answers to new questions. Like any bureaucratic structure, our government lends itself to inertia and bureaucracy is normally better at adapting old answers than conceiving new questions. Adlai Stevenson once said that foreign economics was a field that, at the least, needed some "new cliches." Today, the problem is so fundamental we need new policies based on the realities of the 1970's.

What are the present realities? How have the world economy and the U.S. position in it changed? How should these changes affect U.S. priorities and attitudes? Are the international institutions and adjustment processes of the 1950s adequate to the world of the '70s and '80s? Are the trading relationships acceptable 5, 10, or 20 years ago appropriate and equitable in this new economic world? How can the U.S., while maintaining the necessary internal economic strength, now play its full role in supporting the development of a peaceful and prosperous world?

These are some of the questions that must be asked. But the questions must go beyond assessment of our own economic capacities in the global economy. Even more fundamental issues have to be re-examined. Much of our foreign economic policy has been influenced by, and subordinate to, our Marshall Plan and alliance strategies. These strategies placed security, military-political objectives, and cold war tactics in a dominant position with economic policies largely shaped to serve these ends. To its credit, the United States led and supported the other free nations in their climb from postwar destruction. We did so because a prosperous and strong free world was vital to all free nations, including the U.S. In Europe, war-torn economies were revised and reconstructed. In the early '50s the idea of a unified Europe had begun to grow. By the late 1960s, the European Community had become the largest trading entity in the world, and in 1972 it stands on the threshold of further enlargement, to become an economic power with a population larger than the United States and a GNP approaching ours.

Similarly, we supported the rebuilding of Japan. Having made meteoric economic gains, growing consistently faster than any other nation has ever grown in economic history, the Japan of 1970 is impressively different from the Japan of the early '50s. World income has grown and world trade has grown more rapidly, particularly to the benefit of developed and, to some extent, the developing countries too. We are witnessing the realization of some of our hopes.

Underlying all our efforts, however, have been two fundamental assumptions: first, that as the economies of other leading industrialized countries became stronger, they would accept an increasing share of responsibility for the maintenance of security and economic order in the Free World; second, consistent with these increased economic strengths, we expected they would gradually open their markets to suppliers from around the world -- including the United States -- who depended upon the growth of a non-discriminatory world trade system, supported by a monetary system in which needed adjustments occurred promptly and equitably.

However, as time passed -- and though trade expansion developed to levels unmatched in history -- it also became clear that patterns and practices were developing which were not envisaged in the late 1940s.

The expectation of global growth was increasingly compromised by a parallel -- and accelerating -- trend toward regional or nationalistic preoccupations. It seemed to many Americans that the interests of those countries which had benefitted most from American policies were increasingly concentrating on regional or nationalistic arrangements, which were too often either restrictive or discriminatory or both.

In response to mounting expressions of American concern and urgings to negotiate corrections to these trends, the reply was too often that internal needs or preoccupations precluded meaningful external adjustments. It boiled down to a response of "negotiations later rather than sooner." In the meantime, our own external situation -- as measured by mounting balance of payments deficits and a rapidly deteriorating trade position -- made it increasingly clear to us that this response had to be reversed: we had to convince our partners that negotiations "sooner" were no longer just desirable -- they were imperative.

As a starting point for these new negotiations, we had to recognize we were confronted with new circumstances, and new questions. How do we adjust to the new power balance we helped to create? We can no longer assume that every step towards closer ties between certain countries is beneficial to the rest of the world. On the contrary, we must now ask under what conditions we should support integrative efforts and preferential ties among other countries, what the implications are for our competitive position and what other of our attitudes and policies we must alter to to protect our own interests, and to advance what the President has called the "world interest."

Another case in which our perceptions lagged reality was our view that the international competitive superiority of the U.S. was an unalterable fact of life; that our competitive advantage was so great we could easily afford concessions here and there, in an ad hoc fashion, in the interest of maintaining flexible and friendly relations with our international partners and developing a prospering world market. At home, when we had special problems in certain sectors resulting partially from international competition, we focused less on improving our productivity and competitive position and more on constructing specific protective devices. We must ask questions about our own internal policies, and about our own internal strengths and weaknesses, in evaluating our position internationally. Can we assume, as we have done in the past, that our resources are relatively limitless and that the room for maneuver in meeting the negotiating desires of our partners is wide? Can we assume that we can compete effectively without new policies, even when our competitors have become relatively more competitive than they were in time past -- economically, technologically, and in the management of their enterprises?

The United States and other countries have found themselves increasingly interdependent economically. The rapid growth of trade, international banking and capital markets, and foreign direct investment; the improvement in world communications and means of transportation; and the international mobility of technology have reached the state where economic decisions in one nation often have a major impact on other nations. As governments seek to solve their own internal problems of employment, inflation, or regional development, the solutions found often compound adjustment pains in other parts of the world. Governments, of course, desire to remain sovereign over the domestic interests for which they have responsibility. But the time has come when the proper exercise of sovereignty and of protecting national interests requires international efforts by all governments to avoid conflicts between their respective decisions.

A stable world for the seventies requires an international monetary and trading system which provides orderly and stable conditions for international commerce and finance, and which moderates the decisions of governments so that the actions of one country do not cause economic hardship to other countries. It requires a system which distributes the burdens of responsibility for preserving economic order equitably among the economically stronger countries, and which ensures that creditor countries and debtor countries act responsibly toward each other.

To move in this direction requires an acceptance of more responsibility by the countries which have made the most significant economic progress in recent decades. The United States, though economically very strong, cannot by itself reshape the international economic system. This requires the heightened cooperation of the

other nations which have come into their own position of strength and have a major stake in smoothly functioning economic arrangements. The United States benefited from this system as did all other nations in the free world economy. Now the burdens of responsibility dictate that all Free World Nations cooperate to bring about arrangements which meet the realities of the '70s, and that this responsibility is shared so as to avoid a deterioration in our economic, and eventually our political relations.

Structural Change

The world's conception of our global position and roles -- perhaps even our own conception -- has failed to change in step with the enormous changes in the structure of the world economy. At the end of the war the undamaged American economy contained the dominant part of the world's productive capacity and the U.S. Treasury held half the world's monetary gold. Inevitably we became the chief exporter of the real capital with which war-torn nations were restored to economic health. This task of reconstruction was completed during in 1950's and laid the base for a rapid expansion of world trade and world income. As a result the world's gross annual product reached the record level of about $3.2 trillion in 1970 and world trade increased five-fold over that twenty-year period.

While the U.S. continues to be the world's most advanced economy, the gap between ourselves and the rest of the developed world has been narrowing. In 1950, the U.S. GNP accounted for 40% of the gross world output; today, it is about 30%. Even in the 1960's our exports grew at rates that were only a half to a third as much as those of most of our principal trading partners.

One reason the GNP has narrowed is because some other nations were rebuilding on a previously strong base. Others, at a less advanced stage of development, frequently had growth potentials in excess of ours simply because they have so much catching up to do. But apart from the question of whether this trend continues into the future, our own requirements are clear: we must return our economy to a rate of balanced, sustained growth in order to maintain advances in productivity and to ensure that our economy remains competitive in an open trading system. We must do this to meet the needs and desires of our society at home, and to preserve a strong position in the world as well.

In an increasingly interdependent world economy, trade is a bridge across which national economies interact and compete with each other. Thus, particularly in the context of a declining trade balance, a more relevant indicator of any country's competitiveness in the international economy is not simply overall size or growth but the rate at which its exports -- particularly of manufactured goods -- have grown over a given period compared with other advanced economies. We should remember that export "competitiveness" not only includes price competitiveness but marketing and technological competitiveness as well.

Comparing rates of export growth in the decade of the 1960's (which is recent, reasonably long, and whose base year - 1960 - involves fewer distortions than earlier years), the results are not encouraging. During this period, U.S. exports of manufactured goods increased by 110%, but those of West Germany doubled and Japanese exports rose by 400%. Of the other major industrialized countries of the world, only the exports of the United Kingdom showed less growth than we did.

The factors responsible for this performance are many. They include the emergence of discriminatory trading arrangements abroad, the development by some of our partners of export development programs more aggressive than ours, and, later in the period, a marked deterioration in American competitiveness aggravated by a rapid rise in U.S. labor costs per unit of output. Exchange rates did not reflect these changes. Some countries during this period devalued their currencies, others revalued. However, the devaluation bias of the monetary system resulted in a dollar effectively *re*valued -- which further exacerbated our problems.

Our relative trade position has been declining, and the six members of the European Community, and Japan, have registered the biggest gains. The European Community became the largest trading area in the world. As for Japan, its share of world output and exports have risen in 20 years from about one to six percent, and its domestic economy has grown at over 10% per year in real terms, achieving the most dramatic rate of economic progress in the world.

These changes are not simply a matter of differences in rates of growth. Underlying are structural changes in the *capability* of other economies, both in basic and sophisticated industries. For example,

the European Community already exceeds the U.S. in steel production, and Japan will most likely surpass both by 1975. The U.S. share of the world's automobile market is distinctly smaller than it was only a few years ago. In electronics, we all see evidence of profound changes in the U.S. position -- both in our businesses and our homes. On a more general plane, in the last year or two, many leading industrialized countries have experienced "stagflation" i.e., stagnation combined with inflation, in their manufacturing sectors. This has aggravated the problem of excess capacity and intensified the motivation to find new markets and not give up existing ones. This fact, when combined with shifts in trading relationships brought about by exchange rate realignments could make particular industries, or perhaps, particular countries apprehensive about the future and perhaps less willing to change the existing environment.

While these changes have been taking place, the less developed countries (LDCs) as a group have slightly increased their share of world output to 10%, but have slipped behind as exporters (from 33% to 19% of world exports). The Communist countries' share of world output has risen slightly from 23.5% to 25.5%. Since Russia and China are committed to comparative self-sufficiency, their share of world exports has grown only from 4% to 4.9%, and most of this trade is within the Communist world.

Important structural changes were also taking place within the U.S. itself. Our foreign trade, over $40 billion a year each way, is larger than that of any other single nation. It has grown faster in the past decade than our economy as a whole, so that our exports have risen from 11.6% to 13% of our total manufacturing production. Imports have grown even faster.

However, trade has been increasing faster than income, throughout the world -- on the average about twice as fast, in recent years. Moreover, the ratio of our trade to our production remains small compared with other great trading nations, such as Canada (which exports 62% of its production, Great Britain (48%), West Germany (37%), and Japan (30%). Thus, changes in trade patterns affect the economies of others far more than they do our own. Accordingly, foreign trade issues have loomed less large in our national policies and politics than in those of our trading partners. This explains why other countries have provided a wide variety of aids to producers and exporters over the years to help them compete against external pressures and why other countries have negotiated so firmly in their own behalf in matters of trade.

The rapid increase in U.S. imports, which have grown about 25% faster than exports during the 1960's, has at least three important implications for our economic future.

First, imports have recently closed the gap by which they were exceeded by our exports; in 1971 they will exceed our exports for the first time since 1893 by perhaps $2 billion, or thereabouts. What this means is that our exports have become inadequate to pay for our imports. Consequently, we have attempted to pay for our imports with financial services and transfers, notably the earnings on our private investments abroad. (Exchange rate realignment should bring about a major change in this).

At the same time this is happening, we are tending to become an increasingly service-oriented economy. In 1950 our national output was 70% in goods and 30% in services, but the latter have since grown to 42%. About 60% of our work force is now in services. This has given rise to fears in some quarters that the U.S. will soon cease to be an important manufacturing economy.

These fears are highly exaggerated. Our economy produces around $350 billion in manufactured goods, and we import less than 10 percent of that amount. Furthermore, our total manufacturing output is significantly larger, in absolute terms, that the sum of the entire gross national products of several of our leading competitors in the free world.

Nonetheless, we face real problems. There is an increasing need to increase the productivity, and thereby the competitiveness of our substantial manufacturing sector. Secondly, we need to assign a higher priority to the difficult challenge of improving productivity in services. The kinds of services which make up the bulk of the service sector are certainly less "tradeable" than new manufactured goods and raw materials, except for tourism in the U.S. (one of our least developed industries), finance (which is a profitable export but also a vulnerable one) and management (where we have done well).

Second, our imports have been rising not only in response to our consumer appetities, but because our industry buys an increasing share of its raw materials abroad. Our imports of crude oil, iron ore and copper are growing and we import most or all of our natural rubber, tin, nickel and chrome. Long-range projections indicate that by the year 2000 we will import 30% to 50% of our mineral requirements, including oil. In doing so, we will be competing in world markets with other industrialized nations, such as Japan, which are even more dependent on imported raw materials than we are.

Third, our increase in imports has coincided with a severe deterioration in our basic balance of payments. However, imports are only one factor in our balance of payments deficit. Our military expenditures abroad and the structure of our outflows of private capital have also affected the balance. The deficit is also a monetary and exchange rate problem, discussed below. Whatever the causes, the persistence of our balance of payments deficit through the past decade, and the series of international monetary crises of confidence which it has occasioned, subsumes all our foreign economic problems in it and makes its correction a matter of urgent priority.

Another basic change in the U.S. economy which has had a profound effect on our international competitive position and on our balance of payments is the recent inflationary bias. This inflationary tendency in our economy has taken a particularly visible and virulent form since the mid-sixties.

The phenomenon of a steady rise in wage costs is not confined to the U.S.; it is a phenomenon in all industrialized countries, including Japan. But the rate at which U.S. wages had been rising exceeded our gains in productivity by a wider margin than in other countries. As a result, wage pressure has a more significant effect on our price level, and our exports have become increasingly less competitive with those of Europe and Japan. (There is also some evidence that suggests that some other countries appear to be able to insulate their export prices from domestic prices to a greater degree than the U.S. The extent to which this represents "disguised dumping" as contrasted to a different mix of services, manufacturing and exports requires more intensive study.)

Added to these elements is the important if painful fact that in recent years organized labor, powerful as it is, has changed radically its view on trade policy. Arguing that imports displace American jobs, Labor has become a strong voice for protection against imports of foreign products. Labor has also argued that exports of American capital result in job reduction, and that foreign direct investment must also be curtailed. This is a dominant new fact of American political life with our domestic and foreign economic policies must contend.

Some have argued that had we kept our inflation under better control in the '60s, we would have had no or at least insignificant balance of payments deficits, and our exports would have continued to exceed imports by a comfortable margin. While inflation has obviously contributed to our problems, this proposition, in my view, goes too far in that direction. No single error or event explains our present difficulties and there is no single panacea for them. Inflation; improved capability of other nations, increased energy needs, obsolete trading and exchange rate adjustment arrangements, less favorable commercial practices -- all had their impact.

The sweeping nature of the New Economic Policy announced on August 15 is based on this broader perception that our problems were complex, not simple, and that fundamental actions were necessary to start the nation down a new path.

Some economists had maintained that our balance of payments deficits would soon improve; others said it could be ridden out, even neglected, or left to other nations to absorb or correct. In my judgment, this policy, which several economists have labeled one of "benign neglect," would have had malign results. In my view, there was little assurance that surplus countries would have made the kinds of adjustments called for, much less that such action would have been either adequate, prompt or equitable. This could well have led eventually to a hasty and dangerous reduction of our military commitments abroad, and an equally ill-considered relapse into the most short-sighted forms of trade protectionism.

There were, therefore, no natural forces of adjustment either visible or imminent that could justify a continuation of a passive policy. The disorders in the system were seen to be fundamental and cumulative, and the decisions of August 15 were therefore aimed at fundamental changes in the system.

The decision to close the gold window and the imposition of the surcharge must be seen in this context. To those who have described the August 15 actions as "coercive", "blunt", addictive", "unilateral", etc., I would suggest they re-examine the short and long-term implications of a more passive policy. We felt we had to force the pace of adjustment. For example, had we simply permitted these large and growing deficits to drain our remaining gold (or to leave us subject to this implied threat), in my view, we would not only have negotiated less adequate exchange rate adjustments but this would have seriously affected our ability to negotiate badly needed longer-term monetary reform.

SECTION II - The International System: Theory and Practice

The Institutional Base

The international institutions and mechanisms for managing economic relations and ensuring orderly economic adjustments have also failed to adapt as rapidly as the changes in world economic structure required.

There are a variety of these institutions and mechanisms, but two of them provide the backbone for the rest. The first is, or was, the system of fixed exchange rates agreed on at Bretton Woods in 1944, centered on a stable dollar, and monitored by the International Monetary Fund (IMF).

The second is the set of trading rules and procedures embodied in, and monitored by, the General Agreement on Tariffs and Trade (GATT). It is in theory a set of rules based upon adherence of most great trading nations to the principle of nondiscrimination and to multilateralism in trade and tariff negotiations. That principle has become badly frayed.

The U.S. was a principal architect of these institutions and has been an active supporter of both over the years. The multilateral trading system, favoring global rather than regional markets, and hostile to quantitative restrictions and nontariff barriers to trade, was a logical outgrowth of the Reciprocal Trade Agreements policy which the U.S. adopted in 1934, and has continued under successive administrations of both major political parties.

While there have been too many crises under the IMF-GATT system, none has approached in depth and length the pre-war depression. While there have been cyclical situations of inflation and/or significant unemployment in the major industrial countries, the striking fact is that until now each of these situations has proven to be manageable within the multilateral framework constructed in the post-war period.

Yet, the assumptions about the structure of the world economy on which both these institutions were based were increasingly undermined by the trend of events. Changing world economic power relationships and the changing patterns of currencies, trade, and investment call for equivalent changes in the institutions that are to help manage the international economic system.

The System in Theory

If Americans are to have a clear sense of the future we would like to shape, we shall need to refresh ourselves at least briefly on the theory and purposes of international trade as Americans (and virtually all international economists) have understood them.

From the standpoint of a rational nation, the prime purpose of foreign trade is to obtain abroad goods and services which are either unobtainable or more expensive at home. The consumer's interest -- his real income and standard of living -- is dominant and the function of exports is to pay for the imports that satisfy him, or, more generally speaking, which the nation has collectively determined it needs for its well being and security.

In the pursuit of this goal, each nation finds, within the possibilities open to it at home, a comparative advantage in the production of some goods and services rather than others. If all countries produce those things which they are most efficient at producing, then the world's wealth will be maximized by the international specialization of labor which results. The only limits on this division are set by the possible security danger for a nation in overdependence on foreign sources of strategic supplies ("Defense is greater than opulence." -- Adam Smith).

Protection for all the domestic industries which are not competitive in the world would make international trade pointless; it would also "protect" the consumer from lower prices -- and lower domestic prices are a principal purpose of international trade.

The underpinning to this international division of labor through trade is found in the world exchange rate structure and the international monetary and domestic mechanisms for adjustment. If these were flexible and responsive, then theory suggests that balance of payments equilibrium will be attained on the average over the long run. The indispensable internal adjustment process from relatively inefficient industries to industries with a comparative advantage was assumed to be a smooth, mobile and politically palatable process. Throughout the world, capital and goods would move freely.

It was also assumed that each country would be able to meet its domestic growth and employment objectives with domestic fiscal and monetary policy. Put differently, each country would avoid exploitative international commercial policies that would stimulate domestic growth and employment at the expenses of others -- so called "beggar thy neighbor" policies.

Overall balance in each country's external payments was to be achieved by the equilibrating effect of domestic fiscal and monetary adjustment policies, and, if these proved insufficient, of prompt and adequate changes in each country's exchange rates. Since there was to be no unnecessary building of reserves, each country would in theory be equally likely to devalue or revalue -- whichever was consistent with the "universal" goal of equilibrium. Thus, to avoid revaluing was irrational since it subverted one of the principal purposes of trade -- to lower the price of imports and thereby increase the standard of living of consumers.

The System in Practice

This whole theoretical framework, the birthplace of classical economics, has not been superseded by a better one, and in my view is unlikely to be. Our main task, it seems to me, is to stimulate the convergence of practice and theory.

Thus, most of the problems that have arisen in the world economy are not problems of theory. They are problems of national attitudes, and practices which thwart the operations of the international adjustment process. For example, balance of trade and payments surpluses assumed a virtuous quality, largely because of the stimulative effect on domestic employment and production, and the countries in deficit came to be seen as sinners.

Changes in exchange rates were seen as painful evidence of the failure of political and economic policies. Exchange rate changes were postponed. As a result, the realignments needed became larger, more disruptive internally, and therefore postponed even longer. Frequently, the International Monetary Fund advised its member governments to do what they should have done to keep the payments system in equilibrium. But the reserve-short nations often resisted this advice because the fiscal adjustments were politically painful and devaluation meant a drop in the standard of living, and political failure or a loss of prestige internationally or domestically. The surplus nations resisted because

their successful, and obviously important exporters wished to keep their markets and jobs. These strong exporting interests representing industry, agriculture and labor were politically stronger constituencies than the consumer, who seems poorly organized and under-represented everywhere.

As a result, devaluations have been much more frequent than revaluations -- reflecting the political primacy of exporting and import competing interests and the substantially larger leverage of the IMF on reserve-short, as contrasted to reserve-heavy nations. This imbalance in leverage should not be surprising given the environment that enveloped Bretton Woods; it might have seemed premature and even fanciful, in that U.S.-dominated era, to think that IMF would need to be seriously concerned with surplus-heavy countries. Now in the real world, almost no level of reserves has seemed too high to the governments of surplus countries, and there has been no means of forcing surplus countries to take action. The ghost of 17th century mercantilism, which held the accumulation of gold to be the principal purpose of trade, rose again in the postwar years in the policies of the stronger countries.

As the new world economy emerged, however, elemental principles of arithmetic should have made it obvious that one could not have countries in large and perennial surplus without having perennial deficit countries. Equally elemental understanding of the rapidly changing competitive structure of the world economy also should have made it obvious that the relative trading position of countries would necessarily change, that deficits would occur from time to time, and that a rigid exchange rate structure would not accommodate these changes. In recent years, these problems were greatly aggravated by the untimely flows of billions of dollars, so-called short-term capital flows in response to differences in interest or for speculative purposes.

On the monetary adjustment side, of course, the U.S. had a special role in this recent history. Its dollar was the sun of the gold-exchange system; the U.S. could probably not have changed the dollar's value in gold even if it had wanted to. But in a rapidly changing world economy, no single national currency can remain the rigid standard for all others. It was our willingness to incur perennial balance of payments deficits, and our increasing world liabilities and shrinking reserves that resulted from these deficits, that kept the system going as long as it did, in effect playing a surrogate central bank to the world and producing the liquidity which the system needed. But as these deficits were financed, in effect, by loans from foreign central banks, the dollar also lost the confidence of foreign bankers and invited the charge that we were exporting inflation by increasing, more or less autonomously, the world's money supply. The asymmetry of the Bretton Woods system -- with its devaluation bias and over-dependence on the dollar -- contained no adequate corrective, other than a degree of domestic deflation which the U.S. was no more willing than other nations to impose on its citizens and which, in any case, would have been self-defeating. In any case, such a policy (given the role of U.S. deficits as the main source of international liquidity) would have solved nothing, since without the deficits, international liquidity would have been sorely strained.

The U.S. has now renounced this faulty system and its atlas role in it, and has no wish to resume it in its earlier form.

The surplus syndrome and the sticky adjustment mechanisms which grew up around the Bretton Woods system have resulted in irreconciliable balance of payments goals among nations. These goals were often "reconciled" by mercantilist "solutions," through trade and investment restrictions, which shifted abroad the burden of general domestic economic difficulties, or specific industrial or agricultural adjustments problems. Thus, countries sometimes went to ingenious lengths to export not only their products but also their domestic problems -- and the associated political pain. In the context of these mercantilist policies, however, more employment at home meant less employment abroad. Thus, other countries were increasingly reluctant to accept the import of this pain -- feeling they would be suffering consequences of unilateral decisions taken on behalf of some other country. The cure or relief from pain was often a counteraction in the form of another addictive and restrictive action to shore up the position of weaker countries, causing slow disintegration of the open world economy. At home, the clear and present danger to the special interests of an injured industry usually seemed more pressing and politically persuasive than potential future loss to consumers, and some conjectural damage to an expanding and open world economy.

Thus, in the United States, given the unacceptably high level of U.S. unemployment in recent years, we can understand the pressures in the trade-off between more domestic jobs and lower consumer prices. The legitimate and increasingly urgent problems of internal and adjustment of industry, labor, and agriculture deserve far more positive and comprehensive action -- the over-simplied free trade rhetoric tends to dismiss the problem, and restrictive trade action compounds it.

The problem of domestic adjustment has come to mean more than this, however. As nations have become more economically interdependent, and with the increase in the mobility of capital and technology and the lowering in costs of transportation, many nations now have greatly increased capacity to invade markets rapidly, and we find that pressures for adjustment in particular industries come faster and harder than anything experienced in earlier years. In the United States, in recent years these pressures have been magnified by the state of our internal economy and the apparent intractability of our own unemployment problems. The rising pace of change poses adjustment policy problems which simply cannot be ignored.

The international monetary, exchange rate, and trade adjustment process would in the long run, if it worked as the theory would have it work, sort out the adjustment difficulties and take care of the employment and dislocation effects. In practice, these adjustments come slowly and the disruptive effects come quickly, leaving long periods when the transition is painful beyond endurance. As Lord Keynes once said, "In the long run we are all dead."

Countries therefore must have policies to deal with structural changes among industries, and between industry and agriculture. The key question is how to carry out these changes without unduly disrupting the interests of other countries or the international economic system as a whole. There is a critical need for an effective institutional system which limits the disruptive aspects of such adjustments, just as there is critical need for an effective overall monetary and exchange rate institutional system. One must necessarily conclude that we now face the need for reforms of both the monetary and the trading system, and that reforms in one without the other will not be sufficient to meet the needs of the United States, or of other countries, in the coming decades.

SECTION III - Some Issues: Agenda for International Action

Europe

The United States has long supported the multilateral, non-discriminatory approach to the management of international economic relations, as opposed to bilateralism and discrimination. The United States has global economic interests: it thrives best in a world of nondiscrimination. The American interest is not solely economic, however. Nationalism is politically divisive, whether practiced militarily or economically. The United States has tried to encourage the development of an international system which would contain divisive economic nationalism and exclusive regionalism, so that political as well as economic relations might operate to the general benefit of all countries.

Some countries have looked at their own interests differently. Working from a smaller economic base, and heavily reliant on trade with their close neighbors, these countries have at times preferred to work outside the framework of nondiscrimination and multilateral negotiation. Sometimes, for historic and cultural reasons, they have used preferential commercial relations as a basis for continuing political ties and promoting exports. The countries of the European Community have been most active in practicing this kind of economic diplomacy, providing, for example, preferential access to the Community for certain exports of a large number of African and Mediterranean countries, and in return requiring preferred access for European exports into the markets of these countries. These latter preferences are known as reverse preferences and while they are presumed to be of value to European manufacturers, they are of little value to the developing countries which are required to provide them. These special trading arrangements between the Community and certain developing countries are often tied to aid flows, so that a broad, bilateral economic relationship is maintained.

It has also been argued that these special discriminatory arrangements are politically necessary -- for example, with certain Mediterranean countries with "historic" ties to individual Member States. This may now be even more true since it is difficult to favor one such country over another. Moreover, it ensures favorable ties

with countries which are primarily raw material suppliers, while at the same time restricting the manufactured products of Asia and Latin America.

The Community now is trying to make arrangements for the European countries which do not become full members of the Community, such as Switzerland, Sweden, Austria and Finland. It is proposing free access between the European Community and these EFTA countries on most, but not all, industrial products, and not agricultural products. One of the reasons why many Europeans give priority to regional relations is that European trade is heavily regional trade. The intra-European trade among EFTA and European Community countries accounts for about two thirds of their total trade. Thus, European countries are heavily dependent on trade and most dependent on trade with each other.

American apprehensions about this trend reflect more than a concern for the impact on certain American exports like citrus. In fact, the impact on potential American exports has not yet been great in the aggregate, though individual products or sectors may suffer. In the aggregate, European integration and growth has stimulated U.S. exports to the point where we sell more to Europe than they to us. However, discriminatory arrangements have proliferated in the last few years, and the forces that lead towards splitting up of the world into blocs of influence threaten both the basic foundations of the postwar trading system, and the non-discriminatory basis of political-economic relations which has been of such great benefit. This trend threatens to leave as outcasts the Asian and Latin American countries, at a time when their trade needs are growing rapidly with their rising unemployment. The United States cannot for long be expected to adhere to the principle of non-discrimination when so large a breach in that principle has been made.

The trends in Europe recently have been unfavorable in other regards as well. For example, the Community has developed an agricultural policy which satisfied the political needs of their agri-sectors at the expense of its own consumers and outsiders. This system, based upon very high support prices, is designed to limit other non-member nations to the role of residual suppliers. Since it is based upon high prices without production controls, the combination of high price incentives and technological progress has meant continued increase in domestic production and the generation of surpluses which are then exported. Since the domestic surpluses are priced too high for world competition, aggressive subsidization is used to push the surpluses into the traditional markets of other, more efficient suppliers. By any measure, the Community's policy has displaced imports, increased self-sufficiency, and forced exports onto world markets at distress prices. This system is the essence of mercantilism, forcing more efficient farmers in other countries to bear the costs which the Community itself ought to pay for internally. As a result, European consumers eat less well, and American and other farmers live less well.

All countries have protective mechanisms for agriculture, and we are certainly no exception. The political and social problems exist everywhere, as does the desire to avoid undue dependence on foreign suppliers for one's food. However, when other parts of the world could produce and sell far more efficiently, including some of the smaller trading countries like Australia and New Zealand, there is not real justification for continuation of a system like that of Europe's which passes so much of its adjustment costs on to other nations, distorting world production and trade.

The European system was not fully applied until the mid-1960's. It is from that date that the effects of the system must be measured. There is no doubt that for all the items covered by the Community's variable levy system, American trade and the trade of other countries has suffered. Some will say that Americans have done well in certain other agricultural exports, but that is no justification for the trade distorting practices which do exist, and even here it must be recalled that the Community has from time to time proposed new restrictions to cover these items as well.

Politically, these developments are tragic, given Labor's new trade policies and when farmers must become a main force in the political drive in the U.S. for internationally-oriented policies. A mercantilist agricultural policy as aggressive in its actions and effects as European policy today must necessarily undermine support of American farmers for outward-looking U.S. policies. It is simply a matter of politics in one place causing political reactions in other places. Thus, the multilateral trading system is being seriously eroded by these new trends in agricultural trade. For these reasons we can no longer delay serious discussions on the future of agricultural trade.

These recent trends in Community policy toward internally-oriented problem-solving, and toward regionalism in external relations, seem to crop up in other areas of Community decisions. For example, in regard to certain elements of an emerging Common-Industrial policy, it appears to some that the Community has been trying to work out its technical standards and pollution control methods on a Community-wide basis, without any real effort to do this on a multilateral scale. The use of standards as a nontariff restriction to trade is easy when common standards are set for insiders and outsiders are excluded from deliberations. All countries sometimes sin in this regard, but the Community has recently shown what appears to me to be an excessive preoccupation with the evolution of its internal policies and has not exhibited adequate regard for the effects of these policies on outsiders.

Trade restrictions are a major problem in all countries, but, again, recent experience is disconcerting. The European Community's set of special restrictions, both formal and informal, against imports from Japan (and from Eastern Asia generally), and in turn, Japan's impressive variety of import restrictions are anachronistic survivals from the days before Japan became a member of GATT. But the EC restrictions have been so effective, as have the Japanese restrictions, that Japan supplies only about 3 percent of the Community's outside imports, while Japan supplies 15 percent of the U.S. imports, thus unnaturally enlarging the external U.S. adjustment problem. Thus, the effects of the restrictions are triangular, and hurt more than the bilateral impact suggests.

Thus, there are some immediate problems with the European Community. But in the long run, of greater importance to us is the future orientation of an enlarged and strengthened Community. The Community stands today at one of the great crossroads of Western Europe's historic development. Presumably, it has now more or less defined the geographic extent of the nucleus of a new economic, and eventually political, union in Western Europe. It now has two options ahead of it: to proceed to consolidate or perhaps even enlarge that union as a kind of regional bloc concerned primarily with its own internal problems and its relations with its most immediate neighbors, or to build, from its new-found position of strength, a more open and constructive relationship with the world as a whole.

While we can understand Europe's preoccupation and justifiable pride with its own growth and internal integration, we must now somehow encourage the joint will and energy to increase external integration with the world economy, in parallel with its internal efforts. Carried to extremes, internal preoccupations of any developed world power center can become externally provocative and ultimately self-destructive.

Japan

We shall now turn our attention to another successful and major trading partner--Japan--which presented us with the most urgent set of restrictions. These restrictions, most obviously in violation of the rules of GATT and of OECD, notably overt quotas, have drawn strong diplomatic pressure from the U.S. and other countries and were being dismantled under a government schedule, slowly at first but more rapidly in recent years. Japan's prickly attitude toward foreign investment is also relaxing somewhat under pressure of a different kind.

On the other hand, Japan's more recent post August 15 decision to stimulate its domestic economy through impressive domestic fiscal measures, in this case attacking unmet social needs at home, has not, in my view, received adequate attention. It could signal a lessening dependency on trade surpluses and therefore more equilibrium on the international economic system.

Japan's economy is consciously shaped to meet long-range objectives under three bureaucracies. One of these agencies, MITI, is charged with keeping under surveillance all foreign transactions, in turn keeping keeping Japan's international economic relations consciously subordinated to national policy. This does not, however, mean that trading considerations are set aside; national policy is to help industry secure the cheapest imports and gain markets with rapid growth. International trade is consciously seen as an instrument to promote domestic production and employment. Added to this thrust is the belief that Japan's foreign policy must be expressed primarily in economic terms because Japan does not have a military presence significant enough to influence international security policy.

Japan's bureaucracy is not an "umpire of private business," as in the U.S.; it is a partner and shares its goals. This partnership in planning has helped give Japan the world's largest steel mill and its dominant role in world shipbuilding. It is now stimulating future growth in computers, petro-chemicals, aluminum, aircraft and space. Thus, by a combination of free enterprise and national planning, resources are allocated to strategic growth areas--including exports.

Japan supports an educational system that annually graduates more engineers and technicians than does the U.S., though the U.S. graduates more Ph.D's and spends more for research and development. It is supported by a uniquely cooperative labor force and a high rate of investment that have earned an unparalleled increase in productivity, and by an expanding system of incentives and subsidies for research and development, which the government hopes to see quadrupled (to $13 billion a year) by 1980.

Moreover, as Japan restructures in relation to its labor shortage, phasing in higher technology industries and drawing on the surrounding Asian countries for labor by importing labor-intensive manufactures, the competitive strength of Japan will grow even more. The developing countries near Japan will be increasingly pulled into advanced stages of development by Japan's investments and technology transfers to these countries. Already, the United States has had problems of adjustment to imports of products like textiles and stainless steel flatware from this group of countries. Canada and the European countries have also had adjustment problems in some of the same areas. In other words, the problem of adjusting to Japan's new position of strength will gradually become a problem of adjusting to changing forces of competition from Eastern and Southeast Asia generally.

The United States, Canada and Europe cannot simply turn their backs on that area of the world-- it is crucial that those countries find a place for themselves in world markets to maintain their economic viability and independence. How to adapt to these changing circumstanes poses yet another challenge to American foreign economic policy in the 1970's and beyond.

In relation to Japan's growing position as a strong competitor, and to the Eastern Asian rim more generally, it is of utmost importance that an international system of rules be available and be used to manage the trade relations between these countries and the rest of the world. As for Japan itself, since the logic of Japan's future growth depends on an expanding world market, and expanding Japanese trade and investment in all parts of the world, it would seem vital to Japan's interest to support the multilateral economic system. This means even more rapid opening and enlarging of its trade and business relations with its industrialized trading partners, and far more active and extensive aid and investment in developing countries, worldwide. More effective ways should be found by which Japan can play a role commensurate with its power and its long-term interests, in pursuit of an equitable, nondiscriminatory world economic system.

In short, the world of the 1970's is likely to be increasingly competitive and Japan has already demonstrated in an impressive way its ability to compete in that kind of world. On the other hand, undervalued exchange rates have led to some exaggerated fears that the U.S. and the rest of the industrial world would be "swallowed up" by Japanese competition. We cannot nor would we want to graft the Japanese business culture in the U.S. soil; but we can learn from its remarkable record of growth, and the foresight in its planning for modernization.

Less Developed Countries

Some 100 countries are classified as "less developed." Their average growth rate in GNP over the past decade has been slightly larger than that of the developed countries, but their growth must be measured from a much lower level to begin with. Their populations grow much more rapidly and LDC per capita income grows more slowly (less than 3% versus 4%), and the gap continues to widen between the world's rich and poor. There is no agreed formula for closing this gap, nor is this a feasible goal of U.S. policy. But a more rapid rise in LDC living standards is possible and obviously desirable.

Some LDCs, such as South Korea, Taiwan, Israel, Iran, Singapore, Greece, Brazil, and Mexico, have become success stories of growth. When growth rates are high, experience has shown that exports are likely to grow even faster than their GNP. Moreover, these export expansions are usually in manufactures or processed agricultural

products, not in raw materials. The prospects for more rapid growth of exports of primary products from many of these countries is not good. If LDC's growth is to be self-sustaining, their economies must become at least partly industrialized.

LDC manufactured exports have been characterized by labor-intensive methods of production and simpler technology. These are precisely the kinds of products that meet increasing political resistance in all developed countries because they create job dislocations. Yet if such LDC exports do not find markets, the foreign aid, private investment, and domestically generated capital that created them is wasted or lost. Already the repayment or service on foreign capital has become an onerous burden on some LDCs, who live in a gloomy financial framework. At the same time, the LDCs still harbor many opportunities for fresh foreign loans and investment; and their need for continued foreign aid remains a serious political demand on the developed countries, including the U.S.

Fortunately, the burden of foreign aid to LDCs is now being more widely shared among the industrialized countries. Indeed the U.S. itself has slipped back quite far in its relative effort. We have a vital stake in the expansion and the sharing of a kind of aid that is relevant to the '70s. In formulating our import policy, we must also take account of the LDC's need to export and to sustain their growth. To meet this need we must above all else restore confidence in the growth and competitiveness of our economy, and the equity and reciprocity of the world trading system. (The United States now imports more than a third of the manufactured products of LDCs). On this basis we can encourage efforts by all the developed countries to improve the access to their markets for the exports of LDCs in a balanced and equitable manner ....including our own program for generalized preferences.

Problems of regional adjustment also face us. Our relations with Latin America, for example are under continuing stress, as these countries develop and their political structures evolve with wider participation in economic and political decisions. Some of the difficulties arise from misunderstandings about the American economic role in Latin America. America's close economic relationship with Latin America has generated charges of exploitation and policies designed to frustrate their development. In the long run, bilateral relationships especially on a regional basis tend to lend themselves to this kind of political tension. Politicians in countries where there are problems will often blame a nearby outside force for the difficulties, provided that such a visible outside force exists. It is in our own interest, as well as that of Latin America, to multilateralize the economic relations of Latin America with the world in order to bring in more aid and investment from other developed countries, as well as the U.S., and open markets in other countries for the products of Latin America.

Communist Countries

Relations with the Communist world are now opening up rapidly. The United States has a long way to go in matching the trade levels of East and West Europe with each other. Presently, much of European trade with Eastern Europe and the Soviet Union is on the basis of bilateral agreements. A major effort may now be needed to see how to fit the non-market Communist countries into the multilateral framework of economic exchange among the Western economies. We shall also have to review at home the kinds of guidelines to apply in trading with non-market enterprises.

Canada

The economic interface between the United States and Canada is greater than that between any other two sovereign nations. Over 50% of Canadian corporations with assets greater than $25 million are foreign-owned, primarily by U.S. companies. U.S. citizens control about half of the assets in Canadian manufacturing, oil and gas, and mining and smelting industries. In the trade field, we purchased 66% of Canada's exports and provided 71% of their imports in 1970. As a result of U.S. direct and portfolio investment, the reverse flow of interest, dividend, and other income payments from Canada to the United States is very large.

We attribute a significant part of our widening trade deficit with Canada -- which probably will exceed $2.5 billion in 1971 -- to earlier trading and commercial arrangements that no longer seem necessary or defensible on the grounds of efficiency and symmetry. Our requirements for oil and gas and other raw materials can be expected to continue the rapid growth in Canada's manufacturing sector -- needed to employ Canada's growing and skilled labor force.

As these trade and investment trends develop over the decade of the 1970s, our respective governments will have to devise a closer working relationship to identify and resolve issues that could lead to friction between our countries. The very size of the American economy, with which Canada's is so closely associated, created a special desire for Canadians to nourish their own economic identity. This feeling deserves more sympathetic notice on the American side than it has received. Such a joint effort will improve the control our respective policies have in each others territory and provide a forum to boldly explore new ways of living and prospering together.

Multinational Corporations--and Investment Policy

Finally, we must recognize the rapidly growing importance of that large vehicle of wealth and capital transfers, the multinational corporation. Much is said and little is publicly known about the interlocking effects of these corporations on U.S. jobs, trade, and the balance of payments, and the effects on the economies of other countries. For example, while it is widely asserted that these corporations are "job exporters," there is some reason to believe they actually increase U.S. exports--at least exports of multinational corporations have increased and these exports account for more than a quarter of U.S. manufactured exports. We must seek better understanding of what actually takes place, and better means for comprehending the trade, investment and technology effects of these enterprises in our foreign economic policies. The sheer volume of their activities requires us to take a new look; the pressures from certain interest groups at home and abroad reinforce the need for fresh thinking.

Multinational corporations represent to some the wave of the future in that they already take a "one-world" approach to business. But to others, particularly the American labor movement, they represent a major threat to employment. To nationalists in developed and developing countries alike--but particularly in the latter--they represent a threat of foreign dominance of the national economy.

It is clear that the United States needs a coherent policy to promote the freer flow of capital throughout the world. Bearing in mind that our economy generates more savings for investment than any other economy in the world, we have a comparative advantage here. We also need a policy of promoting foreign investment in the United States because it is in our economic interest to generate more business activity and more jobs and in our political interest to offset the enormous disparity between American investment abroad and foreign investments in the

United States. We also need a new policy to protect our investments abroad against the threats of expropriation and harassment from the forces of economic nationalism.

As international business activities spread throughout the world sometimes through investment, sometimes through services and transfer of technology through licensing, sometimes through sourcing of parts from various plants around the world, sometimes through contractual management relations, the distinctions between trade policy, investment policy, and policies toward international business become blurred. In the long run, it is the whole array of conditions of doing business abroad, and the artificial inducements to operate in one place rather than another that should command our attention. The anti-trust policies, and increasingly the anti pollution policies, of other countries as well as our own should be reexamined, perhaps together, for suggestions concerning the appropriate course of our own policies for the future. Burden-sharing of pollution costs must now receive priority attention. Industrial policy generally should be studied, with an eye to determining the forms of discrimination, such as government procurement policies, which are used to favor home over foreign businesses. These broad types of questions have not had sufficient attention in the past in our policy planning process, but they must now be addressed in the context of the new realities discussed in this paper.

U.S. Trade Restrictions

As international negotiators, we must obviously concentrate our attention on the practices of other countries which frustrate our own abilities to derive maximum benefit from an open world economy. But at home we must become far more conscious of the fact that many of our own policies and practices are equally frustrating to those very partners from whom we expect policy changes. Indeed, if fair and equitable economic relations internationally are our goal, then it is imperative that each of us must change. This is not just to ensure "reciprocity" in a deal. The fact is that without such changes, we risk perpetuating weaknesses in our own domestic economy which will inevitably act as a drag on our ability to exploit our international strengths to maximum effect.

The catalogue of American restrictive practices is also long and growing. Some of these practices result from a too narrowly defined and defeatist-inspired view of what our "national" interest has required in the past. Others were the inevitable counterpart of restrictive practices by other nations. If our vision of a strong, competitive American economy operating in a fair and open international environment is to be realized, we must cut through our past fears and frustrations and strike a bold new course.

Nowhere are these old fears and frustrations more evident than in the variety of protectionist, and ultimately self-defeating, legislative proposals now before the Congress for restricting trade, investment, and the flow of technology. To go down the road signaled by these proposals is to guarantee that, in the long run, the American economy will become less and less competitive and less and less productive. This is a prescription for defeat and an admission of failure. It is not the course we propose to take.

The alternative is to take the offensive against the defects in the present international system, and in our own economy. As in virtually all aspects of life, the best defense is a strong, determined and confident offense. The offensive we will propose is a coherent, comprehensive and positive program of both domestic revitalization and international initiative, designed to build on and emphasize America's strengths, not to resign ourselves to accumulating weakness.

SECTION IV - A Strong Domestic Economy -- Requisite for a Strong and Outward Looking Foreign Economic Policy

Increased Competitiveness

I have earlier suggested the essential importance of the quest for fundamental reform of the monetary system if we are to attain a reasonably balanced and open international economic system. It may not be widely recognized that such a system also has a critical effect on what we have to call "competitiveness".

We must try to understand the relationship between balance of payments equilibrium, fair exchange rates and the "competitiveness" of our economy in international trade. We said earlier that fair exchange rates would make a major contribution toward achieving equilibrium in our overall payments balance. On the trade account, fair rates help establish our competitive position in two ways: they tend to set a price for our exports (in terms of other currencies) which makes it attractive for foreigners to buy our products, and they set prices for foreign goods in our market at which American industry can compete without suffering the artificial disadvantage which an overvalued dollar confers. By the same token, an exchange rate should not be set as to provide either an artificial advantage to exports or a bias against imports. The basic objective of a "fair" exchange rate is to assure overall external balance. In a state of external balance, we are thus "competitive" in the sense that as regards the trade account, we earn enough through exports of goods and services to pay for the products and services we import.

However, we should not assume that achieving balance of payments equilibrium is a sufficient economic goal. Desirable as it is, this does not achieve the larger purpose of improving the national purchasing power and the real income of our consumers.

Otherwise, we would need only to constantly devalue and thereby achieve balance. Repeated devaluations, however, would reduce our future "national purchasing power", i. e., what we were able to buy for our consumers and industries for a given level of exports.

Our objective should be to increase our national purchasing power and the improvement in our consumers' standard of living. To achieve this, we will need to increase our competitiveness, our productivity and,

in general, enlarge the areas of comparative advantage vis-a-vis the rest of the world. The way to do this is to concentrate on the things we do best. This, in turn, will increase our international competitiveness.

Enough has been said above about the current realities to draw some major conclusions about the directions U. S. foreign economic policy should now take. Our situation in the world is not only different, but somewhat more precarious than in the past. Even for a nation as technologically advanced as ours, the world market has and will become increasingly competitive. We can meet this competition with methods that will leave our country and the world a better place to live in. But to continue dwelling successfully in the world, we must take conscious and deliberate steps to make our economy more competitive with those abroad.

First, as I indicated above, it is important to emphasize that development of those competitive strengths depends mainly on our own efforts rather than on the actions of other countries. A strong foreign economic policy for the United States begins in a strong domestic economy. But, as is the case with most fundamental truths, it tends to be overlooked in the preoccupation with the variety of specific issues with which we must deal, and it is vitally important that we not lose sight of it.

Indeed, without a strong domestic economic base in which our own people have a sense of their future, and confidence in their ability to find a productive role in the world economy, a positive foreign economic policy is probably impossible. In a world in which economics is becoming increasingly political, it is not possible to have inward looking foreign economic policies and outward looking foreign policies.

A second fact with which we must contend is the increasing propensity of Americans to question the value structure of our society. It is ironic that this comes at a time when the external demands of a more competitive world economy are rapidly increasing. Many believe that, in the past, too much emphasis was given to producing an ever larger quantity of goods and services while the "quality of life" was subordinated to this drive. Some charge that our past and present concerns about productivity and economic growth are concerns about production for production's sake, as if growth were an end in itself. The argument is made that we need no longer be concerned with growth, believing either that affluence is assured automatically, or that we should even take steps to hold growth in check while we concentrate our resources on problems of quality.

According to these arguments, one would logically be led to conclude that growth and the "quality of life" are irreconcilable concerns. I do not share this judgment. In my view, improvements in the "quality of life" in our society can best flow from an economic base which is strong enough to make these improvements realities. It is important that we reconcile these views since failure to do so will not only frustrate the achievement of our "quality improvement" goals but will also keep us from realizing the growth and productivity objectives which are necessary for our competitive position and an increased standard of living.

To achieve the appropriate balance in the pace and quality of growth, we need to find new ways to harness our productive potential to achieve our qualitative goals. For example, technology is, in itself, indifferent to the uses to which it is put. Decisions about how to use it rest with man and society and our task is to decide wisely, remembering that without constant efforts to sustain our growth potential and strengthen our international competitiveness, the resources necessary to implement the needed changes in our society which will improve life's quality will simply not be available. This is what the international division of labor is all about.

In the international division of labor, the U.S. has many comparative advantages, but the most obvious are in agriculture, management, capital goods, and advanced technology. In the past, our competitive position has also suffered in many product areas where we would have been price competitive at fairer exchange rates. Thus, with realigned rates, we might reasonably expect that comparative advantages could emerge in some areas of lower technological content. However, in its most meaningful sense of an improved standard of living through international trade, our continued competitiveness depends more on new investment in plant and equipment, more on growth in research and development and more progress in training appropriate talent and manpower, particularly in the new skills U.S. workers will require as our society moves increasingly to more industrial sophistication and services.

This will not be an easy task. The challenge before us is difficult and will require both imagination and determination on the part of both government (the Congress and Executive) and the nation.

Investment

The President's initiative in August of this year, proposing a job development tax credit for new investment was the first, indispensable step in this direction. Its prompt appproval by the Congress shows that awareness of the new realities of worldwide competition and the fundamental importance of new investment, in both the creation of new jobs and improvement of the nation's productivity, is growing.

The President was convinced that investment in new plant and equipment -- where we are far from competitive in the incentives we offer as compared with all major Western industrial countries -- is essential to our future. It is equally essential that our citizens as a whole -- and industrial workers especially -- understand that, without the investment we need to stay competitive, both productivity and jobs will suffer. One reason our workers earn higher incomes than any in the world is because the machinery they know how to use enables them to be the most productive. But other nations are putting similar machinery into use, and, unless we continue to improve our own, the real output (productivity) of our workers will decline and with it, jobs, income and, in the long run, the satisfaction which men derive and need from the knowledge that their work is useful, both to themselves and their society.

Technological Opportunities

A second indispensable element in this process is the need first, to bring technology increasingly to bear upon the process of enhancing both the quality and quantity of our production and second, to deal effectively with the urgent social problems of our time.

A comprehensive approach is being taken in the Administration's new technologies opportunity program. For example the exploration of new energy sources for the future could greatly reduce our dependence on imported oil. In the nuclear breeder reactor program recently announced by the President, we are striving to have a generous domestic supply of the cleaner kind of power.

We also need to stimulate our economy's industrial research and development efforts. Industry -- to enhance its competitive position internationally as well as to produce more efficiently goods for the domestic economy, needs to do more to develop new products and processes. To achieve this goal, it it is clearly appropriate that the Federal Government consider new methods for bringing forth the new technologies upon which productivity and competitiveness depend. Proposals, including new incentives for this purpose, will be submitted to the next session of Congress.

Thus, it is essential that we identify some of the promising opportunities in the 1970's where it makes good economic sense, good technological sense, and good social sense for America to invest as part of a national effort to discover and shape America's future. This does not mean America must lead in everything -- which it cannot do and should not attempt to do -- but rather it should lead in those things that make sense for America to lead in.

Manpower Training Needs

By 1980, full employment will require jobs for almost 100 million Americans, about 20 million more than today's level. The problem of finding jobs for this labor force will require both an economy growing at its full potential (which, in turn, means exploiting to the fullest our international opportunities) and a much improved system of fitting manpower skills to job requirements.

The U.S. today, for example, is over-supplied with technical manpower for its defense and space requirements. Yet there are shortages of laboratory specialists, medical assistants, computer technicians, and maintenance personnel for other complex equipment. Less than half of available jobs have been filled in these specialities.

The mis-match of technical skills to opportunities and what might be the current and perhaps continuing excess supply of college graduates is compounded by an apparent shortage of appropriate vocational training in high schools and post high-school education and training. It is estimated that 8 of 10 in high schools should be receiving occupational skill

training, yet less than 1 of 4 are receiving it, and much of this training is not directed to anticipated needs in the labor force.

"Mid-stream" or mid-career training for adult employees is also limited. With rapid changes in the demand for labor brought about by innovations in technology, shifts of demand, and opening of international production, the labor force needs new ways to adapt to structural change.

The '70s hold much promise for the U.S. If full employment can be reached, our GNP by 1980 will exceed that of 1970 by 50%, in real goods and services. The internal functioning of the labor market and its training institutions must be improved. Training itself needs to become more responsive to demand, and the flow of job information -- matching skills to opportunities -- requires improvement.

I believe we may be approaching a decade in which fundamental reorientation will be necessary to provide the career education, upgrading, and conversion of old to needed skills in the labor force of the '70s. Without it, the mistakes of the past could be repeated, paid for in abnormal unemployment and wasted opportunity.

Shaping the Future

And finally, if we are to shape and indeed realize our future in this competitive world of the 1970s, are we not going to have to predict the future and define new strategies, in better ways than we ever have?

This does not mean that we have to embrace central planning like that practiced in the Communist countries, nor does it mean adopting the system of Japan or of any other particular country. It does mean, it seems to me, that we have to develop our own methods, define certain long-range economic and technological objectives, and create sufficient certainty in the intention to meet those objectives that our own private and public institutions can then generate the required long-range actions to do so.

Part of an effort to shape the future must be a concern with an organized program effort both to develop new sources of industrial material and energy (partly, through the technology of substitutes for natural materials) and the conservation of scarce materials to assure an ecologically balanced and attractive world. In 1970, the Congress created a National Commission on Materials Policy whose task is to inventory U.S. and world resource availabilities and needs, project these requirements into the future and make recommendations for an appropriate national materials policy. The President has directed that a task force of the Council define the issues and cooperate fully with the Commission in this review. We are acutely conscious of the need to construct a program which helps achieve in a balanced way our competitive, security, and ecological objectives.

It is not that the competitive challenge of the 1970s will not ask a good deal of all of us; it is rather -- given a sense of national purpose -- that we must make commitments about our economic future, and we must exert the will to compete and to lead.

SECTION V - A Work Program for International Economic Policy

At the President's direction, the Council on International Economic Policy has undertaken a wide-ranging review of specific issues in our foreign economic relations the purpose of which is basically two-fold: to enable us to construct a coherent strategy for the new era and to recommend new policies.

The following sections discuss the elements of the kinds of new programs which we now have under active consideration. However, I must emphasize that these proposals are still in the development and evaluation stage. Final decisions depend on Presidential review of any new initiatives which may be proposed, either as changes in existing policy or as proposals to the Congress for its consideration.

Adjustment Assistance

Adjustment to change is the essential feature of any healthy, dynamic economy in the modern world. In our society, with its relatively limited dependence on foreign trade, the magnitude of the adjustments which occur out of purely domestic structural changes is far greater than that directly attributable to the interaction of the rest of the world on our economy. These adjustments are often painful but, in the end, serve to make us stronger and more prosperous as a nation.

As regards adjustments due to import competition, while it may be true that they may be but a fraction of those which occur for domestic reasons, it is nevertheless a fact that the burden may be heavy one for a particular industry to bear. Furthermore, a program to build on America's strengths by enhancing its international competitiveness cannot be indifferent to the fate of those industries, and especially those groups of workers, which are not meeting the demands of a truly competitive world economy. It is unreasonable to say that a liberal trade policy is in the interest of the entire country and then allow particular industries, workers, and communities to pay the whole price. This is particularly unacceptable at a time when unemployment levels are high and there is widespread concern over jobs. To correct the defects of the present program, several avenues are already being explored by a task force of the Council on International Economic Policy. The most important of these are summarized below.

1. The broad national policy purpose of adjustment assistance should be to strengthen the U.S. economy by helping facilitate the processes of economic and social change brought about by foreign competition. The objective of an adjustment assistance program should be to make U.S. industry as a whole, including existing industries, more productive and competitive and thereby provide better paying jobs for American workers. When necessary, the program should be oriented toward encouraging the movement of workers and capital resources from activities no longer economically viable to those that are. In fact one index of the competitive strength of an economy is the proportion of its resources that are employed in activities in which the country excels.

2. Adjustment assistance should be given a new focus. Early action mechanisms (including strengthened governmental information systems) should be developed to spot trade import problems and begin dealing with them at the earliest possible moment. This would entail not only identifying actual and potential import-impact areas, but also pinpointing foreign trade distorting or disruptive practices on a world-wide basis, which are likely to give rise to significant U.S. adjustment problems. As part of this effort, we need to speed up the process of making anti-dumping determinations and the decision-making process related to escape clause and unfair practices legislation.

3. The program should be strengthened by building means for analysis of trade problems on an industry-wide basis, and providing a variety of assistance to encourage maximum self-assistance and market-oriented responses on the part of industry. Delivery of workers' benefits should be greatly accelerated. Finally, we need to determine whether and if the program could be broadened to include assistance to communities severely affected by foreign competition.

Clearly, the whole adjustment assistance effort is of great concern to organized labor. Developing a program which can be accepted by the unions, and communicated positively by union leaders to their membership will not be easy, but union support is critical to the program's success. Unions standing to lose membership through the retraining of their members for new crafts will have to be convinced that their workers will enjoy real benefits as a result.

Even when accelerated by a program of assistance, the adjustment process takes time -- and in recent years some economic changes associated with increased imports have occurred very fast. When increasing imports have the potential to bring change faster than the adjustment system can cope with it -- and thus to bring hardship -- some have suggested that temporary orderly marketing mechanisms should be available. We are now exploring this possibility to develop criteria for invoking such mechanisms, and to see how these criteria can be internationalized so that such temporary protection could be available in all countries on an equitable basis.

However, if temporary mechanisms are used to restrict the volume of trade, it would seem to me to be desirable to consider the requirements of a concurrent, orderly adjustment program for the domestic industry which is gaining protection. By introducing a domestic adjustment program as well, we would ensure that the period of special protection is actually used to assist an orderly adjustment, and not used as a permanent crutch, at the expense of consumers at home and efficient producers in other countries.

Export Expansion

We must be wary of an export expansion policy simply designed to celebrate exports for exports' sake. Export promotion policies must be viewed in the context of an overall fiscal and monetary policy designed to keep the economy on a full employment growth path with reasonable price stability.

Nevertheless, within the context of such overall policy, exports can be an important generator of jobs. It is estimated that every billion dollars of (real) U.S. exports creates 60,000 to 80,000 jobs. In the absence of distorting incentives, these jobs are usually better paying than those in import-competing industries. If our exports were now in adequate surplus (i.e., our trade balance had shifted from deficit to the size of surplus needed to bring our overall payments balance into equilibrium), the direct and indirect job effects of that surplus would have added between 500,000 and 750,000 men and women to the employed labor force. It is thus in the national interest to see to it that our exports are not at a disadvantage in responding to world demand, and that our exporters are equipped to take full advantage of the opportunities available.

The first export expansion imperative is a reformed monetary system to keep the dollar from becoming artificially overvalued again.

Also, other countries have long engaged in a variety of export-promoting measures. The U.S. needs more such measures of its own to correct certain international inequities and to realize our potential for growth in international markets. In our own export promotion, we shall also seek, in negotiation with other nations, to clarify and harmonize the international rules and limits that govern this national quest for markets.

Our Council's work program includes action in five major areas: tax incentives, export financing, easing of regulations, East-West trade, and better government services.

(1) Exports: Tax Policies

Our tax treatment of exporters has been less favorable than that of other countries and should be improved. The creation of the Domestic International Sales Corporation (DISC) permits the deferment of taxes on some export earnings and should bring U.S. treatment more in line with that of other nations, as well as giving U.S. firms clearer rules within which to plan their export programs. Other aspects of tax policy as it relates to export competitiveness are under study. For example, if the U.S. should adopt a Value Added Tax (perhaps at least partially substituting for existing direct taxes), GATT rules would permit a system of border taxes and export rebates as is the custom elsewhere.

(2) Exports: Financing

Special credits for exports are a common practice among trading nations and are provided in the U.S. by the Export-Import Bank. We are considering new ways to encourage the more flexible discounting of short-term export paper to make credits more widely available and to enlist the interest of smaller and medium sized banks and businesses in export opportunities. We may also wish to expand government insurance of certain export risks.

(3) Exports: Antitrust and other Administrative Restrictions

Our antitrust laws may contain inhibiting disadvantages to many potential exporters. The Webb-Pomerene associations have proved an ineffective offset to these disadvantages. Other possible checks to export expansion, such as excessive regulatory provisions, documentation and commodity controls, are being reviewed for possible removal or relaxation.

The Japanese example of promoting large trading companies, which specialize in export development, is well worth evaluating. There are countless small and medium sized U.S. firms which lack resources or know-how for dealing in highly competitive export markets. A trading company especially equipped to do so could place many of their products in these markets.

(4) Exports: Communist Countries

As I noted previously, the opportunities for the expansion of exports to the USSR and Eastern Europe are significant -- although important political, as well as strictly economic, issues remain to be resolved before we can take maximum advantage of these opportunities. Our study will outline some of these for Presidential decision. They include the desirability of offering Most Favored Nation tariff treatment to those Eastern Countries with whom we reach satisfactory arrangements concerning our own exports, and the expansion of export financing possibilities for American firms doing business with Eastern Countries.

(5) Exports: Goals and Organization

Export expansion deserves a high national priority not only because of the jobs it creates, but also because of our growing need for imports and because a trade surplus will probably continue to be required to help finance our other external security and economic commitments. As a national goal, export expansion may well require the reorganization of many government services relating to it. Our commercial services need upgrading and expanding in many ways now under review.

There is an unfortunate asymmetry in the politics of trade policy; even though exporting and importing interests are almost equal in an economic, or dollar and cents sense, they are far from equal in a political sense. Exporting interests have been perennially under-represented in the public and political dialogue on trade policy. It is understandable that legislators come to feel there must be more injury than benefit to industry from trade. And the consumer, who also benefits in important ways from trade, is hardly heard from at all. If we are to have a balanced trade policy, it is important that these under-represented groups be energized.

International Investment

It is true, as I noted previously, that we do not know enough about multinational corporations. Accordingly, high priority is being given by a task force of the Council on International Economic Policy to obtaining the basic data and carrying forward hardheaded analyses. Yet we cannot wait for all of the facts to come in before formulating new policy initiatives.

Some of the specific issues which arise within this framework are the following:

Investment Controls

These controls were perhaps appropriate during the period when our balance of payments was under pressure, but their role is being reassessed in the light of important developments, following exchange rate realignment and in the context of a reformed monetary system.

Taxation

A crucialLabor argument about the multinational corporations relates to what is seen as their favorable tax treatment, since overseas earnings are not taxed by the U.S. until repatriated. There is also a widespread international concern over the tendency of the multinationals to maximize profits world-wide by exploitation of variations in national tax systems and manipulative inter-company pricing. This situation calls for review of U.S. tax practices and for new international understandings about both taxes and accounting procedures.

Extraterritoriality

Foreign criticism of American multinational corporations frequently stresses the affront to the foreign country's sovereignty which may result from the extraterritorial application of U.S. law to U.S.-owned corporations. Some Canadians, for example, to whom the dominant role of U.S. investment is the subject of great political concern, have suggested that a government-to-government undertaking not to apply domestic legislation to corporations acting in the other's territory would greatly assuage political tensions and permit business to be conducted according to commercial criteria. Others argue that the application of American antitrust laws and practices abroad handicap the U.S. competitive position in those countries.

Foreign Investment in the U.S.

In general, the Federal Government treats foreign corporations the same as domestic corporations. In addition, the advantages that states, regional development areas, and some cities offer likely investors are generally available on a non-discriminatory basis. Foreigners frequently allege, however, that our antitrust laws and most particularly the way they are administered, inhibit foreign investment in the U.S. It also seems likely that insufficient information is available to the potential foreign investor about opportunities in the U.S. or that, at the very least, facilities for communicating available information are inadequate for the job. Thus, a more vigorous promotional campaign might yield dividends. The problem is not entirely dissimilar from what we experience in promoting U.S. tourism.

Expropriation and Other Forms of Foreign Harassment of or Discrimination Against U.S. Business

While expropriation policies of other governments create acute political problems, more subtle methods of harassment or discrimination -- for example, with respect to tax advantages, rights of establishment and access to convertible foreign exchange -- pose equally serious problems. In the developed world, our Friendship, Commerce and Navigation treaties and the Organization for Economic Cooperation and Development Capital Movements Code provide some protection, but throughout the developing world the foreign corporation often has a less secure legal position. There would appear to be a manifest need for an international code to govern national treatment of foreign investments. It would be desirable for developing countries to subscribe to and honor such a code but failing this, a coordinated approach for the developed countries to such issues as expropriation (we plan to release in a matter of weeks a statement of U.S. policy on this subject), discriminatory practices, investment insurance, and dispute settlement would be desirable. At the same time, such a code governing national practices might well be supplemented by a code of good behavior for corporations.

The difficulties of negotiating such codes can hardly be overestimated but their importance for the fair treatment of international business in an open multilateral world can hardly be underestimated.

Legislative Possibilities

The recent report of the President's Commission on International Trade and Investment Policy (the Williams Commission) recommends a major new initiative to liberalize international trade, including the eventual elimination of all tariffs and new arrangements to make trade in agricultural products responsive to factors of comparative advantage. Task forces of the Council on International Economic Policy are actively studying these recommendations and the possibilities for new legislative initiatives which would equip the President with the authority he needs to break through the sterile trade quarrels of the past and develop new arrangements to promote international commerce and finance in a growing domestic and world economy.

We are studying the kinds of Presidential authority needed to deal with tariffs, (we should not forget that tariff reduction can be an effective antidote to regional preferential arrangements, for if there are no tariffs, of what value are tariff preferences?) the very important non-tariff barriers, special problems in agriculture and measures particularly needed to deal with trade issues involving less developed countries and the Eastern Countries. We are considering the directions we should move in internationally and the kinds of authority we may require to negotiate agreements or codes relating to international investment issues. It may also be desirable to propose new legislation to deal with the temporary disruption of markets due to a rapid

build-up of imports, and revisions in existing legislation concerning relief from import competition and unfair international trading practices (including antidumping and countervailing duty laws). Council task forces are attentive to the problem of discrimination abroad against U.S. exports and will propose measures to deal with it as needed.

Finally, we need to relate these issues to new programs designed to stimulate the competitiveness and development of America's economic strengths; to promote needed domestic adjustments and to deal constructively with our major domestic economic and social problems in an interdependent world economy.

The Williams Commission emphasizes the fact that "the [major new series of international] negotiations -- and the preparations therefore -- must involve the private sector and the Congress so as to ensure domestic consensus on U.S. objectives." I fully endorse this recommendation, and our study of new legislative proposals will include strategies for meeting this requirement. During the post-August 15 negotiations, for example, we have attempted to keep interested committees and members of Congress informed on the progress of the negotiations.

SECTION VI - Negotiating a New Era

The new international economic policy is only just launched. A significant exchange rate adjustment has been achieved. Trade negotiations are in process in the short term, and prospects for longer term negotiations are being assessed.

While the Administration pursues a program of restoring competitiveness and vitality to the economy at home while negotiating with our trading partners abroad, basic challenges to the world trading system remain. These issues must be grappled within the weeks and months ahead in order to assure realism in our objectives.

For example, the Most Favored Nation (MFN) principle has been the guiding spirit to trade liberalization. However, with the enlargement of the European Community and the association with the remaining EFTA countries, one half of the world's industrialized trade may be conducted at preferential rates. Regional trading arrangements are expanding, not contracting. What implications does this have for the MFN principle? What should a new system have to say about regional free trade areas?

In a world where developed countries are zealous in maintaining or enhacing their trading positions and where LDC's, some with surprising manufacturing potential (particularly if one projects a logical expansion of today's mobility of capital and technology) are also seeking to improve their lot, what systemic changes are needed to assure a full, fair and digestible expansion of trade and capital flows?

Are present institutional arrangements adequate? GATT has been ineffective partly because it is overly dependent on the weak rule of consensus. Institutional changes are probably also required in the monetary area. For example, promoting responsible acts on the part of surplus countries is probably a necessary ingredient of reform. This would likely require important changes in the rules of the International Monetary Fund.

To meet the new realities, not only our policies but our methods of diplomacy will have to be changed. Our international negotiating stance will have to meet its trading partners with a clearer, more assertive version of new national interest. This will make us more predictable in the eyes of our trading partners. I believe we must dispel any "Marshall Plan psychology" or relatively unconstrained generosity that may remain... this is not just a matter of choice but of necessity.

We must seek reforms of the international economic system in all its dimensions: monetary, trade, and the conditions of doing business generally. The international aspects of the New Economic Policy are a warrant of this intent. It is essential to adjust the system to the new realities, or else the new realities will make the present system irrelevant, leaving us with no effective mechanisms for moderating our international economic relationships.

The simple realignment of exchange rates will not be enough. Unrealistic exchange rates have created serious distortions; they encouraged abnormal trade surpluses and deficits; they created artificial inducements to invest in some economies where assets were valued too cheaply; they artificially distorted the patterns of some economies in favor of exports over domestic economic reforms. New rate relationships will ease many of the difficulties--temporarily. We must have longer term monetary reform. Among the issues on the agenda of negotiations for reform of the monetary system are the need to establish a new regime under which there is a presumption that exchange rates will change when needed rather than a presumption that they will remain fixed and inflexible for long periods; a need to equalize the incentive to adjust for surplus and deficit countries; and the need to determine a rational, certain procedure and means for the creation and regulation of international liquidity that reduces the world's present dependence on U.S. deficits and gold. At the present time, the Department of the Treasury through the interagency group it chairs, the so-called Volcker Group, is actively studying alternative monetary systems as part of the process of formulating a United States view.

However, reform of the monetary system must not be seen as an end in itself. The monetary system lubricates the machinery of international trade and investment, but as we have seen, the trading system has to be altered to insure against structural distortions to industry adjustments, to avoid international conflicts, and to provide a basis for world trade expansion. We must begin this effort now and show that constructive negotiations can achieve results. We have already begun new planning for broad-based negotiations on reform of the whole trading system. Japan, Canada, and the European Communities have now agreed that we should move in this direction.

It is our intention that these new systems, if they are to fit the new realities and meet our national needs, must be characterized by shared leadership, shared responsibility, and shared burdens. All of the relatively stronger nations, and especially the European Community and Japan, must now accept a wider sense of world responsibility. Whatever their regional policies or preoccupations, they owe parallel responsibilities to the world trade, monetary and investment system which I trust the U.S. will continue to support.

Nations are bound to differ in their views of the benefits and nature of this global economy. For this reason, we must recognize that our negotiations will mean mutual concessions. Definitions of reciprocity are no longer so obvious, nor so easily compared to horse trading, as they once were. Instead, we must seek a civilized system which establishes objectives, principles and procedures to which all nations, or at least the strongest nations, commit themselves, and one that will enlist the loyalties and hopes of the weaker nations.

The costs to nations of changes will not be measureable in traditional terms. It is a question of finding a common good, a common basis for conducting international economic relations.

It is such a system, and not an artificial American advantage which we should now seek. We certainly do not intend to retreat into an economic fortress America, nor to lower our sights from the continuing worldwide progress found in an improved system of world money and trade. If we take measures, as we must, to improve our own competitive strength in this area, it is because we believe we can thus best contribute to the creation of a more effective system of equitable opportunity for all countries, large, small, rich and poor.

The tradition of the Yankee trader, which we may proudly invoke, is a tradition that placed its faith in more trade, not less. And now that others have become first-rate economic powers in their own right, there must also be the realization that political, economic and security questions are inseparable in long-range policy planning, and that it is the global relationships which in the end must be protected and nurtured. In an increasingly economic, interdependent and competitive era, we shall also find increasingly that economics is politics.

That increasing interdependence, which also spells increasing prosperity and peace, cannot however be taken for granted. We are all at a crossroads where short-sighted national and regional interests beckon in a different direction. Until last August 15, I am afraid the forces of history were pointing toward a world of mutually receding and inward-looking blocs, precariously and even dangerously divided in asymmetrical mistrusts. The President's August initiatives were predicated on a vision of a different kind of world. It is a more open, outward-looking, multilateral, prosperous, increasingly symmetrical and well balanced world -- in which a commonly accepted system of rules and behavior patterns will assure the continuing prosperity of each and all.