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The Challenges of International Economic Policy

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My subject, although not quite so broad as all outdoors, is perhaps more appropriate to a year's seminar than a single lecture. The difficulties it presents lie less in the enumeration of the challenges than in finding the answers—answers not just in an intellectual sense, but in a way that will move the world outside the university. In the end, people need to be impelled to respond to threats that may still seem abstract and abstruse, removed from our daily life, even though they are very real.

Americans have shown again and again that they can respond well to crises that are evident to them. Understandably, their reactions are less certain, less forceful, and apt to be mired in interminable debate when the challenge is less visible, when we still can put off changes in the way we live. To take the most obvious example, can we really get excited about the energy problem—excited enough to take action that affects our pocketbook and our style of living—when the oil storage tanks are full and the local gas station may be undercutting the price of his competitor down the road? Certainly, President Carter is trying to drive the message home, and he has properly made energy a number one priority. Yet, we have not really acted so far. If we procrastinate further, what are the chances of dealing at all effectively with the crisis that seems so likely to come, sooner or later, in the crucial energy sector of our economy, a sector in which large changes require lead times of years or even a decade or more?

The energy problem deserves to be on the top of the list of our international economic priorities partly because it cuts across and complicates our other problems. It is not only a matter of the huge increase in the prices of petroleum products. Important and painful as that is, the higher prices, as we permit them to be reflected in our domestic markets, at least provide strong incentives to adjust by both conserving and producing.

We also face the hard fact that, in physical terms, our sharply increased oil imports are now nearly equal to our shrinking domestic production. That places an enormous burden on our balance of payments. Oil imports are running at $45 billion per year, equivalent to *all* our imports only six years ago and almost 40 percent of all our current exports.

The violent changes in the petroleum markets have contributed heavily to a second challenge: the need to deal with the huge imbalances in international payments that have emerged for a number of countries. Such imbalances are not a new feature of international economic life, but they have assumed a new dimension.

Much attention recently has been given to the prospect of a trade deficit for the United States of perhaps $30 billion this year, several times any previous figures; as I just suggested, our oil imports are a major contributor But, taken in isolation, that figure can be misleading as to the extent of our problem. We earn a net of well over $10 billion a year on our foreign investments and on services. We are well placed to attract foreign capital. We are a strong and relatively stable country.

Other countries, including some much poorer ones, have found themselves in a larger deficit position, relative to the size of *their* economies. Meanwhile, the oil-exporting countries have *surpluses* on current account on the order of $40 billion. So long as those surpluses exist, other countries, taken together, will have a deficit. But oil cannot fully explain the extent of the current imbalances or how they are distributed. A handful of oil-importing industrial countries, led by Japan, also have large and persistent surpluses. The deficits of others far exceed the impact of oil prices on their imports.

The size and persistence of these imbalances have led directly into a third problem: the need to finance these imbalances, with the concomitant increases in international indebtedness. From an immediate point of view, it might be argued that this challenge, assessed with so much foreboding a few years ago, has been met successfully. A combination of sharply expanded commercial bank lending, larger flows of official assistance to developing countries, and some strategic use of the medium-term lending resources of the International Monetary Fund have, together, bridged the gap in the payments position of most countries without drastically impairing their development programs or growth.

We should pay tribute to the resourcefulness and flexibility of the international capital markets and official organizations in meeting the needs that followed the oil crisis. But let us also clearly recognize there have been elements in this process that cannot be sustained indefinitely. In some instances, financing was so freely available that borrowing countries were slow to take necessary measures of adjustment, thereby building up debts at a rate that would threaten their capacity to service their debts and increasing the risk of abrupt curtailment of new loans. The bulk of the bank lending has been for relatively short terms—

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substantially shorter than the need—which introduced a potential element of instability that could be damaging to both growth and the maintenance of open markets. Helpful as it has been, bank lending—and the short-term indebtedness of some important borrowing countries—cannot reasonably continue to grow at the same rates of speed without at some point jeopardizing economic and financial stability.

Dealing with the problem of international indebtedness is only one facet of a still broader challenge: how to meet the aspirations of the developing countries—the so-called poor South—for a higher standard of living, and do so in ways consistent with the prosperity and health of the Northern industrialized world. In a sense, the OPEC nations found a way to meet their own needs by forming a cartel for the supply of oil. But in the wider interest, including that of

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resource-poor developing countries, that is hardly a model we can afford to see emulated. Perhaps it is fortunate that the same technical possibilities exist for few, if any, other commodities. But the basic issue of recognizing and meeting the aspirations of the poor will not go away. While I can barely scratch the surface of this problem now, the acerbic tone of some of the so-called North-South dialogue points to the threat of divisive actions, with implications of political as well as economic tensions, if cooperative approaches are not agreed upon.

Finally, in setting the international agenda, I think we must plainly recognize the threat implicit in all these other challenges to the basic fabric of a liberal, market-oriented world economy. At a time of economic trouble there is a temptation for any country, including our own, to try to meet its immediately visible problems by pushing off adjustments onto its trading partners by means of unilateral protectionist measures. Widespread unemployment, pressures on international trading positions, an inability to obtain international credits, and fear of new competition from developing countries—any one of these can be the breeding ground. Today, in one country or another, we have a combination of all those factors at work.

The fallacy in the protectionist instinct is, of course, quite clear from a global perspective. Even though protected markets may seem attractive from the viewpoint of a particular industry, the net rewards are nil. More than that, when everyone plays the game, they are negative. Collectively, we would all end up losing markets and pay a high price in economic distortions, inefficiency, and political friction. The United States, as the leading trading nation, could hardly expect to indulge in protectionism all by itself.

This might seem a formidable list of problems, but I believe it reflects the shape of the world today. I do not believe, however, that we need to approach the international agenda in a pessimistic, defensive mood. The whole record of the postwar era gives grounds for confidence.

Amid the desolation of economic life in many countries after World War II, we built from scratch new international financial institutions, the IMF and the World Bank, that have stood up for thirty years. Trade barriers have been decisively reduced and the gains consolidated in the GATT trading rules. As recently as the early 1970's we managed a virtual revolution in the international monetary system. All of this has been reflected—taking the broad sweep of the past three decades—in an unparalleled era of growth, an enormous expansion of international trade, and dramatic gains in the welfare of some of the poorest countries of the world.

None of this was, in prospect, simple. If we cast our minds back only four years when the oil crisis burst upon an unsuspecting world, we can readily recall the portents of gloom at that time. Indeed, the concern was justified. In the next year, we saw both record levels of inflation in the industrialized world and the deepest of our postwar recessions We are still feeling the effects Yet, much progress has been made toward restoring a healthy economic environment.

Growth in the United States has averaged almost 6 percent a year in the past two and a half years, and we have 7 million more people employed. With some exceptions, growth has resumed in industrialized countries abroad as well And, notably, growth in the developing world has been at a faster rate than in the industrialized countries abroad, averaging 5 percent, only fractionally below the favorable record of the late sixties and early seventies. The rate of inflation, while still far too high, has been cut almost everywhere.

These accomplishments were not accidental. In part, they were a reflection of positive, deliberate governmental policies. Into that category, I would put the vigorous measures adopted almost everywhere, through monetary policy or otherwise, to bring inflation under control, while encouraging and facilitating economic recovery. A number of countries have addressed with some success their external payments problems. At the same time, steps have been taken to enlarge international official financing facilities so that adequate funds could be brought to bear at sensitive points

Perhaps as important is what governments *refrained* from doing. They have not, in general, retreated behind protectionist barriers to trade. With rare exception, capital markets were left free to function both here and abroad. Rather than introducing a panoply of controls, exchange rates have been permitted to swing to support needed adjustments in payments positions, although wide and erratic movements have sometimes been a cause of concern.

In these circumstances, markets for both goods and money have been able to make many of the needed adjustments. I have already touched upon the role played by international financial markets. New syndicated international bank loans and bond issues totaled some \$140 billion-\$145 billion in the three years 1974-76, two and a half times the previous three years and more than six times the volume in the late 1960's. Meanwhile, imports of the oil-producing countries have quadrupled since 1973, reducing their current account surpluses from nearly \$70 billion in the immediate aftermath of the oil price increases to about \$40 billion today. While the great bulk of those shipments was from industrial countries, the nonoil developing countries have managed to increase their total exports at a rate of about 15 percent a year since 1974, bringing their deficits to more manageable although still high levels.

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But let us look, equally, at what remains to be done. First there is energy. While the degree of effort and success has varied among countries, many still lack forceful and comprehensive energy programs. In particular, the United States—consuming 40 percent of the world's energy and a third of its petroleum products—has been a laggard. Although our use of energy has been prolific, far above other countries' per capita or per unit of production, we have less conservation. Oil imports have increased by nearly \$20 billion in the past two years alone, directly accounting for about half of the reversal in our trade from a surplus of \$9 billion to a deficit of \$30 billion. The four major European countries and Japan are all using significantly less oil per unit of production than in 1973; we are using virtually the same amount.

Fortunately, from the standpoint of financial stability, the oil producers have tended to invest the bulk of their liquid funds in the dollar, helping to finance our balance of payments and maintaining the value of our currency in world markets. That policy is ultimately justified primarily by confidence in our financial policies and in our economy, which places an extra premium on the way we run our affairs. Given the burden of the oil imports on our external payments, to maintain that confidence it is particularly important that we can point to the prospect, over time, not of inexorable increases in our oil imports but of a decline.

I know the specifics of any energy program are controversial. They are bound to be when the implications for both the consumer and industry are so

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large. Different points of view about how to attack the problem need to be heard and are being heard. But, amid all that controversy, let us not lose sight of the crucial message—that we need a strong energy program and that the time is already late.

In a second area, financing, we have already had some helpful initiatives. Quotas in the International Monetary Fund are about to be raised, providing that institution with an additional $6½ billion to $7 billion in usable currencies. A supplementary credit facility, the so-called Witteveen facility, amounting to some $10 billion in total, is awaiting endorsement by national legislatures, including our own. Together with $8½ billion of existing usable resources, the IMF should be reasonably well equipped to meet the more immediately foreseeable needs through this decade, provided our Congress and other legislatures act in a timely way.

But the potential requirements remain huge. Not allowing for aid programs, the nonoil developing countries are still running deficits in the neighborhood of $25 billion-$30 billion a year. The smaller and economically weaker OECD countries—Spain, Portugal, Turkey, Greece, and others—have combined deficits of some $20 billion.

Commercial banks can supply part of those needs, if all goes reasonably smoothly. The issue is not, as some have suggested, "bailing out" the banks of existing commitments. But they cannot—they should not—in the interests of their own diversification of risks be asked to continue to carry so much of the load. Needs for official finance, beyond the amounts already in train, are therefore foreseeable. It is only prudent that international negotiations to that end have begun in the framework of both the IMF and the World Bank.

Funding from the IMF and the World Bank brings benefits beyond the money itself; indeed, this must be part of the ultimate justification. Substantial IMF lending is conditional. In other words, it is dependent upon borrowing countries undertaking orderly programs of adjustment to eliminate or to reduce sharply their needs for external loans as time passes. This often requires dealing with difficult underlying problems of domestic policy. But success in these efforts is crucial, not only in a domestic context, but in protecting the structure of private, as well as public, international credit.

Long-term money from the World Bank is directed primarily toward productive projects—projects that promise reasonable rates of return. Success in those efforts ultimately supports internal growth while improving the capacity of the borrower to service international indebtedness.

The difficulties and sensitivities of working with sovereign countries in support of effective economic policies are well known. But official international institutions in many instances are better equipped, and better positioned, to undertake this delicate work than private lenders. That fact—together with concern over the growing exposure of banks to risks of foreign lending, as well as the vulnerabilities of countries to the risks of dependence on relatively short-term private financing—has stimulated some thinking that the great bulk of lending to developing countries be channeled through official institutions. Alternatively, some have hoped that the IMF might take a much more active role in influencing the decisions of private lenders, that it would, in effect, take upon itself a kind of role as an international credit rating agency, act as a middleman for private funds, or encourage private lenders to commit money only in conjunction with IMF loans.

Those sweeping proposals have foundered, I think rightly, on both practical and conceptual grounds. Governments have demonstrated no willingness to provide money to the official institutions on the scale that would be required. Neither potential borrowers nor lenders want their flexibility and choices so limited. And it is at least doubtful that any single institution is uniquely equipped to do the job, or could or should be given the immense power of credit allocation that it implies.

Much less formally, and without the same implication of comprehensiveness or compulsion, more *ad hoc* arrangements involving a combination of official and private credits to particular borrowers have developed. For instance, some bank lending is specifically conditioned on parallel IMF loans or standby arrangements. Lenders in some instances have entered into co-financing arrangements with the World Bank, working out mutually complementary and dependent financing terms. Efforts are under way to improve the information available to private lenders.

All of this strikes me as highly constructive and worthy of further experimentation and development. One thing seems clear; substantial public *and* private credits will be needed for an indefinite period ahead. Each has advantages—and each has dangers—if carried too far. A complementary approach, with private and public lenders both carrying a portion of the burden and risk, seems to me the prudent course.

Over time, the success of all these efforts will be dependent on the economic environment in which they proceed. There can be no question that the most important single contribution the United States, and the industrial world as a whole, can make to that environment is to maintain reasonably steady growth. And, I think the lesson has been driven home that those prospects are closely linked to the success of our efforts to deal with the inflation that has become so deeply ingrained in recent years. Obviously, those goals of growth and price stability are critical, regardless of their implications for international policy. But the international considerations do, it seems to me, raise the stakes enormously.

It is not a process which any one country, even one so large as the United States, can indefinitely maintain as if it were an isolated island. Let me suggest one reason. Over the past two and a half years of recovery, this country has been among the fastest growing in the industrialized world, not so much because our recovery has been exceptionally rapid, but because that of others has been relatively slow. One result has been that our imports, even apart from oil, have been

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growing relatively fast, spurred in some instances by aggressive selling by foreign industries faced with slack markets elsewhere. At the same time, with investment relatively weak abroad, our exports have been almost flat. Some calculations suggest half or more of our current deficit can be traced to differences in growth patterns here and abroad.

Fortunately, some of the same factors helping to account for much of our trade deficit help make the United States especially attractive to foreign investors, potentially bridging the gap in our payments. I say fortunately because our trade deficit does not appear to stem from circumstances in which our basic competitive position has been impaired, or in which a generalized depreciation of the dollar is helpful or appropriate To the contrary, as Secretary Blumenthal and Chairman Burns have recently emphasized, a strong

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and stable dollar is in our interest, as it is in the interest of other countries who are dependent on reasonable stability in our currency to conduct international trade and finance and to manage their reserves in orderly fashion. That stability can be better assured to the extent that it can be foreseen that the next major swing in our current account position will be in a positive direction, that our current deficit is indeed in considerable part cyclical, and that the climate for investment, domestic and foreign, is improved.

More broadly, that prospect is fundamentally related to our success in controlling inflation, as well as to the success of our energy policies.

Beyond this, today, more than ever before in the postwar period, we need to recognize and cope with the risk that—deliberately or inadvertently, here or elsewhere—nations will turn inward for solutions, seeking relief for themselves by closing markets to others.

In this country, a week hardly passes when the case is not put that foreign competition has contributed to the closing of a plant or sizable layoffs. The causation often seems direct and certainly visible, even when the underlying situation is clouded by other factors.

In some cases, such as in shoes, in textiles, and increasingly in certain electronics products, the competition is mainly from poor countries, countries that will need expanding foreign markets if they are to grow and service their debt. In other cases, as in steel, the competition is from some of the strongest of our trading partners.

The mistake we could make is to forget that these pressures are not unique to the United States and that the countries from which we import are usually also large markets for our export industries. Jobs are at stake at both ends—here and abroad, in export- as well as import-competing industries.

We stand on strong ground when we insist that competition be fair as well as open, when we guard against dumping and export subsidies.

We need to insist that our open markets are matched by others—and the negotiations now under way at Geneva provide a forum for that.

We will meet with understanding when, in limited and special circumstances, the pressure for rapid change is so great that adjustments can reasonably be slowed through mutual agreement.

The dividing line between those policies and unilateral decisions to close certain markets may sometimes seem thin, but maintaining that distinction is vital to world economic stability and prosperity.

Difficult as it is, the line needs to be drawn. Upon that basic distinction rests much of the hope for world economic progress and order. All those other challenges I have been raising do seem to me solvable in a context of growth and open trade, but not if we collectively retreat into a world where each seeks special advantage.

Unlike the immediate postwar period, the United States, important as it is, no longer can dominate the world economy. We cannot undertake almost alone to underwrite the stability of the monetary system, to maintain open markets, to carry the bulk of assistance programs. We live in a much more complicated world—in many ways a less comfortable world—where sovereign countries, sensitive to maintaining their independent power of decision, must yet work in harness if they are to achieve their objectives.

Intellectually, no one disputes the slogan of interdependence. Emotionally, it is still hard to accept that interdependence encompasses the reality of mutual *dependence*. But it is that realization that needs to guide our conduct. The United States cannot unilaterally direct the course of the world economy. But if we don't show the way, who will?