THE U.S AND THE WORLD ECONOMY: THE NEXT FOUR YEARS*

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Introduction

The next four years present unprecedented challenges of economic policy-making to the second Reagan Administration. It faces the urgent need to reduce large and continuing budget deficits, to bring greater stability to international finance, to strengthen a seriously threatened world trading system, to manage a still precarious international debt situation, and to help meet the critical capital requirements of the developing countries.

Answers to these questions cannot be further evaded or postponed without threatening the welfare of the United States and the cooperative international economic order established at the end of the Second World War. We are living on borrowed money and on borrowed time. For the United States and for other countries, an economic moment of truth has arrived.

The way in which the Administration handles these issues will affect the world economy for years to come. For

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if one thing is still as true as it was forty years ago, it is that the United States, with the strongest economy and the strongest currency in the world, is still at the center of the international economic system. Its internal economic decisions, for better or for worse, are the greatest single influence on that system. The United States is no longer in a position to write the rules of the international economic game, but it still shapes the economic environment in which everyone else must play.

Although the United States is the key actor, other nations have major policy responsibilities. Europe, Japan and the developing countries have not sufficiently faced up to the hard economic choices essential to their own well-being and that of the global economy. Part of the new reality is that international economic responsibilities will have to be better shared in the future than they have been in the past

There is also a crying need for greater cooperation among the international economic institutions, among economic policymakers in different countries, and among financial, trade and development ministries within countries. The linkages between nations and between policy sectors are now too close for piecemeal management by fragmented jurisdictions.

What is most urgently needed now, as we confront 1985, is not a set of new _international_ initiatives, but fundamental changes in the _domestic_ policies of the key economic players

Unless these domestic changes are made, whatever international order still exists is in jeopardy. And paramount among these policy shifts has to be the assertion of strong leadership on the part of the United States.

This report is designed to clarify public thinking on the economic issues facing the new Administration and other governments. We maintain that an essential first step in dealing with any of these issues -- and the most pressing economic decision facing the second Reagan Administration -- is the need for the United States to restore a balanced domestic economic policy.

We therefore propose, as our first recommendation, that the President, as soon as possible, convene a meeting with the leaders of the House and the Senate of both parties to produce a bipartisan deficit reduction package. The reduction of the deficit is not a panacea. But it is a prerequisite for restoring order to an international economic climate that is increasingly characterized by fragmentation and drift. With American leadership putting its own house in order, the outlook is still optimistic. Without it, we risk an economic crisis of global dimensions. That is the opportunity, and the danger, of the four years ahead.

In the following pages, we offer proposals in the four areas of finance, trade, debt and development None of these issues can be dealt with in isolation. Without improved domestic economic policies in the United States, Europe and Japan, the

world will continue to suffer from high real interest rates, destabilizing capital flows, and volatile and misaligned currency relations. Without a more orderly and rational set of exchange rates, the postwar system of multilateral trade will eventually collapse under protectionist pressures. And without lower interest rates, more open markets, and larger international capital flows, the Third World nations will be unable to service their debts and meet minimum development goals necessary for the fulfillment of basic human needs and the survival of democratic institutions.

I The U.S. Deficit, the Dollar, and the International Monetary System

The single greatest threat to international financial stability today is the present unsustainable course of the U.S. economy. The Congressional Budget Office (CBO) estimates that even assuming a continuation of the current recovery at approximately 3 to 3-1/2 percent real growth over the next five years, and even assuming a 2 percent drop in real interest rates, Federal budget deficits will rise from $182 billion in fiscal 1985 to $263 billion in fiscal 1989. Using CBO projections Martin Feldstein, former Chairman of President Reagan's Council of Economic Advisers, further estimates that even with a 5 percent rate of real growth for the next five years -- a record of economic performance we have never come close to achieving -- we would still have a deficit of more than $150 billion in fiscal 1989. There is thus no chance

whatever that we can "grow out of the deficit," unless we make fundamental changes in our tax and spending policies.

Indeed, due to the recent economic slowdown, the Reagan Administration's Office of Management and Budget now estimates the deficit for fiscal 1985 at $210 billion -- more than the CBO forecast of $182 billion cited above. Thus the CBO deficit projection seems unlikely to prove too pessimistic And this projection tells us that with the continuation of present policies our national debt, which has already doubled from $700 billion in 1981 to over $1400 billion today, will double again to about $2800 billion by 1989. Annual interest payments on that debt, which were as little as $7 billion in 1960 and $96 billion in 1981, will be $181 billion in this fiscal year.

Our unprecedented deficits reflect a combination of the significant tax reduction of 1981, the explosion in defense spending, the dramatic rise in debt interest payments, and the automatic increases in Congressionally-mandated social programs. Payments on debt interest, defense and Congressionally-mandated entitlements now account for more than 80 percent of the Federal budget. By fiscal 1989, according to the CBO projections, these three items will exceed revenues by $64 billion. This means we will have a deficit even if we eliminate the entire apparatus of national civilian government.

These figures reflect a nation living beyond its means and failing to build for its future. In the verdict of

the financial markets, these deficits will eventually be monetized by increasing the money supply. The markets also foresee half of our domestic savings used just to finance our deficits, leaving insufficient savings available for the needs of the private sector. Such expectations contribute to high interest rates and to lower levels of private investment, less housing, lower productivity gains, and ultimately to lower growth.

The U.S. budget deficit has serious international ramifications as well. It is being financed by huge capital flows from abroad, money which is needed to help revive the sagging economies of Western Europe and the Third World. The inflow of foreign funds stimulated by high interest rates has pushed up the value of the dollar, with devastating effects on American export industries. The strong dollar has helped produce a staggering trade deficit of more than $130 billion in 1984 which could reach $150 billion in 1985, has already generated protectionist responses and built up tremendous pressure for additional protectionism. Even when service transactions and unilateral transfers are taken into account, our deficit on current account is over $100 billion in 1984 and figures to be near $120 billion in 1985. In short, we are now borrowing $100 billion or more each year from other countries.

Within the next few months, the United States will become a net debtor nation for the first time since 1914. If we continue to borrow from other nations as a result of rising

domestic deficits, we will have a net foreign debt in three years greater than that of Mexico, Brazil and Argentina combined -- well over $300 billion. We will no longer, as in the past, be able to count on net international investment earnings to finance our trade deficits. On the contrary, we shall have to accept future reductions in our consumption standards to service our growing indebtedness to foreign nations. In a very real sense, present policies are placing a mortgage on the lives of future generations. In plain language, the longer Americans continue to consume more than they produce, the longer they and their children will have to consume less than they produce.

While we tell the heavily indebted developing countries to "put their houses in order," the fact is that under present policies we could not ourselves qualify for a loan from the International Monetary Fund. And we are manifestly violating our obligations under the Fund's Articles to cooperate with other countries to lessen the extent and duration of imbalances in the international balance of payments.

The present rate of U.S. foreign borrowing, in our view, is unsustainable. It has been wryly remarked that selling bonds abroad has become a major American export industry. Now this has been supplemented by massive borrowing abroad by U S. banks. But will foreigners be willing to finance indefinitely this huge amount of U.S. borrowing? It is misleading to argue that the large amounts of foreign money now in U S. securities and banks "have no place else to go" -- some of that money will

begin to move elsewhere if confidence in U.S. economic management is shaken and investors seek to avoid large losses from an anticipated fall in the dollar. Moreover, a run on the dollar could be precipitated if foreigners become saturated with dollar holdings and become unwilling to go on lending us $100 billion a year of new money. A cessation or even a sharp reduction of our present large inward capital flows would trigger a liquidity crisis, drive up U.S. interest rates and precipitate a collapse of stock and bond prices.

We are not predicting that such a frightening scenario is about to come to pass. At the moment, confidence in the United States and in the dollar remains high, and prospects for a "run on the dollar" seem remote. But a central characteristic of international finance today is its extreme unpredictability and volatility. Literally anything can happen in a "world monetary system," as Helmut Schmidt has said, which "does not deserve the name." We are also concerned with the political implications of large and continuing U.S. external deficits, which will aggravate Alliance relations and erode the willingness of the American people to bear their share of NATO defense costs and international development financing. We wonder, in short, whether a nation going deeper and deeper into debt to other countries can also remain the world's strongest political power and the leader of the world's democratic forces.

As a crucial first step toward restoring equilibrium in the international financial system, we urge the President to seek a bipartisan consensus with the Congress on a four-year

deficit reduction package. Such a package will necessarily require compromise from the leadership of both political parties Among the main elements we suggest slowing the rate of real increase in the defense budget to 5 percent, reducing civilian spending through health cost containment and the trimming of farm subsidies, and increasing tax revenues through such devices as the following:

-- eliminating the deduction of interest payments except for mortgage interest payments on principal residences up to a ceiling;

-- imposing a modest oil import fee and a modest gasoline tax (e.g., $4 per barrel and 20¢ per gallon);

-- narrowing the scope of the accelerated depreciation and investment tax credits presently allowed; and

-- some form of minimum tax on the economic income of corporations.

We estimate that these tax measures and expenditure reductions could yield between $100-$120 billion per year between now and fiscal 1989. More will have to be done, but this would r present a reasonable beginning.

Quite apart from its value in raising additional revenue, we consider the first of our tax proposals of special importance for policy reasons. The present deductibility of interest payments (a feature virtually unique to U.S. tax law) artificially stimulates borrowing and raises U.S. and world interest rates; while the deductibility provision cuts the effective rate of interest for wealthy U.S. individuals and corporations, foreign

borrowers, including the heavily-indebted developing nations, bear the full brunt of the resulting higher interest charges. Elimination of deductibility (except for mortgage interest payments on principal residences up to a ceiling) would help restore better balance to both the U.S. and the world economy.

The second of our tax proposals -- the modest oil import fee and gasoline tax -- by offsetting recent and likely future declines in world oil prices, would maintain pressures for energy conservation (and provide a modest encouragement to domestic production) without raising U.S. energy costs significantly compared to those prevailing a few months ago

At the same time, other nations need to set in motion complementary policies aimed at restoring some balance to international financial flows. The Western European countries are beginning to recognize that they need to provide more opportunities for productive investment in their own economies -- by encouraging entrepreneurship; by permitting the transformation of obsolete industries; by loosening up rigid labor markets; by reducing the role of government in their economies; and in some cases, by easing monetary or even fiscal policy to promote faster growth and more jobs.

Japan needs to relax still further the restrictions on its imports and its capital markets. Stimulation of Japanese internal demand is also essential if Japan is to reduce its huge trade surpluses that have produced so much of the recent protectionist surge in the United States and the rest

of the industrialized world. Large-scale international borrowing by Japanese government agencies and private firms could also be encouraged to achieve a better balance of international financial flows and exchange rates.

The developing countries, for their part, will need much more responsible and imaginative economic management than they have had in the past, if they are to adjust to a world of more limited capital flows. This includes better incentives for industrial and agricultural production, more realistic exchange rates, the reduction of public sector deficits and more effective means of keeping what capital they have from leaving the country.

With the increased interdependence which exists today, including the high degree of capital mobility among nations unforeseen at Bretton Woods, it is even more essential that countries adjust their domestic economic policies with a view to maintaining a mutually beneficial world economic system. It is no longer possible to have complete national policy autonomy and maintain an open international system of trade and capital flows. If we wish to preserve the latter we shall have to accept some limitation on the former.

At the 1982 Economic Summit meeting in Versailles, it was decided that Finance Ministers from the key currency countries would meet regularly with the Managing Director of the International Monetary Fund to discuss coordination of macroeconomic and exchange rate policies. This decision was reaffirmed at the Williamsburg Summit. Unfortunately, however,

there is little evidence to suggest that these decisions have led to a meaningful process of international policy coordination To have any practical result the key currency countries, including the United States, must demonstrate the political will to consider seriously international factors in their domestic policy decisions. We believe the United States should now lead in the establishment of an improved system of multilateral surveillance to review the domestic fiscal and monetary policies of the key currency countries. This is an essential step towards achieving more stable currency relationships in better relation to underlying competitive conditions -- an objective as much in the interest of the United States as of its economic partners.

The instrument for such multilateral surveillance, in our view, should be a group such as the Interim Committee of the International Monetary Fund, or possibly the smaller Group of 10. The world is not ready, obviously, for supranational control of national economic policies, nor even, perhaps, for "target zones" of key currencies maintained by a combination of national policy commitments. But we believe a group of Finance Ministers and their deputies should now meet at least every three months, and in special session when circumstances so require, to seek consensus on the changes that are needed in national policies in the interest of international monetary stability. Rules of procedure such as the formal recording of decisions and a process of follow-up monitored by the IMF staff could provide a discipline in the

current surveillance process that is presently lacking.

Intervention in the exchange markets will be of limited value if domestic policies are not better coordinated If a more meaningful system of multilateral surveillance is established, however, the G-10 countries could, in appropriate circumstances, undertake cooperative exchange market intervention to restore more orderly exchange market conditions and exchange rates more reflective of purchasing power parities

The importance of establishing international cooperation in the formation of domestic policies cannot be overstated. Financial flows now dwarf trade flows; some $20 to $30 trillion in capital flows now cross the foreign exchange markets in a year, compared with roughly $2 trillion in goods and services. With exchange rates responding to international capital movements and often bearing little relation to trade competitiveness, great pressure is developing to divorce the exchange rates in the capital and goods markets. This separation of rates can be achieved by two means: import restrictions and export subsidies which permit a country to maintain international competitiveness despite an overvalued currency; or taxes and other limitations on free capital movements which dilute the impact of interest rate differentials on the exchange rate. However, either method would undermine the progress which has been made towards an open international trade and investment system, and run the risk of political manipulation and economic inefficiency. It would be far better to avoid

the need for restrictions through pursuit of more internationally-oriented fiscal and monetary policies within the key trading nations.

II International Trade, the GATT System, and Adjustment Policies

The overwhelming trend in international trade today is the steady drift toward more managed trade. By one estimate, as much as 50 percent of world trade is under some form of management by governments. A multitude of restrictive trade agreements have sprung up outside the framework of GATT, producing a new climate of uncertainty that is impeding the growth of trade and investment. These bilateral export restraint agreements now cover textiles, steel, autos, shoes, and numerous agricultural products, all in violation of the normal trading rules set forth in the GATT. In addition, countries have increasingly adopted "industrial policies," using direct and indirect subsidies, government procurement policies, foreign investment incentives, export performance requirements and the like. As a result, the concepts of multilateralism and open markets embodied in GATT which have served the world well are in danger of being abandoned barely forty years after their adoption.

Even the United States, which was firmly committed in the postwar era to the principle of open multilateral trade, has been turning recently to regional and bilateral trade agreements -- the Caribbean Basin Initiative, a free trade

agreement with Israel, and a sectoral free trade arrangement now under discussion with Canada. Similar bilateral arrangements have been explored with Saudi Arabia and the ASEAN countries of Southeast Asia. These kinds of agreements may serve a useful purpose provided they are brought within the multilateral framework, which means making them compatible with GATT rules or phasing them out after a fixed time period But if the process of Balkanization of trade continues, it is not an overstatement to suggest that the GATT could become as obsolete as the old Bretton Woods system of fixed exchange rates.

Thus trade policy is at a crossroads. In our view, the U.S. should take the lead in renewing the industrialized nations' commitment to reducing trade barriers in a multilateral framework. It should propose that GATT be updated to face the challenge of bilateral agreements and industrial policies, subjecting both to a multilateral process of notification and surveillance, while it also develops new rules to cover service trade and trade-distorting investment practices

In specific terms, we recommend:

1. A new round of multilateral trade negotiations to extend the GATT's effective mandate to bilateral restraint agreements, industrial policies, services, agriculture, and trade-distorting investment practices.

2. The parties to GATT should work out procedures and rules for the administration of bilateral restraint agreements The GATT should be prenotified of their formation and

be given authority to exercise surveillance over them, including the monitoring of their impact on all parties. An adjustment plan should be drawn up for the industry or region affected by each agreement and a date set for its termination The GATT should undertake to review each pact periodically to see that the necessary adjustments are taking place on schedule

3. The GATT should establish a new surveillance committee on trade-distorting domestic policies, whether called industrial policies or otherwise. Countries adversely affected by the trade-distorting domestic policies of other GATT members could question these policies and seek changes, even where no specific violations of existing GATT rules are involved. The committee could seek to develop agreement on which industrial and other domestic policies are consistent with the letter and spirit of the GATT and which are not

4. The United States should practice the economic efficiency it preaches abroad, by granting protection only under specific conditions. Any company or industry seeking import protection from the International Trade Commission or the White House should be required to submit an adjustment plan showing how it will restructure in order to restore competitiveness or get out of the business in question. The plan could include commitments to increase investment in modernized plant and equipment, restrain wage increases and executive compensation, or shift into new lines of production. After a given time period (e.g., 5 years), the protection would automatically expire and not be renewable.

5. The United States should strengthen its adjustment assistance program for workers displaced by imports, which has been severely reduced in recent years. The revitalized program should put its main emphasis on worker training and retraining rather than the simple income maintenance that was the main feature in past years.

6. The United States should embark on a comprehensive national program to enhance its international competitiveness In addition to a better macroeconomic policy leading to lower interest rates and a properly aligned dollar, this primarily means developing our neglected human capital -- preparing the skilled work force we shall need in future years through more investment in education at all levels, particularly in math, science and engineering. It means encouraging more spending on civilian research and development through tax incentives and government support to universities. It means an anti-trust policy that permits the pooling of research by companies in the same industry. It means tax incentives focused more effectively on promoting new investment in plant and equipment. And it means a strengthened Export-Import Bank that assures American exporters credits and credit insurance fully competitive with that provided by other countries.

In the controversy over whether or not the U.S. should have an "industrial policy," it is often forgotten that our government is already intervening like a brain-damaged octopus. The challenge is to move from random, politically-

motivated actions and subsidies that frequently impede industrial adjustments to more limited and rational interventions that enhance the competitiveness of the United States. It has been estimated that Washington presently dispenses some $100 billion a year to industry directly and in the form of "tax expenditures" without any priorities and virtually no consideration of how these various subsidies combine to affect a given industry or the economy as a whole. For exmple, the United States spends five times more on research and development in commercial fishing than on research and development in the steel industry The government provides a special $500-$600 million annual tax benefit to the timber industry, but no such special tax advantages for semiconductors. It is doubtful whether any national interest is served by the haphazard allocation of national resources that results from this hodge-podge of policies.

7. Accordingly, we recommend an immediate effort by the Council of Economic Advisers to determine exactly how existing government programs of direct and indirect subsidy affect specific industries and the economy as a whole, with a view toward rationalizing the government's already massive intervention in the economy and promoting national competitiveness.

III International Debt

To the surprise of many observers, the Third World debt situation is no worse today than two years ago, when the Mexican and Brazilian payments crises first erupted. The recent successful rescheduling of the Mexican debt has

provided breathing space, and similar reschedulings may soon be negotiated with other countries. Such reschedulings are useful, but they do not "solve" a crisis that will be with us for decades.

Between $800 and $900 billion of debt is still owed by developing nations; almost $400 billion of it by Latin countries alone. The situation in some of the major debtors -- notably Argentina -- is extremely problematic, and elsewhere borrowers such as the Philippines will clearly have grave difficulty in servicing their foreign debts in this decade.

There is a limit to which the major debtors will be willing to maintain austerity policies that sacrifice domestic growth and standards of living for the sake of repaying foreign creditors. Most governments will find it politically and economically impossible to maintain the present adjustment process unless private and official capital flows combined with expanded export opportunities are available beyond the amounts that are presently foreseeable.

A key issue is where the additional capital is going to come from in the near term pending the restoration of economic growth. The commercial banks -- the principal source of the past decade -- have made it abundantly clear that they will not be increasing substantially their exposure in the Third World. In 1983, according to World Bank figures, net financial transfers from banks to the developing countries were actually negative by an amount of $11 billion, and in 1984 bank lending to less developed countries has recovered only slightly. Even

debtor nations who have continued to service their obligations have been hurt by the widespread resistance to new bank lending abroad.

Some means of restoring the long-term credit available to these countries, and to debtors undergoing major adjustments, must be found. The World Bank estimates, for example, that if the debtor nations are to maintain adequate growth, export, and debt service performances, they will need an annual growth in current debt of about 4-1/2 to 5 percent

It is in the interests of the United States and other industrialized countries to find ways of making this capital available. The economic costs of debt defaults shaking the stability of our banking system or of vanishing developing country markets for our exports are obvious. Largely because of the economic contraction in developing countries, the United States alone lost $18 billion of exports between 1980 and 1982, which, according to the Overseas Development Council, eliminated approximately 600,000 jobs. Between 1982 and 1983, industrial countries' exports to developing ones dropped by $43 billion. It has been estimated that growth rates in the developed world would have been one half of one percent higher in 1983 if those exports had remained at their 1982 levels

We therefore recommend:

1. A doubling of the capital of the World Bank or, alternatively, the establishment of a Bank subsidiary with a higher "gearing ratio" than that of the Bank itself -- i.e., the ability to make loans greater than its total capital.

2. Greater coordination between the IMF and the IBRD in devising growth-oriented policies for the debtor countries. Much as a troubled industry needs a long-term adjustment plan to put it back on track, these countries need long-term growth strategies, backed by Bank funds, as well as the Fund's traditional short-term stabilization policies.

3. A more active role by the World Bank in co-sponsoring new loan syndications with commercial banks to debtor countries as a means of keeping private capital flowing

4. The World Bank, the industrialized countries, and the heavily indebted countries should cooperate in creating new incentives for direct private investment in the developing countries, including investment insurance and possibly some means of converting debt into equity.

5. The GATT, working with the World Bank and IMF, should seek significant trade barrier reductions on behalf of developing countries.

IV Long-Term Development

In their relations with Third-World countries, the United States and other developed nations face both short-term questions of debt repayment and long-term questions of economic growth and political stability. As we move to deal with the former we should not lose sight of the latter.

The real victims of the International economic forces at work today are, as always, the weakest: the poorest countries who perenially bear the heaviest burdens of adjustment

The debt burden, the high interest rates, the costly dollar, deteriorating terms of trade and protectionism have combined to erase many of the gains made during the 1960's and 1970's. Current economic forecasts envisage a recovery in Latin America so slow that the per capita income of 1980 will be barely regained by 1990. For sub-Saharan Africa, the World Bank foresees that without action, per capita income in the year 2000 will actually fall below the level of 1960.

Harsh cuts in virtually every Third World budget have produced sharp declines in spending on health, family planning, education, research, all at the expense of these societies' futures. Similarly, much of the progress in servicing the international debt has come at the cost of many countries' long-term well-being, as they have stripped their forests, depleted their mineral reserves, and preempted their agricultural lands to produce commodities for needed foreign exchange.

With so many of the forces buffeting these countries beyond their control, the international community has a moral obligation to provide some capital transfers back into their economies. Moreover, such assistance is in the industrialized countries' own economic self-interest. The developing countries are among the best customers of the industrialized world -- as much as 35-40 percent of the exports of the developed countries are purchased by the developing countries. As the last three years have demonstrated, when growth lags in the South, the factories in the North are among the first to feel

it. Moreover, the collapse of democratic forces in countries like Mexico would create a more hostile world environment and threaten vital U.S. interests.

We therefore urge the following measures:

1. The industrial nations should increase the resources and lending programs of the World Bank and the IMF above the levels presently authorized. Fund conditionality should be made more flexible and more oriented toward long-term structural adjustment.

2. The industrial nations should maintain, in real terms, their past levels of support for the International Development Association, the chief source of concessional development finance for the poorest countries. This would require a change in U.S. policy in favor of a $12 billion Seventh Replenishment of IDA, instead of the current U.S. insistence on a replenishment of $9 billion. The current U.S. policy saves the U.S. less than $250 million per year but costs IDA over $750 million annually from other donors.

3. The industrialized countries should expand their bilateral assistance programs, particularly those that are targeted toward improvements in agricultural productivity, management capabilities, and meeting the basic needs of the poor, including education, health and family planning.

4. Even though we urge an expansion of World Bank and IDA lending, we also urge that these two agencies look more carefully at the market criteria of their loans, to be sure that they are not financing the production of products

already in world surplus.

5. Both developed and developing countries must devote more attention and resources to helping reduce Third World rates of population growth. If present trends continue -- and they are likely to do so in the absence of greater action -- Africa's half a billion people will grow to almost 3 billion, India's 700 million to more than 1.2 billion, Mexico's 70 million to 200 million, before stabilizing some time in the next century. Such increases will almost certainly be accompanied by higher rates of abortion and female infanticide and will destroy any hope of economic progress and political stability.

In the final analysis, the developing countries' futures will depend upon their own policies. As Paul Hoffman remarked at the beginning of the Marshall Plan, "only the Europeans can save Europe." The developing countries must get their own economic houses in order, and only their own commitment to wealth-creating strategies, to incentives for industry and agriculture, to improved savings rates, to better managed public projects, and to more responsive bureaucracies, can assure them a decent future -- no matter what the United States and the industrialized world do.

6. The industrialized countries should therefore support efforts by the more successful newly industrializing countries, such as South Korea, to share their experiences with other developing countries. South-South international development exchanges should be greatly expanded, for they offer

a depoliticized, collegial setting for the transmission of expertise on economic development. They can provide an attractive alternative to the more paternalistic economic assistance models of the past.

V International Policy Cooperation and International Institutions

There is a widespread sense of disillusionment with existing institutions, and little enthusiasm for establishing new ones. Yet as our previous discussion suggests, there is no way that American interests can be advanced without a greater effort to strengthen the International Monetary Fund, the World Bank, and the GATT, and to get them to work together more effectively. This should be a high priority both for the United States and other countries.

There is also a pressing need for some forum where the interrelated problems of exchange rates, trade, debt and development can be discussed and negotiated among nations. We believe that this can only be accomplished at the highest level, among heads of government, who have the authority to make the critical trade-offs that will inevitably be necessary.

We therefore urge that:

1. The industrialized nations should revitalize the summit process, which in recent years has degenerated into an annual media extravaganza, long on photo opportunities and short on substance The summits now need to be used to put the stamp of approval on package deals or policy trade-offs in which the seven summit countries take real commitments

to modify their policies in the general interest. To help assure the followup of these agreements, a small prestigious group of private individuals should be appointed to issue a frank and public report to governments, evaluating their post-summit performance of agreed obligations -- a report card, in effect, that could inject some discipline into what has become a superficial and even cynical process.

2. The United States should develop a new mechanism to integrate economic decision-making within the United States government, so that domestic economic management, trade policy, international debt and international development policy are all shaped in harmony with a full understanding of their interrelationships. We strongly urge a bold Presidential initiative to integrate all domestic and international economic policy-making in the White House, under the authority of a senior Presidential advisor working with the appropriate Cabinet officers.

In conclusion, we repeat our appeal for more effective leadership on the part of the United States. Today, as never before, American economic policies have a global impact, and the international consequences of those policies reverberate on the U.S. economy in ways we need to take more seriously. In such a world, the U.S. must act, above all, to reduce its unprecedented budget deficits.

Clearly, the U S has an obligation, both to itself and to the rest of the world, to manage its economic affairs in ways that strengthen, not weaken, the international

financial and trading system. So do other nations. This will require not only more balanced domestic policies but a greater degree of international cooperation in which every sovereign nation makes its fair contribution to a needed economic adjustment

For too long, American economic policy has been made as if the rest of the world did not exist. That is an illusion which this country no longer has the luxury to entertain. The next four years will require American leadership that is at once more realistic, more consensual, and more sensitive to our domestic responsibilities, than we have ever seen.

Other countries could not reasonably ask for more, and we cannot reasonably settle for less.

Explanatory Note:

This report is the first in a series which will be issued as part of the continuing Aspen Institute program on "Governance in a World Economy." The program brings together government officials, legislators, businessmen, trade union leaders, and scholars in an attempt to build a new consensus on domestic and international economic policy. The report draws substantially upon two seminars held in 1984 -- the first, of an American group, which met at the Wye Conference Center from June 8-10; the second, of an international group, which met at the Aspen Campus from August 25-30. While acknowledging their debt to the many useful ideas presented at these meetings, the authors bear sole responsibility for the content of this report.