ESSAYS ON ECONOMIC POLICY AND FOREIGN POLICY

Charles Wolf, Jr.

March 1987
The RAND Corporation

Papers are issued by The RAND Corporation as a service to its professional staff. Their purpose is to facilitate the exchange of ideas among those who share the author's research interests; Papers are not reports prepared in fulfillment of RAND's contracts or grants. Views expressed in a Paper are the author's own and are not necessarily shared by RAND or its research sponsors.

The RAND Corporation, 1700 Main Street, P.O. Box 2138, Santa Monica, CA 90406-2138
These eleven essays were previously published--sometimes in a slightly abbreviated form--in *The Wall Street Journal*, *The Los Angeles Times*, *The New York Times*, and *The Washington Post*, in the period from April 1985 through March 1987. They are collected here to make them more accessible, and also perhaps to make them more interesting as a group than they would be as separate pieces.

The collection is a sequel to the group of "op-ed" essays on economic policy and foreign policy previously issued in March 1985, as P-7039-RGI; none of the "op-ed" pieces in the present collection was in the earlier one. The tenth and eleventh pieces in the present collection, "Soviet Economy and U.S. "Opportunity" and "Consensus and Dissensus About the Soviets," were co-authored by Professor Henry S. Rowen of the Stanford University Graduate School of Business.
CONTENTS

PREFACE ................................................................. iii

Section I
What Comes After Gramm-Rudman-Hollings? ......................... 1
A Panglossian View of the Economy ................................. 5
The Trade Deficit: Myths and Realities ............................. 9
A "Soft-Landing" for the U.S. Dollar .............................. 12
The Missing Chapter in the International Debt Story ............ 16
"Star Wars" and the Economies of Western Europe ................ 19

Section II
Ideology Has More Than One Face .................................. 25
Democracy in the Third World: A Missing Ingredient ............. 29
Cooperative Forces for Low Intensity Conflict .................... 33
Soviet Economy and U.S. "Opportunity" ........................... 39
Consensus and Dissensus About the Soviets ....................... 43
SECTION I. ECONOMIC POLICY
WHAT COMES AFTER GRAMM-RUDMAN-HOLLINGS?*

It is not too early to consider what, if any, changes in U.S. federal budget processes should follow Gramm-Rudman-Hollings (GRH). Even if the Supreme Court reverses the lower court's decision and finds that GRH is constitutional, it remains timely to consider other means of improving the flawed federal budget process because the lead-time for any such improvement will be long.

Besides GRH, the principal proposals in contention for revamping the process are a balanced-budget amendment to the constitution, a Presidential line-item veto, or perhaps a "son of GRH": extending GRH or reconstituting it if the Court finds its present provisions invalid.

From the standpoint of sustaining long-term economic growth none of these measures would be as meritorious as another one: namely, requiring that the rate of growth in total federal spending should be no greater than the rate of growth of GNP. This rule would prevent the ratio between government spending and GNP from rising in the future as it characteristically has in the past.

Two central facts provide support for establishing such a cap on spending growth. First, there is a generally significant negative relationship between the rate of economic growth, and the size of the government sector (as measured by government spending as a ratio to GNP, or by the tax take as a ratio to GNP). Depending on which measure of government size is used, as well as a number of other factors (for example, the particular countries and the time period considered), research done both at RAND and the World Bank suggests that for each increase of 1% in the size of government, long-term economic growth decreases between 0.1% and 0.6% annually in both developed and developing countries.

*A slightly abbreviated version of this essay was published under the title "After Gramm-Rudman, Look to Spending Cap" in the Wall Street Journal on June 26, 1986.
Second, while the peacetime growth of federal government spending has been perennial and seemingly inexorable (even under the Reagan Administration, this ratio has risen from 21% to 24%),\textsuperscript{1} the real increase in federal spending in any particular year has tended to be smaller when the federal budget deficit was larger in the preceding year. Between 1963 and 1984, a 1% rise in the real budget deficit in any particular year lowered the next year's increase in real outlays (after subtracting interest payments on the federal debt) by approximately $3.1 billion below what would have been expected absent the previous year's deficit. Evidently, larger deficits do have some restraining effect on Congressional proclivities to spend.

That real budget outlays continued to rise along with rising deficits, is not inconsistent with this finding: increases in government spending would have been still larger if the deficits had been smaller.

These relationships suggest the inherent shortcomings of the proposed balanced-budget amendment, or of any offspring of GRH: neither of these proposals would prevent increases in government spending above the rate of increase in GNP, if the then President were less adamantly opposed to tax increases than is Ronald Reagan. Consequently, under a budget-balancing proposal unrelated to a cap on spending growth, a strong possibility exists that the ratio of government spending to GNP would continue to rise, thereby resulting in downward pressure on economic growth.

The budget-balancing resolution, which was recently rejected by the Senate, would have capped spending growth by linking the requirement for an annually balanced federal budget to a restriction on the rate of growth in tax revenues. However, this restriction is omitted from the budget-balancing resolution which 32 state legislatures have already approved, as the basis for a constitutional convention.

\textsuperscript{1}If spending by state and local government is included, the total government spending ratio for the U.S. is currently about 35%. Among the Western European countries, the comparable ratio is about 46%, while that for Japan is about 20%.
One advantage of a presidential line-item veto is that it would not inherently lose the restraining effects of deficits on the growth of government spending. However, the veto power would still leave open the possibility of disproportionately large increases in government spending if a subsequent president's use of it were not as focused on reducing spending as President Reagan's would probably be.

Numerous objections to the ratio cap on the growth of government spending can be cited: for example, the ratio cap would make the fiscal system inflexible and unable to respond to emergencies such as acute domestic recession, or national security threats; furthermore, such a cap might simply lead to a relative increase in spending by state and local governments, with similarly perverse effects on long-term aggregate economic growth; and, finally, our ability to forecast prospective rates of growth in real GNP is so limited that implementation of the proposed proportional cap on spending growth would be infeasible.

These objections can be readily answered. First, in the event of overriding national needs for larger government outlays, Congress could suspend the cap, thereby allowing the growth rate of spending to exceed the growth rate of GNP for perhaps a year at a time. That this could be done expeditiously in the event of a national security or other emergency does not imply that it should be made easy: for example, a supermajority of the Congress might be required to temporarily suspend the cap. The public attention that would then be activated by the suspension would limit the likelihood that it would be done casually. If, in the absence of formal suspension, Congressional appropriations nevertheless exceeded the cap, the President could be authorized to apply across-the-board cuts to reduce appropriations, or to sequester them to keep spending below the cap.

With respect to possible expansion of spending by state and local governments as a result of the cap on federal spending, two counterarguments can be given: first, some devolution along these lines is probably desirable and in keeping with the so-called "new federalism" advocated by every Administration from President Kennedy's to President Reagan's; and second, nearly all of the state constitutions require a
balanced budget, thereby constraining state governments' spending levels. The California constitution already places a cap on the growth of state and local government spending by limiting it to changes in population and inflation. (In contrast to conventional views about California's relaxed life-style, that state's budget process is considerably more disciplined and rigorous than most, and certainly more so than that of the federal government.)

Finally, while it is true that the forecasting problem makes the proportional cap on spending growth difficult to implement in any particular year, this is equally true of the budget balancing amendment, and of GRH. Both would require the forecasting of revenues, and these in turn are sensitive to forecasts of GNP. Moreover, mistaken decisions due to forecasting errors would not be disabling for the proportional spending cap; mistakes in one year could be redressed in the next year.

In sum, unlike other proposals for controlling government spending, limiting the rate of growth in spending to the growth of GNP has the advantage of flexibility (for example, it would still allow deficits to be considered as an appropriate instrument of fiscal policy in special circumstances), as well as the distinct advantage of focusing on the main issue, namely the ratio of government spending to GNP, rather than on the secondary, if not unimportant, issue of achieving a fiscal balance. Focusing on the main issue would also promote increased effectiveness of government spending by obliging Congress and the Administration to concentrate on the allocation of a constrained budget, rather than on how much is to be spent.
A PANGLOSSIAN VIEW OF THE ECONOMY*

There are ample grounds for greater optimism about the economy's prospects than the prevailing gloomy consensus.

This consensus is reflected in the foreboding phrases recently emanating from most of the frequently cited commentators: for example, "an economy that has made little progress" (Data Resources); "a stalled economy" (Economic Policy Institute); "the trade deficit is an economic disaster" (National Association of Manufacturers); "warning signals flashing 'trouble ahead'" (New York Times op-ed); "no revival in sight for the industrial side of the economy" (Shearson Lehman Brothers); "the inevitable impact of those untamed killer deficits" (Newsweek); "continued, sizable deterioration of the trade balance [and] a further drag on GNP" (Institute for International Economics).

The prevailing consensus is not only gloomy--it is also procrustean: indicators that appear inconsistent with it are reinterpreted to prevent even the slightest ray of light from obscuring the prevailing gloom. Thus, the recent jump in the index of leading indicators is dismissed as due to "robust financial markets, not to underlying economic strength" (Shearson Lehman Brothers)--as though the two were quite unrelated.

There are several reasons for skepticism about this portentous view. One reason is that the forecasters have erred so often in the past that there is little ground for expecting them to be accurate now. While this provides some grounds for confidence that they'll be wrong again, fortunately there are other, more substantial reasons for at least moderate optimism now. Our current economic problems (was there ever a period when the U.S. economy was completely problem-free?) have been either overstated, or are associated with readily accessible remedies.

Consider, for example, the three most evidently serious problems: the two deficits—budget and trade—and international debt.

The federal budget deficit is forecasted to be about $200 billion for 1986 and thereafter. Surely, this imbalance is undesirable. However, it is equally sure that it is not disabling. From the standpoint of the effect of government borrowing on credit markets, the federal deficit should, first of all, be viewed in conjunction with the forecasted budget surpluses of the states. This probably shrinks the consolidated federal and state deficit for 1986 to about $170 billion or $180 billion. Assuming that the Senate and House can sustain, in the appropriations process, the modest spending reductions they have already agreed to in setting their budget ceilings, the consolidated deficit figure will decline by another $40 or $50 billion. The consolidated 1986 deficit then shrinks to between 3 percent and 3 1/2 percent of the GNP.

Although this is still large, in relative terms it is well below deficit ratios that Japan has regularly exceeded, while sustaining its high rates of economic growth during the past 10 years. Actually, the comparative international growth experience of other countries as well as Japan suggests a different, and neglected, lesson: sustained economic growth can more easily be reconciled with deficits of this size than with total government spending at our current scale—over 36 percent of the GNP.

Next, consider the "other" deficit. The 1984 trade deficit was $123 billion, and that forecasted for 1985 is $140 billion. Only an antiquated, yet persistent, neo-mercantilism explains use of the exaggerated term "disaster" to characterize what is bound to be only a transitory problem. The trade deficit is attributable to the fact that U.S. investment exceeds domestic savings. The deficit thus facilitates a higher level of U.S. investment—hence, future U.S. growth and higher productivity—than would be feasible if the trade account were in balance or in surplus at the present level of U.S. savings. That the trade deficit has been accompanied by a high rather than declining exchange value of the dollar as would normally be expected, indicates simply that holders of non-dollar assets have been more bullish in their
evaluation of the U.S. economy than of the foreign economies in which their non-dollar assets were previously held. This accounts for their wish to hold increasing amounts of dollar assets, thereby increasing the demand for dollar assets and bidding up the dollar's exchange value, until quite recently.

Moreover, there is an automatic mechanism which assures that the trade deficit will be transitory. If and when U.S. investment declines, or U.S. savings rise, or asset holders change their evident if recently somewhat diminished preference for dollar assets, the trade deficit will be reduced and eventually eliminated. While any or several of these changes could occur abruptly and disruptively, there are stronger reasons for expecting the adjustment to come about gradually and smoothly. The decline in the dollar's value since March suggests that a gradual adjustment process has already begun.

Finally, the international debt problem is also subject to more benign, as well as more accurate, interpretations than those reflected by the handwringers' prevailing consensus.

For example, it is seldom recognized that the real costs, as distinct from the accounting costs, of the $500 billion of international debt owed by the developing countries, as well as by Eastern Europe and the Soviet Union, have already been incurred. The real costs are the goods and services, the commodities and machinery, previously exported to the debtor countries by the creditors. These costs represent the benefits forgone by the creditors (principally, but not exclusively by the United States), because their factors of production--labor, capital, and materials--were used for the benefit of external borrowers, rather than for internal investment, research and development, and consumption in the lending countries themselves. Consider, for example, how much higher U.S. productivity would be if a significant share of the loans made in the 1970s to Latin America had instead financed new investment and research and development in the United States, or if Western European loans to the Soviet Union and Eastern Europe had instead financed investment and R&D within the European economic community.

The accounting problem arises from the fact that these debts are subject to widely differing repayment prospects, as suggested by discounts of from 10 to 90 percent currently prevailing on the secondary
debt market for these assets. If and as the commercial banks holding these assets are obliged to revalue their balance sheets accordingly, bank losses will ensue. However, so long as their net capital, or shareholders' equity, remains even slightly positive—which can, and ultimately would, be assured by the Federal Reserve Bank, as lender of last resort—this adjustment will simply mean a reduction (in some cases, a very substantial reduction) in the market values of bank stocks. Shareholders of the major bank holding companies would thus lose, although depositors would not. But even if the share prices of Citicorp, Manufacturers Hanover, or Chase were to fall to single digit values, there need be no great stress for the economy as a whole. Indeed, that's the way markets work: the stockholders of these banks have experienced large profits and dividends in the past (their stocks have outperformed the market as a whole, during the past 10 years); it is not unreasonable or inappropriate that they may experience substantial losses in the future.

In sum, even if the economic outlook falls somewhat short of the Panglossian "best of all possible worlds," it is much brighter than the picture portrayed by the prevailing consensus.
THE TRADE DEFICIT: MYTHS AND REALITIES*

In popular discussion of economic matters, frequent repetition of erroneous or dubious propositions sometimes results in their public acceptance. Frequently, familiarity with the propositions, rather than their accuracy, accounts for the conventional wisdom.

Consider the following bits of conventional wisdom about the U.S. trade deficit:

1. A trade surplus contributes to economic strength, while a trade deficit detracts from it;
2. The recent U.S. trade deficit arises because U.S. exports are unable to compete in protected foreign markets;
3. Some form of U.S. protectionism is desirable to protect and defend our economic recovery; and
4. The trade deficit signifies a loss of American jobs and increased unemployment.

Each of these commonly accepted beliefs either is wrong, or at best is only a small piece of a much larger, and sharply contrasting, truth. Accuracy would warrant correction or major reformulation of each proposition along the following lines.

First, exports actually subtract from a country's available resources, while imports add resources and thereby provide the means by which the importing economy can invest more and consume more than it otherwise would be able to do. Contrary to the conventional wisdom, the principal purpose of trade is to obtain imports, not to hand over exports. Exports are the means to obtain imports, not the other way around. Imports enhance the economy's capabilities, while exports diminish them. Consequently, an export "surplus" actually depletes an economy's strength, while an import surplus (trade deficit) increases

---

*A slightly abbreviated version of this essay was published under the title "The Trade Deficit: Myths and Realities" in the Los Angeles Times on December 26, 1985.
Although it is true that the U.S. trade deficit cannot and will not go on forever, it is surely not unusual for worthwhile and beneficial circumstances to be of finite duration.

Second, the U.S. trade deficit has arisen not because U.S. exports have fallen, but rather because U.S. imports have risen very substantially. That U.S. exports can and do compete effectively in foreign markets is indicated by the fact that, between 1983 and 1985, U.S. exports increased from $200 billion to about $220 billion at the same time as the trade deficit was rising from $62 billion to over $130 billion.

Of course, the explanation for the increased trade deficit is the sharp rise in U.S. imports: from $263 billion in 1983 to about $350 billion in 1985. It is no doubt true that U.S. exports could increase considerably more than they have if the protective trade practices of other countries were liberalized, and if and as the dollar's exchange value is somewhat reduced. Nevertheless, it still makes far better sense to view the U.S. trade deficit--for good or for ill--as due to the insufficient ability of U.S. domestic production to compete effectively with imports within the U.S. market, rather than to the inability of our exports to compete in foreign markets.

Third, inasmuch as substantial real economic growth has been sustained in the United States during the past few years notwithstanding the increased trade deficit, protectionism can hardly be advocated as necessary to "protect" or "defend" the U.S. recovery. On the contrary, since, as noted above, the deficit itself provides substantial benefits to the U.S. economy, advocates of protectionism in the U.S. should realize that their advocacy actually amounts not to a defense of the recovery, but rather to an attack on consumers and investors.

Finally, while it's true that larger exports generally contribute to more jobs (although in certain instances that's not necessarily so), it is no less true that expanded imports also contribute to more jobs: for example, in the processing and fabrication of imported raw materials and unfinished goods, and in the packaging, distribution, marketing, and servicing of end products. Moreover, the capital inflow that counterbalances the trade and current account deficits plainly adds to jobs through the added domestic investment that is thereby financed.
The bottom line, of course, is that the U.S. economy has in fact been an employment engine compared with the economies of Western Europe and even Japan. U.S. civilian employment increased by 7 million jobs between 1983 and 1985, while the trade deficit was growing from $62 billion to over $130 billion.

"Economics," it has been remarked, "is common sense made difficult." Much of the recent public discussion of the U.S. trade deficit suggests a different relationship: namely, faulty economics impedes common sense, while good economics (plus a few facts) can help it.
A "SOFT-LANDING" FOR THE U.S. DOLLAR*

There is a straightforward and readily accessible, although not easy, way to bring the high-flying dollar down for a soft landing. Those in France, West Germany, and Great Britain, and to a lesser extent, Japan, who profess concern about the prevailing exchange rates for the dollar of over 10 francs, more than three marks, nearly one pound sterling, and over 250 yen, respectively, have an opportunity to bring about a reduction of these rates and a corresponding appreciation of their currencies by perhaps 10 to 20 percent. Moreover, this can be accomplished in a year or eighteen months by policies that represent sound economics as well as common sense.

In 1968, an influential French commentator named Jean Jacques Servan-Schreiber published a book entitled "The American Challenge." At that time the U.S. economy was providing a substantial outflow of capital to the rest of the world, rather than receiving a substantial inflow, as at the present time. Servan-Schreiber expressed alarm over the dynamism of American business which, by combining capital with organization and technology, threatened to reduce the European economies, and that of France in particular, to a sort of economic vassalage—"industrial annexation," as he termed it. According to Servan-Schreiber, meeting this American "challenge" required Europeans to emulate American business methods, and to invest domestic capital in the development and use of advanced technology, thereby repelling the threatening American economic invasion.

What is now needed to bring about a smooth adjustment in the dollar's exchange parity is to stand Servan-Schreiber's prescription on its head. What the undervalued European currencies require to halt and reverse their continued depreciation is an inflow of American capital, technology, and organizational skills. What Servan-Schreiber wished to oppose and discourage in the 1960s is precisely what should be welcomed.

*A slightly abbreviated version of this essay was published under the title "A Dollar's Worth of Advice" in the Wall Street Journal on April 17, 1985.
and encouraged in the mid 1980s! The challenge that the Europeans now face is how to stimulate interest among holders of dollar assets in acquiring non-dollar assets.

To sustain this conclusion requires a brief review of the paradoxical situation in which the world economy currently finds itself.

In 1984 the U.S. had a trade deficit of $123 billion, representing an increase of over $50 billion above the 1983 trade deficit. Net invisible earnings realized by the U.S. from investment income, services, and remittances, were about $12 billion, so the current account deficit was about $111 billion. It very likely will be higher in 1985.

Such a substantial and rising current account deficit would normally be expected to result in a fall in the exchange value of the dollar. That the dollar has instead continued to appreciate reflects the fact that, at then-prevailing exchange rates, holders of francs, marks, sterling, and even yen assets wished to acquire a larger volume of dollar assets than was supplied in international financial markets through the U.S. current account deficit. The reasons for this preference were, and are, numerous and powerful: high U.S. interest rates; low current and expected inflation; large business profits and an expectation of their continuance; and the general buoyancy, as well as safety, of the American economy. In any event, as a result of this preference for dollar over non-dollar assets, the market-clearing "prices"--that is, the exchange rates--of the dollar in terms of foreign currencies rose during 1984, and continue to do so.

The solution, or at least melioration, of the dollar's ascent follows directly from this simplified account. All that is needed to arrive at a smooth adjustment for the dollar is that some holders of dollar assets should find it preferable to acquire non-dollar assets instead. If the supply of dollars in international financial markets--which has already been enlarged by the U.S. trade deficit--were to be further expanded by a modest increase of perhaps $10 to $20 billion, due to a change in the asset preferences of some holders of dollar assets in favor of non-dollar assets, then the dollar exchange parity will decline. On simplified, but not implausible assumptions, an increased outflow of dollars of this amount might be expected to reduce the
dollar's value relative to several of the other major international currencies by 10 to 20 percent. Moreover, the decline is likely to be moderate and smooth if it comes about in this manner rather than drastic and abrupt, because dollar assets will continue to be attractive to large numbers of former and present holders of non-dollar assets for the numerous and strong reasons noted earlier.

The problem for the Europeans and the Japanese can be stated quite simply: namely, how to motivate some dollar asset holders to tilt their portfolios somewhat more in favor of non-dollar assets, and how to do this by measures that improve, rather than distort, the efficient functioning of their respective markets and economies?

There are several concrete and feasible means of doing so which would not only make holdings of non-dollar assets more attractive, but would, at the same time, eliminate or at least reduce the market distortions that already exist in these economies as a result of barriers, regulations, inflated transaction costs, and taxes. These measures include the following:

1. "privatizing" some presently nationalized industries (as exemplified by the recent denationalization of British Telecom), while aggressively marketing their shares in the U.S., as well as in European and Japanese domestic equities markets.

2. removing regulatory and other existing barriers to direct investment by U.S. firms and to joint ventures between them and domestic firms (recent joint ventures in Japan between RCA and Sony, and between Ford and Mitsubishi, are examples of what should be expanded there, as well as emulated in Europe).

3. reducing or removing presently existing fees, licensure requirements, and other obstacles to the establishment and expansion of U.S. service industries and firms abroad, in such fields as accounting, finance, insurance, and law. Facilitating and encouraging such activities by U.S. firms, rather than discouraging them, as, for example, Japanese regulations more typically do, can be expected to attract U.S. capital which is typically linked, at least informally, with these service industries.
4. lowering business taxes, and especially capital gains taxes, to rates that are not higher than those prevailing in the U.S.

While some of these measures would take longer to implement than others, credible commitments by European and Japanese policymakers along these lines could have near-term effects. Such commitments would alter expectations and change behavior by present holders of dollar assets in anticipation of these policy changes. Incidentally, contrary to some arguments that have been made recently, simply achieving higher rates of European and Japanese economic growth is as likely to result in further appreciation, rather than depreciation, of the U.S. dollar. The reason is that more rapid growth in these economies will stimulate U.S. exports, and higher U.S. exports will reduce the U.S. trade deficit, thereby reducing the dollars supplied by this means in international financial markets. As a result, the dollar's exchange parity may tend to rise with foreign economic growth, rather than to fall.

In sum, achieving a "soft-landing" for the dollar requires an updating and inversion of Servan-Schreiber's 1968 prescription. The "challenge" facing Europe especially, and to a lesser extent Japan, is how to attract, rather than repel, American capital. Even modest success in meeting this challenge would mitigate the worries that have been expressed about the muscular dollar.
THE MISSING CHAPTER IN THE INTERNATIONAL DEBT STORY*

Among the four largest debtor countries in the Third World, one (Korea) currently commands an A-1 credit rating in world capital markets, enabling it to borrow amply at rates equal to the best available to any borrower in those markets. The other three (Argentina, Brazil, and Mexico) can borrow only by pleading with new creditors, or by coercing old ones using the explicit or implicit threat of default as the stick. In either case, the A-B-M countries are obliged to accept restrictive conditions, as well as interest rate and other terms that reflect the extra risk that lending to them is believed to entail. As an indication of this perceived risk, the existing debts of Mexico, Argentina and Brazil trade on the secondary debt market at discounts of 38 percent, 33 percent, and 24 percent, respectively. By contrast, the existing debt of Korea is worth at least a hundred cents on the dollar.

Among the four countries, Brazil's and Mexico's total debts are the largest ($108 billion and $100 billion, respectively), Korea is next ($52 billion), and Argentina is fourth ($50 billion). As a group, the four account for more than half of total Third World debt.

What explains the striking differences in the credit standing of the four? The contributing explanations include several that are familiar, and one that is much less familiar and certainly less publicized, but which is probably of still greater importance than the others. Moreover, the less familiar one carries with it major, as well as neglected, policy significance.

The familiar explanations relate to the fact that Korea has been and is a rapidly growing (over 10 percent in 1986) economy, with booming export industries, a manageable debt service ratio (about 15 percent), and an increasing inflow of direct and equity investment from abroad.

*A slightly abbreviated version of this essay was published under the title "Missing Chapter in Third World Debt" in the Wall Street Journal on March 19, 1987.
By contrast, Argentina, Brazil, and Mexico are experiencing only modest or very slow economic growth, limited export growth in relation to their massive debt burdens, and a dearth of foreign capital inflow.

The less familiar explanation lies in the sharply contrasting history of capital flight in the three poor credit risks (Mexico, Argentina, and Brazil) on the one hand, and the strongly rated fourth one (Korea), on the other. To a very substantial degree, the prior debt accumulated by the A-B-M countries simply financed capital flight from those countries, whereas nearly all of Korea's prior debt contributed directly or indirectly to capital formation, and to increased production and export capacity; it is the latter that accounts for Korea's current strong credit rating and competitive position in world markets.

Between 1976 and 1985, cumulative capital outflows from Argentina and Mexico represented more than 50 percent of their total accumulated debt. The corresponding capital flight figure for Brazil has been estimated at between 10 and 18 percent of its total debt, but this is probably an underestimate. In other words, for the three A-B-M countries, capital flight—accomplished by whatever direct or indirect means—amounted to about $95 billion of their total collective debt of $260 billion. In effect, 35 percent of these countries' total borrowings was directly nullified by acquisition of foreign assets by their own citizens and other nonbank institutions. So-called "sovereign debt" was thus incurred by the three governments in exchange for assets acquired by private citizens or institutions of their respective countries.

This situation has a direct bearing on the predicament in which these and other Third World debtors, as well as their creditors, currently find themselves, on the dubious wisdom of most recent plans and proposals that seek to improve matters, and on finding a more promising approach to resolving the debt problem.

If and as the enormous 1975-1985 flight of capital from Argentina, Brazil, and Mexico is reversed, their demands for further borrowing will be reduced, their access to it will be eased, and the economic effectiveness of their subsequent borrowing will be enhanced. On the other hand, unless and until such capital repatriation occurs, there is
every reason to expect that further borrowing will, to a considerable extent, be nullified by further capital flight. Even with the existence of tighter exchange controls in the three countries, new borrowing can be converted into new capital flight in various ways, for example, by overinvoicing of imports, underinvoicing of exports, and other adroit measures designed to circumvent the controls.

An important conclusion follows: efforts to ease the Third World debt problem should focus on the conditions that promote and provoke capital flight, and on the conditions that will induce capital to return. These conditions relate to political stability and the predictability of the political environment, to tax and monetary policies, to labor and wage legislation, to regulatory policies, and to the general political and administrative climate for investment—whether by repatriated "old" capital, or by new internal or foreign capital. If and as progress is made toward improving these conditions, less new borrowing will be needed, more will be accessible, and the burden of servicing existing debt will be eased. In the absence of such progress, new loans will be wasted and the burden of outstanding debt will simply be magnified, thereby further dimming future prospects of repayment.
"STAR WARS" AND THE ECONOMIES OF WESTERN EUROPE*

It is no secret that prevailing European attitudes toward the Strategic Defense Initiative ("Star Wars") are acutely ambivalent.

On the one hand--the political and military one--the Europeans are somewhere between skeptical and hostile to both the concept of strategic defense, and to its likely consequences. On the other hand--the economic and commercial one--the Europeans are, by and large, seriously concerned about the danger of being "left behind" technologically if they don't participate in SDI, or in the putatively parallel, but demilitarized, R&D program proposed by the French--"Eureka."

European opposition to SDI is based on two somewhat inconsistent themes. If SDI "works" technically, and is "cost-effective" operationally (which means that the increased costs of improving strategic defenses turn out to be less than the increased costs of offensive forces needed to counter such improvements), the Europeans fear the U.S. and the Soviets might work out a "deal" between them that would leave Western Europe more exposed to the risk of conventional war. If SDI does not work--an outcome the Europeans believe is much more likely--they fear the result would be a ratcheting upward of the arms race, heightened East-West tensions, and insufficient attention to improvements in NATO's conventional military capabilities.

Associated with these reservations is an argument viewed by many Europeans as the clincher: SDI is not only undesirable for the reasons noted, it is also unnecessary; 40 years of nuclear peace have resulted from the deterrent effect of mutual assured destruction without effective defenses--post hoc, ergo propter hoc is the contention--so why rock the boat?

Notwithstanding their profound reservations, and quite apart from the merits of these arguments, the Europeans are nevertheless tempted by SDI for an entirely non-military reason: they think it may provide the

* A slightly abbreviated version of this essay was published under the title "SDI Is No European Elixir" in the Wall Street Journal on October 23, 1985.
"cutting edge" of new technology, and a much-needed stimulus to the disappointing rates of growth in output and employment of their ailing economies.

A recent commentary by John Newhouse conveys this somewhat starry-eyed view:

Some Europeans are saying that . . . Star Wars won't budge very far from Square One militarily . . . but the commercial spinoff from all that money spent on the most awesome technologies could be immense: phrases like "third industrial revolution" are bandied about . . . Star Wars will have an even greater impact on high technology commerce in the years ahead than the Apollo program had in the nineteen-sixties and seventies.

The sober truth is that such hopes are distinctly unwarranted and unrealistic. The ills that beset the Western European economies won't be allayed, let alone cured, by participation either in SDI, or in Eureka. Actually, Eureka suffers from a further lapse of logic. Eureka is based on two implicit premises: first, Star Wars technology is likely to generate major commercial spinoffs; and second, these spinoffs will be more accessible to American firms which participate in SDI than European firms which do not. (Note that this second premise implies that the potential commercial spinoffs from SDI would be "appropriable" by participants, but not available to "free riders"). The conclusion is then erroneously drawn that Western Europe should have a parallel, but demilitarized program, to develop similar technologies and thereby avoid being placed at a technological disadvantage relative to American firms participating in SDI.

Eureka's lapse of logic is simply this: if there were likely to be substantial commercial payoffs from these technologies, and if they were appropriable, then there would be no reason for government financing of the R&D in the first place! Private firms would have powerful incentives to do the job on their own. Only if the principal payoffs from the technology were military, rather than commercial, would government financing be justified.
In any event, there are several reasons why these "awesome technologies"—whether from Star Wars or from Eureka—won't much help the European economies. One reason is that the programs themselves will be highly capital-intensive and "brain" intensive. Employment and output effects will be exceedingly limited, and largely confined to a very small segment of engineering and science professionals in research laboratories, experimental "skunk-works," and testing ranges. Subsequent impacts on employment and growth are very uncertain, probably quite small if they occur at all (in fact, the results are more likely to be labor-saving than labor-using), and surely postponed until the very remote future.

The other reasons relate principally to the fact that Western Europe's main economic problems derive from structural and institutional conditions quite independent of Star Wars technologies and most unlikely to be affected by them.

In the past decade, annual rates of GNP growth in the Western European economies have fallen from an average of more than 3 percent in the 1976-80 period to less than 1 percent in the 1980-85 period. During the same time, European unemployment rates have risen from an average of less than 6 percent to more than 9 percent. (The current unemployment rate in the U.K. and the Benelux countries is about 13 percent, and in France, West Germany, and Italy, it is in the 8-10 percent range.)

Although many factors contribute to this disappointing performance, the two principal causes are fairly clear: first, diminished economic growth has been heavily influenced by a very substantial increase in the size of the public sector in Western Europe relative to the market sector; and second, the sharp rise in unemployment has been heavily influenced by a substantial increase in European wages relative to productivity.

Public sector expenditures have risen from less than 40 percent of Western Europe's aggregate GNP at the start of the 1970s to 50 percent currently. Empirical analyses done at the World Bank for the 1970s' decade and at The RAND Corporation for the 1972-1982 period, show a statistically significant negative relationship between economic growth and expansion of the non-market (government) sector relative to the
market sector. According to this statistical relationship, the substantial rise which has occurred in the share of European GNP represented by public sector expenditures—itself attributable to fundamental political and social conditions prevailing in Western Europe—explains about half the reduction in Europe's rate of economic growth occurring in the past decade.

The sharp rise in Western Europe's unemployment rate has, in turn, been principally due to increases in real, or inflation-adjusted, wages which have exceeded increases in labor productivity. This disparity has occurred because nominal wages have been fully indexed to cost of living changes, and because politically sensitive governments and party coalitions have allowed or encouraged additional wage and non-wage benefits irrespective of productivity growth. As a result, real wages in Western Europe have risen in the past decade by one third relative to wages in the U.S., where more flexible labor market conditions have prevailed. And employment in Western Europe has remained nearly constant since 1975, while increasing by more than 18 million in the U.S. during the same time period.

If these underlying causes of Western Europe's economic difficulties are remedied, the sclerotic performance of the European economies will be improved. If they're not remedied, Europe's economic outlook will remain clouded. In any event, the remedies and their prospects are quite independent of SDI or Eureka. Neither program should be "sold" as a means of easing Europe's fundamental economic problems. Such hoped-for effects will not occur, and if the programs' supporters encourage or indulge these unrealistic hopes, disappointment and recriminations will ensue in the future, and will then further weaken the NATO alliance. Those who support the alliance should not encourage European participation in either SDI or Eureka by holding out a prospect of economic and commercial benefits from these programs that are most unlikely to ensue.

If European (and, for that matter, Japanese) participation is to occur at all, the best way to bring it about is for governments to avoid placing unnecessary obstacles in its path. Allowing for special handling where classified research may be involved, European firms, laboratories, scientists, and engineers, wishing to participate in the
R&D program—*given* the defense-related purpose which motivates it—should be allowed to compete and cooperate as they are able and willing, without either endorsement or opposition by their governments. The NATO governments would, of course, have the opportunity and the obligation to decide upon their participation in SDI if and as deployable, cost-effective defensive systems emerge.
SECTION II. FOREIGN POLICY
IDEOLOGY HAS MORE THAN ONE FACE*

When the term "ideology" (or its cognates--"ideologues," or "ideological") appears in the media, the reference typically has two characteristics: it is critical or derisive; and it is applied to the "conservative right," rather than to the "liberal left." On the basis of casual empiricism--simply, counting the recent references I've seen--I estimate the odds are 5 to 1 that these characteristics will be associated with the reference!

Three recent examples, among many possible ones, illustrate the point:

- From the New York Times: ". . . the Reaganites' ideological obsession with Cuba and Nicaragua has blinded the Administration. . . ."

- From the Los Angeles Times: "The President and the ideologues who surround him seem blind to these complexities."

- From the New Yorker Magazine: ". . .[Reagan] is less leashed, less careful about what he says, more combative, more ideological. . . ."

Why--among the range of controversial issues to which the "ideological" label is frequently applied--is the application so heavily concentrated on one side? Why, for example, are intensified efforts to dislodge the Sandinistas and to thwart Cuba considered "ideological," while rejection of these efforts is not?

Why, to take another issue, is strong advocacy of the Strategic Defense Initiative often termed "ideological," but opposition to it is not?

Why is it "ideological" to call the Soviet Union "an evil empire," but not "ideological" to consider it simply a troublesome, troubled, and perhaps paranoid state?

---

*A slightly abbreviated version of this essay was published under the title "What's Wrong With an 'Ideology'?" in the Washington Post on June 16, 1985.
Why is it "ideological" to favor defense spending over spending on domestic programs, while the reverse preference is not?

Why is "pro-life" ideological, but "pro-choice" is not?

To personalize the point, why is it generally accepted that many of the positions espoused by President Reagan are "ideological," while those favored by Teddy Kennedy or Tip O'Neil are not? Why is the National Review's William Buckley "ideological," but the New York Times' Anthony Lewis is not? Why the Defense Department's Richard Perle, but not the State Department's Richard Burt? Why is Pat Buchanan typically cast as an "ideologue," while Stu Eisenstadt never was? And why is the Wall Street Journal considered "ideological," but not the Washington Post?

Why, to generalize the point, is the derisive, put-down label applied to one side so frequently, but to the other side so rarely?

The simple answer is that the media which employ the label are themselves antagonistic to the positions they apply it to, and sympathetic to the ones they refrain from applying it to. No doubt there is much truth in this, but it's not the whole explanation.

The rest of the explanation lies in the widely accepted assumption that the positions termed "ideological" actually are more rigid, less willing to compromise, less receptive to evidence that contradicts them, and hence more justifiably subject to criticism and derision than the contrasting, "non-ideological" positions.

In fact, this assumption is unwarranted, not because the factual basis for the so-called "ideological" positions is strong, but because the factual basis for the opposing "liberal left" positions is equally weak.

Consider the issue of trying to cut the Federal budget deficit by reducing domestic spending rather than reducing the growth of defense spending. The case for protecting defense spending while concentrating cuts on domestic programs rests on several key premises: the vulnerability of U.S. land-based missile forces to a Soviet first strike, and the relative invulnerability of Soviet land-based missile forces to the same threat from the U.S.; the deficiencies of U.S. and NATO conventional capabilities relative to those of the Warsaw Pact; the
need to replace a geriatric strategic bomber force with one that is more modern and more capable; and, most important of all, the assertion that, unlike domestic programs, the Federal government provides the only means to meet these defense needs.

None of these premises is without merit, although all of them are arguable, except the final one. There is no one else to do the defense job besides the Federal government.

On the other hand, the contrary view about cutting defense spending as much as, or more than, domestic spending rests on a different, and opposed set of key premises: namely, the Soviets are and will remain fully deterred by existing sea-based missile forces; NATO's conventional capabilities are, even if less than desirable, quite adequate compared with those of the Warsaw Pact, partly because the non-Soviet forces in the Pact are too unreliable for the Soviets to be confident of using them; the B-52 bomber force is old, but it can "hang on" until the "stealth" replacement arrives; and, finally, while it's true that the Federal government is the only means of providing for defense, waste should not be protected by this lame excuse, and various domestic programs (for example, social security benefits, student loans, even Amtrak) are important and won't get done unless the Federal government does them.

The point of this attempt at constructing a fair balance is simply that the second set of arguments is no less arguable nor more convincing than the first. In both cases, corroborative as well as conflicting evidence must be marshalled, compared, evaluated, and in the final analysis, subjected to fallible human judgment to arrive at a personal or a policy conclusion. But, most assuredly, the pro-defense view is no more "ideological" than its opposition.

The same sort of balance sheet, with the same conclusion, can be arrived at for all the other issues mentioned earlier.

When someone impugns the views of another as being "ideological," it's usually a safe bet that the comment applies at least equally to the source as to the object.
DEMOCRACY IN THE THIRD WORLD: A MISSING INGREDIENT*

Winston Churchill's aphorism about democracy ("the worst form of government except for all the others"), also applies to the "Third World," although this application was probably not the author's intention. In any event, the problem in the Third World is not whether democracy would be better or worse, but rather how to get it launched in a manner that provides a fair test of Churchill's proposition.

Social scientists have written tomes about the formidable obstacles confronting nascent, or pre-nascent, Third World democracies, and the recent histories of the Philippines, Pakistan, Korea, and Indonesia—to cite a few examples—provide ample evidence of these difficulties.

Nevertheless, improving the chances that Third World democracy can succeed faces one major obstacle that has been largely overlooked in the past: what can an ex-president or ex-chief of state in a Third World country look forward to doing after he moves out of the presidential palace? In the absence of an answer that is both feasible and attractive, it is not surprising that Third World leaders as different as Marcos in the Philippines, Zia in Pakistan, Suharto in Indonesia, and Chun Doo Wan in Korea are willing, if not eager, to convince themselves, or be convinced by others, that the best interests of their countries require extending their tenure—whether by imposing martial law, amending or suspending the Constitution, or rigging an impending election. Frequently, the result is that democracy is aborted, or continues to function as a discredited sham.

By way of comparison, consider the extraordinary range of opportunities open to ex-presidents or ex-heads of government in the United States and other democracies in the developed world. For example, exiting leaders can write best selling books and serve as newspaper and TV commentators (Nixon); they can join numerous corporate boards, and can be featured speakers at national and international

*A slightly abbreviated version of this essay was published under the title "How to Put Autocrats Out to Pasture" in the Los Angeles Times on February 9, 1986.
meetings and conventions (Ford and Helmut Schmidt); they can establish university-based research and conference centers named after themselves (Carter). And their presidential successors, as well as the media, typically seek their counsel on a more or less regular basis.

Besides the substantial income realized from such activities, ex-presidents may receive annual lifetime stipends ($69,000 plus $96,000 for office help, in the United States) as a result of their prior government service. And all of this leaves ample time for golf, skiing, tennis, and softball!

Of course, this package still adds up to less than the challenge and excitement of the presidency. But the point is that there definitely is "life after the White House," or after #10 Downing Street, or after the Elysee Palace. Indeed, the range of activities and income accessible to ex-presidents adds up to an appealing combination of financial security, personal stimulus, and public stature.

Now, consider the contrasting prospects facing Marcos (sic), Zia, Chun, and Suharto, and their genre, if they exit their present posts. The options are limited and unattractive. Corporate boards don't stand in a queue to invite their participation. Publishers don't compete for rights to their memoirs by offering lucrative advances and royalties. And the media don't clamor for their weekly or monthly comments. Moreover, their prior associates in government or the military typically avoid, rather than seek, their company, lest contact be viewed by the new incumbent as a sign of disloyalty or, worse still, of a potential coup.

Thus, if a Third World ex-president continues to reside in his own country, he is likely to be ignored. If not ignored, he may be viewed as a thorn in the side of a successor whose tolerance for having him around may be limited. (Even lesser presidential challengers, like Benigno Aquino in the Philippines and Kim Dae Jung in South Korea, became personae non gratae to the reigning leadership.)

Exile, whether voluntary or induced, may then appear as preferable to the circumscribed, if not risky, prospects at home. (It is not surprising that Marcos may have acquired property in the U.S. and elsewhere, and that other Third World leaders have salted wealth abroad as insurance in case exile becomes their most attractive option.)
In sum, the options that are readily available to Third World ex-presidents are few and unattractive. Moreover, such options as do exist are likely to appear especially dismal by comparison with being head of state. The result is that incumbent leaders may contrive or conspire to prolong their tenure, resulting in the deferral and discrediting, if not demise, of one incipient democracy after another.

Can anything be done to remedy this situation? Not easily, for a clear and compelling reason: the absence of inviting prospects for post presidential careers in Third World countries is rooted in their limited economic, technological, and social development. It is no less true that the abundant opportunities open to ex-leaders of democracies in the West and in Japan are rooted in their advanced economic, technological, and social development.

Yet this doesn't mean that successful democracy is bound to be a rare occurrence in Third World countries until their economies and societies attain a level of development more like that of the first world. At the least, a few concrete steps can ease the problem sooner.

For example, large private corporations and foundations (e.g., Ford, Rockefeller, MacArthur, Johnson) might consider Third World ex-presidents as possible directors or board members when their records in office and other credentials so warrant. And, within Third World countries themselves, certain institutional developments might improve the situation. For instance, in Korea, discussion and planning are fairly well advanced to establish a privately endowed "think tank" with an agenda for research and international conferencing relating to foreign policy and defense issues that might provide one or more prestigious positions to attract an outgoing Korean head of state. The process might also be helped by establishing reasonable stipends to support ex-presidents who exit their offices in accord with proper constitutional procedures.

Recognition of what has been a neglected problem can perhaps suggest some useful remedies. The result can be at least a modest improvement in prospects for the success of democracy in the Third World.
COOPERATIVE FORCES FOR LOW INTENSITY CONFLICT*

The Soviet Union's operations in the Third World are characterized by a surprising degree of multilateralism, while those of the United States are often characterized by a no less surprising degree of unilateralism. This asymmetry arises because of the development and use by the Soviet Union of an effective network of cooperating "fraternal" communist states (e.g., Cuba, Vietnam, East Germany, Nicaragua, North Korea), as well as supportive noncommunist states and entities having convergent interests with those of the Soviet Union (e.g., Libya, the PLO, Syria). These participants perform military as well as nonmilitary roles, and provide contributions of different types and amounts. Although the operational details are obscure, the players in this "Red Orchestra" are conducted by the Soviet Union, which also pays most of the bills.

Through this network of cooperating elements--involving division of labor, and varying types and amounts of participant contributions--the Soviet Union has acquired a significant advantage in its long term, multi-faceted competition with the West. Of course, the Soviet Union also has significant disadvantages in this competition. For example, the generally poor economic performance of centrally planned and tightly controlled Soviet-type economic systems has led to growing disenchantment with them. And there are currently six anti-communist resistance movements actively under way within the extended Soviet empire: in Angola, Mozambique, Cambodia, Ethiopia, Afghanistan, and Nicaragua.

Nevertheless, the balance between these advantages and disadvantages does not warrant complacency. In meeting the current and likely recurring threat of low intensity conflicts in the Third World, we should seriously consider a basic change in the way we think about and prepare for such conflicts. Typically, our approach to these

*A slightly abbreviated version of this essay was published under the title "U.S. Could Use Its Own Cubans and East Germans" in the Wall Street Journal on May 1, 1986.
contingencies has understandably concentrated on whether or not the U.S. should be involved. If any consideration has been given to engaging other partners in a collaborative effort, the focus typically has been on our European allies, usually with modest results.

The change in approach would involve encouragement for the development of cooperative military forces by Third World countries themselves, capable of conducting, in cooperating with the United States, and among themselves, low intensity military operations in the Third World when the need arises. The purpose of these loosely aligned forces would be to contain and reverse communist imperialism in the Third World, to advance legitimate, indigenous movements that seek liberation from communist imperialism, and to further the mutual interests of the U.S. and its cooperators in promoting more pluralistic and more open political systems in the Third World.

This approach has obvious precedents in prior U.S. policy endeavors, as well as in recent policy pronouncements. The precedents include employment of Korean combat units in Vietnam in the late 1960s; forming, equipping, and supporting the Meo hill tribes in Laos in the early 60s; supporting freedom fighters in Afghanistan since 1980 (with Pakistan’s cooperation), and the contras in Nicaragua since 1981.

The idea would represent a further development of the inchoate Reagan doctrine, foreshadowed in the President’s 1985 State of the Union message,

Support for freedom fighters is self defense, and is totally consistent with the OAS and UN charters... (We should) support the democratic forces whose struggle is tied to our own security; and subsequently elaborated by Secretary of State Shultz:

So long as communist dictatorships feel free to aid and abet insurgencies in the name of “Socialist Internationalism,” why must the democracies, the target of this threat, be inhibited from defending their own interests and the cause of democracy itself?

"Cooperative forces" would be drawn from countries and movements within the Third World willing and able to act in concert with the United States for the advancement of mutual interests. Although the mutuality might be only partial, it could permit some division of labor and sharing of burdens between the cooperating countries and the United States. The policy would be overt and explicit, although in some instances there might be reasons for implementing it through more quiet channels.
The Soviet Union has repeatedly asserted that its support for wars of national liberation in the Third World is quite compatible with improved U.S.-Soviet relations. The U.S. could adopt a similar stance. U.S. support for cooperative forces, and for legitimate movements which seek liberation from communist imperialism in the Third World, does not preclude improvements in bilateral U.S.-Soviet relations and continued negotiations for mutual arms reductions.

"Cooperative forces" can be clearly distinguished from "proxies" or "surrogates." Proxies act at the behest of a controlling power, which bears all of the accompanying costs. Cooperative forces act from mutual interest, and therefore share costs, responsibilities, and decisionmaking. Among possible cooperating countries are Egypt, Jordan, Morocco, Pakistan, Turkey, Venezuela, Brazil, Argentina, Korea, Indonesia, the Philippines, and Taiwan. Even China has become an actively cooperating country through its appreciable support for freedom fighters in Afghanistan and Cambodia.

From the standpoint of potential Third World cooperators, several incentives might motivate participation: for example, helping to deter, contain, or reverse a common threat; enhancing their regional and international influence and stature; and improving their military and related capabilities.

From the U.S. standpoint, the development of cooperative forces may also have numerous advantages: allowing for division of labor, and some degree of specialization between the United States and its associates; providing a vehicle for political, as well as economic, burden-sharing; and providing a means of reducing the gap between U.S. interests and commitments, and U.S. capabilities. Such a partnership would also provide opportunities for complementarity in the planning, equipping, and operations of U.S. and cooperating forces.

In both the deterrence and the conduct of low intensity warfare, cooperating countries can participate in various ways: providing training and equipment; offering maintenance and other forms of logistic support; extending limited financial support; and, in some instances, providing small combat units.
In their military dimension, two different types of cooperative military forces can be distinguished: cooperative local forces and cooperative mobile forces. Cooperative local forces are exemplified by the "freedom fighters" currently active in Afghanistan, Nicaragua, and Angola. Cooperative mobile forces would consist of a loose coalition of combat military elements from cooperating Third World countries, with logistic and backup support provided by the U.S., as well as other cooperating countries. Mobile forces would be available at the invitation of beleaguered Third World countries to enhance their own capabilities for resisting and defeating communist revolutionary movements. El Salvador may provide an example of the possible utility of such forces.

The era of Gramm-Rudman-Hollings plainly requires that careful consideration should be given to the costs of any new program before it is launched. Incremental costs of cooperative forces should be low for two reasons. First, cooperators would be expected to bear part of the costs because the endeavor is intended to be joint and the burden to be shared. Second, participation would become a major criterion in allocating the present level of Security Assistance funds, as well as the governing criterion for any additional funding authorized and appropriated for this purpose. Because the Security Assistance funding would be a vehicle for jointly planning the forces and contributions of cooperating countries, as well as those of the United States, these funds could have a multiplier effect.

A fair evaluation of the idea of cooperative forces, and its subsequent translation into a practicable policy instrument, cannot be accomplished easily or quickly. Meeting Congressional concerns will require, among other things, a persuasive argument that political, as well as economic, burdens will be shared, and that cooperative forces will reduce, rather than increase, the likelihood that U.S. combat forces will be engaged. Eliciting participation from prospective cooperating countries will depend on their assessment of the mutual benefits to be derived from this type of loosely structured, security partnership. The likely concerns of our European allies must also receive careful consideration.
Plainly, all of this would require further study and a serious multiyear effort if an effective network of cooperating elements were to be developed to meet the challenge of low-intensity conflicts in the Third World. In the process, the asymmetrical advantage hitherto often realized by the Soviet Union through its "Red Orchestra" may be redressed by development of a "Blue" one.
SOVIET ECONOMY AND U.S. "OPPORTUNITY"*
(coauthored with Henry Rowen)

The idea that the sick Soviet economy compels Moscow to seek a new arms pact with the U.S. is in fashion. Sovietologist Seweryn Bialer says in Forbes, Never in the past 20 years did they want arms control as badly as today." Peter Tarnoff of the Council on Foreign Relations says in the New York Times, "We can exact better arms-control terms from Moscow today than at any previous time in the two Reagan Administrations." Others see a "historic opportunity." Our own views, which emphasize the long-run drag on Soviet military power from continued poor economic performance, have been (wrongly) interpreted in a similar vein by some people.

Reality here is complex. The Soviets do face troubles that could, in the most hopeful analysis, lead to a cut in arms and force a turn to serious economic liberalization at some point. But in the meantime, a Moscow regime could sustain its military effort and even veer toward re-Stalinization out of desperation. And, though a slowdown in the Russian military buildup might be a part of any transition steps, the West must remember that strategic superiority in arms is a crucial element in the design of the Soviet system. This ought to wave caution flags in front of those here who look to arms agreements and expansion of trade as a bridge to peace.

Mikhail Gorbachev is quoted (in samizdat) as calling his economy "a mess." And despite his efforts, it's likely to keep doing poorly. Contributing to the slowdown has been the large and rising share of resources devoted to the military and to extending the Soviet empire via the use of proxy states.

Faced with this severe pinch, Moscow is pushing an arms-control strategy--so successful in the past in restraining the U.S.--to buy it time to regroup domestically while yielding no part of its global

*This essay was published in The Wall Street Journal on December 11, 1986.
military position. The emphasis is on stopping the Strategic Defense Initiative, but its aims are much broader. Important Soviet policy makers see a need to increase the nation's capacity for "high-tech" warfare, largely conventional but also nuclear. This can be a particularly expensive task, one ill-suited to present harsh economic realities. The deus ex machina could be a transfer of critical Western technology and capital, and inducements for the U.S. to hold back its own military modernization.

For several decades, Soviet economic growth has been slowing; over the past decade, U.S. government estimates show it at a little over 2% annually. We, and some other analysts, think it might have been lower. Planned growth for 1986-90 is about 4%, while many Western analysts believe it really will be about 2% and perhaps lower, signifying near stagnation in per-capita terms.

One-third or more of additional national output went to the Soviet military or empire over the past decade. By now, they absorb more than 20% of the Soviet gross national product (vs. less than 8% for the U.S.). The payoffs have been a much-strengthened military position, the ability to conduct a war in Afghanistan without noticeably weakening strength elsewhere, and support for the Cubans, Sandinistas, Vietnamese and other members of the empire. Evidently, the Politburo judged the gains to have been worth the high costs. There is little reason to believe that Mr. Gorbachev and the other new men value these power benefits less than did their predecessors.

But they face a serious problem: If they can't get the country's economy moving ahead, sooner or later something will have to give. (It might be Mr. Gorbachev's tenure in office.) The present effort to improve productivity, largely through discipline and new bosses, is unlikely to work for more than a short time at best. What follows then? Even more Stalinist discipline would meet strong internal opposition. Market decentralization, Chinese style, would help, but such a move would be strongly resisted by the nomenklatura, much of which is digging in its heels at Mr. Gorbachev's largely modest changes. (The recent legalizing of private service activities is a significant step, but prohibiting the hiring of any labor shows the strength of the resistance to change.) Less military spending would help realize Mr. Gorbachev's
capital plant-modernization goals, but people who take pride in overtaking the West militarily want to build on, not abandon, that achievement.

Hence the appeal of a revived detente that would help bring in more technology and capital, undermine support for military spending in the West, and lessen the need for heavier Soviet military spending while increasing the payoffs from any new military programs undertaken.

This strategy worked in the 1970s. The Soviets made a great leap forward in military power and in extending the empire not only through their own vigorous efforts but also because their enemies relaxed. The U.S. took the accords on ballistic missiles and missile defenses as a general signal to spend less on arms and to develop fewer weapons systems. For example, the number of known Soviet systems deployed in the first half of the 1980s—which reflected new projects put in development during the detente of the 1970s—was twice that of the U.S.

The story of the 1980s is different. By the end of the 1970s, the Soviet detente/arms-control strategy was eroding and almost met its demise with the invasion of Afghanistan. Since then, the U.S. has recovered somewhat militarily, the overseas parts of the Soviet empire are under challenge on all fronts, and the Soviet economy is in deep trouble.

To the Soviets, the 1970s are a better model, and we are seeing an attempt to revive it. The Soviet leadership has reason, once again, to be hopeful. Congress, which slowed research on more accurate guidance for missiles for a period in the 1970s, now prohibits testing of anti-satellite weapons, strictly limits production of chemical weapons, favors a narrowly restrictive interpretation of testing of anti-missile defenses under the ABM treaty, and has threatened to impose a one-year moratorium on all nuclear tests. Self-limitation, which borders on paralysis in some areas, has not been confined to Congress. It was the executive branch that chose not to deploy the neutron bomb in Europe after the Europeans had agreed to it and that long neglected improvements in the command-and-control systems.

Internally, the Soviet leadership faces a more complex choice than guns vs. butter. It is nuclear missiles (and defenses against Western ones) vs. conventional weapons (especially higher-technology ones and
those capable of delivering both nuclear and conventional munitions) vs. supporting embattled members of the empire vs. investment goods vs. consumption goods. In the internal struggles, a coalition may exist between some in the military and the economic modernizers on the merit of investing more in high-tech, flexible capital equipment even at the expense of reduced weapons procurement now in order to be able to produce better weapons later.

A precedent is Khrushchev's move in the 1950s to reduce the army, create the strategic rocket force and cut military spending (then increase it in the 1960s). Now there are similar pulls in these and other directions, and no one knows how they will be resolved in the short run. But unless economic performance improves over the long run, a decade or more, the Soviet Union will lose ground militarily.

One pull that has been widely noted in the West is toward giving higher priority to non-nuclear forces. Former Chief of Staff Marshall Ogarkov is interpreted as advocating this—with a strong nuclear backup. But the savings realizable from this shift are likely to be small, because the Soviets spend much less on nuclear than conventional forces. And, if they slow the pace of modernizing their nuclear forces and have a smaller number, they might still end up spending more on these forces because of the new weapons' higher cost.

They clearly don't want to face the array of advanced technologies that the SDI could produce. Better to get the U.S. to abandon these defensive efforts (as it did in the 1970s) or persuade Washington to wrap them in a web of constraints. On form, these constraints would be rigorously monitored and enforced by the American press and political system.

We may indeed have a "historic opportunity." But given the record of earlier agreements and what we know about the Soviet internal situation, this "opportunity" may be no more than a way of facilitating a Soviet switch in military strategy and the bolstering of this adversary's capacity for a more diversified arms challenge. Instead of relaxing and relieving Moscow, the West should do its best to leave the Kremlin with only one viable option: dealing with its internal problems by spending less on the military and the empire and taking further and bolder privatizing steps.
CONSENSUS AND DISSENSUS ABOUT THE SOVIETS*
(coauthored with Henry Rowen)

Seldom has there been such uniformity of expert opinion as there currently is concerning the conditions and prospects of the Soviet Union. Yet, ironically, this consensus has not diminished, and perhaps has even intensified, prevailing disagreements about preferred U.S. and Western policies.

The present consensus concerning Soviet conditions is based on a reasonably solid body of facts and accepted inferences:

- **Economic Growth.** Between 1971 and 1986, Soviet economic growth has persistently declined, and the growth of aggregate productivity has decreased or been negative. According to the Soviet Union's own estimates, annual growth of national product declined from 5.7% in 1971-1975 to 4.2% in 1976-1980, and to 3.4% in 1981-1985. The corresponding U.S. government estimates are 3.8%, 2.7%, and 2.2%. Independent estimates by the authors and several other analysts suggest even lower growth rates. Soviet growth targets for the 1986-1990 period are about 4%, while the prevailing consensus among Western analysts is that the actual figure is more likely to be about 2% and perhaps even lower, signifying near stagnation in per capita terms.

- **Hard Currency Earnings.** Soviet hard currency earnings have declined in the past two years by about 30% from $32 billion in 1984 to $22 billion in 1986, mainly due to lower oil prices and to some reduction of Soviet hard currency arms sales. As a result, Soviet borrowing from the West has risen sharply, and is likely to continue at a high level.

*An abbreviated version of this essay was published under the title, "On Soviets We Agree to Disagree," in the Los Angeles Times on January 20, 1987.*
Military Spending and Military Power. Growth of Soviet military spending has apparently slackened somewhat, just about keeping pace with the reduced growth of Soviet national output. Official U.S. estimates of the burden imposed by Soviet military spending suggest a share between 15% and 17% of Soviet GNP, and there are reasons for believing that the actual burden is even higher. Notwithstanding the slower growth of military spending, Soviet military power is formidable as a result of both accumulated military expenditures in prior years, as well as the high levels of current outlays.

Social Conditions. Alone among the world's industrial countries, the Soviet Union has experienced an increase in infant mortality and an unprecedented decline in life expectancy between the end of the 1960s and the early 1980s. Moreover, the decline was due not only to the aging of the Soviet population, but to a rise in age-specific death rates across age groups. As Mikhail Bernstam has pointed out, among the large number of Soviet ethnic groups, the Russian population has been the most severely affected by this deterioration. During the same period, there has also been a sharp increase in alcoholism in the population as a whole.

Politics. Despite the bear's evident sickness, the control exercised by the Soviet ruling class--the nomenklatura--remains firmly anchored in the Party and its supporting pillars of power: the KGB and the military.

The aforementioned consensus among putative Soviet experts is less clear on the question of whether, and in what ways, Gorbachev wants to reform the Soviet economic system. Nevertheless, there is general agreement that his ability to change the system--quite apart from his wishes--is severely limited by the fundamental clash between the requirements for maintaining centralized political control, and the requirements for increasing incentives, decontrolling information access, and decentralizing opportunities, that would be at the core of genuine reform.
If there is general agreement about these prevailing conditions, what are the policy differences, and why do they persist?

At the risk of some oversimplification, the policy differences can be divided between two broad orientations: "detente-minus"; and "containment-plus."

The *detente-minus* position harkens to the 1970s’ era of detente, which it views with some nostalgia, occasionally mixed with an acknowledgment, as well as mild criticism, that the benefits of detente in the past were perhaps too one-sided. According to this position, a new and updated version of detente could realize a better balance through harder bargaining on the part of the West, and tighter "linkage" between Western "quids" and Soviet "quos." The West would thus benefit more, and give up less, than in the 1970s' detente: hence, *detente-minus*. Among those holding this position are the West German Foreign Minister, Hans Dietrich Genscher, many of our European allies, former Secretary of State Cyrus Vance, and many members of Congress and of the State Department.

*Detente-minus* acknowledges that the Soviet Union is a hostile adversary, with values inimical to those of the West. However, according to this policy stance, we can "do business" with the Soviet Union, because it shares with us a mutual interest in avoiding war, is genuinely anxious to avoid confrontation, and is less inclined than in the 1970s to expand its empire in what is, in any event, the relatively less important Third-World arena. The *detente-minus* position views the Soviet Union as more or less similar to other nations in seeking to advance its national interests, and therefore willing to make and to adhere to agreements that reflect these interests.

Based on these assumptions, the policies favored by adherents of *detente-minus* include arms control agreements (with SDI favored as a bargaining chip to be traded for lower offensive force levels), increased economic relations with the Soviet Union encouraged by subsidies where necessary, expanded "dialogue" on a wide range of economic, scientific, and technological matters, and general acceptance of the Marxist-Leninist states that have arisen in the Third World as well as ones that may arise in the future.
The containment-plus stance harkens back to the earlier 1950s' and 1960s' theme of the younger George Kennan (his views have changed rather sharply since the 1947 Mr. X article). Whereas, the original formulation of containment envisaged military, political, and economic resistance to expansion of the Soviet empire, the newer version would add prudent efforts both to reverse the expansion in the overseas empire that occurred in the 1970s, and to alter the most noxious and secretive aspects of the Soviet system itself; hence containment-plus. Among those holding this position are President Reagan, his key cabinet and sub-cabinet aides, some members of the Congress, and Zbigniew Brzezinski.

Containment-plus views the Soviet Union as an "evil empire" (the adjective is currently not fashionable, although the concept remains influential), which may alter its tactics, but not its basic and irreconcilable long-term aim: namely, to "bury" capitalist democracy. According to this policy stance, the Soviet Union, because of the priority it accords to military power and the empire, as well as its obsession with secrecy, centralized political control, and the coercive power of the secret police, cannot abide a non-conflictual, open, international environment. Containment-plus tends to view the only common interests between the Soviet Union and the West as confined to the avoidance of a major war, and the control of nuclear proliferation.

The containment-plus view opposes the use of SDI as a standard bargaining chip to further arms control negotiations, and instead urges accelerated and sustained research and development of strategic defense capabilities. Other policies favored by containment-plus include implementation of the Reagan doctrine through support for "freedom fighters" and cooperative forces to reverse the Soviet empire in the Third World, as well as expanded information programs to reach and influence the peoples of the Soviet Union and of its extended empire. Adherents of containment-plus would limit economic relations with the Soviets, confining them to ones that are strictly unsubsidized.

Of course, there are shadings within, and combinations between, detente-minus and containment-plus. There is even occasional movement between them: for example, Henry Kissinger, the original architect of detente in the 1970s, currently occupies containment-plus ground.
The fundamental disagreement between *detente-minus* and *containment plus* rests on their basically different assumptions concerning the *proper* objectives of U.S. and Western policy, and the *actual* objectives and character of the Soviet Union. That the deep policy disagreements associated with these two positions remain unaffected by agreement concerning Soviet economic, social, political, and military conditions follows unsurprisingly from the depth of the disagreements and their underlying assumptions. The persistence of such sharp disagreements among putative foreign policy experts suggests what psychologists refer to as "cognitive dissonance": if convictions are held strongly enough, they can abide a very wide range of unexpected and seemingly contradictory events without undergoing change.

In foreign policy, expertise may thus contribute more to agreement on diagnosis than agreement on prescription. The latter requires the exercise of judgment, and that of the public may be as good as or better than that of the experts.