The Economic Club of New York

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The Honorable Peter Jay
British Ambassador to United States

Admiral Stansfield Turner
United States Director of Central Intelligence

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Questioners: George Malone, Deputy Director
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Leo Cherne, Executive Director
Research Institute of America

Introduction

Chairman Tim Dunleavy

Good evening. I'm Tim Dunleavy, Chairman of the Economic Club and your presiding officer this evening. The other day Ed Locke, our president, suggested I might open up with a little tidbit of the Club's history so he presented me with a little piece of memorabilia – the Club's program from their second dinner 70 years ago on December 12, 1907. It certainly must have been quite an occasion. To begin with, the dinner included seven courses – everything for gourmets and gourmands alike. It started with oysters on the half shell, through a fish course, two meat courses, and two very excellent wines.

The food for thought was presented by no fewer than five noted speakers. Let me read them to you: the Honorable William H. Langdon, District Attorney for the city and county of San Francisco, Melville E. Ingalls, Big Four Railway Chairman of the Executive Committee, the Honorable Charles A. Prouty, Interstate Commerce Commissioner, John G. Milburn, Esq., a lawyer from the state of New York, and then Professor Jeremiah W. Jenks from Cornell University. Of course, the subject they were discussing wasn't Ty Cobbs' .350 batting average that year nor was it the electric vacuum cleaner that was invented that year. Rather, it was the present federal policy in relation to trusts and corporations – a topic where the pros and cons haven't changed much in seven decades. They've just gotten a little more complex. With all that food for discussion, I'm sure the event ran well past midnight. But we can tell you that we're going to break at 10:00.

Before getting started, I have a very pleasant duty to perform. Jim Davant, would you please step up here please. As Chairman of the Economic Club last year, Jim was the architect of our club activities and provided us with a splendid example of service. That is why, Jim, that we wish to present you with this small token of the Club's appreciation, or perhaps I should say tokens of appreciation. They are two Big Apples, handcrafted in crystal by Steuben, one for your office and one for your den at home. Jim...(Applause)

James W. Davant: Thank you very much, Tim. Last year we decided we had one thing to do, and that was to improve our management. And with Tim and Ed Locke, I think we've done just that. Thank you. (Applause)

Chairman Tim Dunleavy: Thank you Jim. And now on with our program. Our discussion tonight covers the broad-scale situation in worldwide economics – both at present and with an eye to future developments. With us are two men who can give us considerable insight into that thorny subject from two different perspectives – the economics of the Free World and the economics of the Communist world. The title of this evening's discussion, stated rather graphically by Ambassador Jay, is "Fat Years, Lean Years: Can we Control our Fate?

As has been our tradition in the past, after both of our guests have spoken, we will have a question and answer period. This time we polled our membership well in advance for their suggestions as to specific questions. Some will be reflected amongst those asked tonight by our two interlocutors – two gentlemen who have gained considerable stature in diverse professions. George Malone, to my right, is the Deputy Director of the *Wall Street Journal's* Editorial Page and a former Foreign Correspondent for the journal covering major areas of Europe, Africa, and the Middle East. George, will you please stand up. (Applause) Leo Cherne, seated to my left, is a noted economist, Executive Director of the Research Institute of America and a foreign affairs specialist who has served as Chairman of the Board of the International Rescue Committee since 1951. Leo...(Applause)

Our two guests tonight have a few things in common, other than the subject of economics. This is quite a coincidence. Both have obtained degrees from Oxford in philosophy, politics, and economics and both have had some experience in naval service and both have had considerable experience in the field of international economics.

Opening our discussion and speaking on the Free World is His Excellency, Peter Jay, the British Ambassador to the United States. Ambassador Jay was introduced to statesmanship early in life as the son of a well-known Labour member of Parliament, the Right Honorable Douglas Jay. He was educated at Winchester College in Oxford and served two years in the Royal Navy earning the rank of Sub-lieutenant. With that background, a life of public service seemed a natural for him. After three years at the Treasury, he left to become economics editor of *The Times* of

London. In 1972, Ambassador Jay became a nationally recognized television personality. And in 1975, he was elected a Director of the Royal Society of the Arts.

Peter Jay has received many such honors, but perhaps the most telling honor that he has ever received was his selection in 1974 by *Time* magazine as one of the key future leaders of the world. Despite such well-earned tributes, Ambassador Jay remains very much a family man, with a son and two daughters, his wife Margaret, who is here this evening. Mrs. Jay, would you mind standing and let the gentlemen see that lovely...(Applause)

And besides his family and his wife Margaret, he has an undaunted love of the sea. Last year, Ambassador Jay captained his own boat across the Atlantic to join us in our bicentennial celebrations. That dash and bravado along with political savvy have gained him the respect of statesmen in countless countries, including that of his father-in-law, Prime Minister James Callaghan, I think. Ladies and gentlemen, it is a distinct pleasure to introduce to you Ambassador Peter Jay. (Applause)

The Honorable Peter Jay

British Ambassador to the United States

Mr. Chairman, Ambassador Richard, Mr. Director, ladies and gentlemen, I suppose there must be greater honors than being invited to address the New York Economic Club, but since I have no expectation of being invited to address a Joint Session of the Congress, I would like to record that for me this opportunity today is about as flattering and as exciting an occasion as I am likely to experience. And I notice also that not even Wendell Willkie could describe a Joint Session of the Congress as a nonpartisan forum. I also noticed, Mr. Chairman, from your opening remarks, that my father was nine months old at the time of the first meeting of this club. And that I think is, to me at least, strong evidence of its venerability.

I thank you sincerely for the honor that you have done me, and I beg your forgiveness in advance for what I feel is my manifest inadequacy for so challenging an assignment. I suppose too, Mr. Chairman, that there must have been, there must be some higher distinction than being asked to share a platform with Admiral Turner. But right now I have the greatest difficulty in recalling any, bearing in mind that he presides over the greatest information-gathering organization in the world. And that is no bad thing to have behind you when it comes to writing a speech. (Laughter and Applause) And bearing in mind also, Mr. Chairman, that the director has a background in both Oxford and the Navy. It is true, as you have said, that I share those two things with him. But there is, I'm afraid, a difference. He is an Admiral of the United States Navy whereas I am to this day, despite what you said, Mr. Chairman, a midshipmen Royal Naval volunteer reserve retired. (Laughter)

Mind you, sir, I got a nice letter from the Admiral commanding reserves when I retired generously, I thought, on his part overlooking the memorable occasion when under the astonished gaze of half the top brass of the British Mediterranean fleet – those were the days when we had one – I was ordered to fire my ship's main armament on our annual inspection day and I succeeded somehow in firing the barrel of the main gun for which I was responsible, several hundred feet astern into the waiting ocean. That, sir, just isn't quite the same thing as making it to the top in the way that Admiral Turner has done. I'm glad, ladies and gentlemen, that you appreciated that because we're about to get down into some very heavy economics.

My assignment today is not made any easier by the somewhat conflicting terms of reference that I've been given. Namely, to describe the economic outlook for the Free World, to answer 19 specific questions ranging from how can the United States retain the free enterprise system that Great Britain has lost...(Laughter and Applause)...to what is the outlook for the British economy over the next several years. And finally, and I suspect above all, not to take more than 20 minutes about it. I did, in fact, though spend one long night at the typewriter painstakingly preparing succinct answers to each and every one of those questions and I have the text with me in case anyone should think that I'm seeking to avoid any of them. But I think, sir, I should turn to a more general theme and take a look at least at the economic situation and prospects of the Western world particularly Western Europe.

As our continent has indeed been in the grip of a serious recession ever since the collapse of the 1973 boom, the process of recovery has been very slow – in many cases imperceptible. And many forecasters, including for example the formidable staff economist of the OECD, now expect 1978 to see a rise in economic activity too slow to prevent a yet further rise in unemployment in Western Europe. Now, sir, our opinions differ considerably about the causes of this recession, some would and indeed have put the blame mainly or even entirely on the deflationary effects of the quintupling of oil prices in the winter of 1973 - '74 combined with the inability of the OPEC countries to spend more than a moderate part of the gigantic levy which they had in effect imposed on world oil consumers.

Others would start, and indeed have started, by putting much more emphasis on the unhealthy boom and the reasons for it which preceded the recession and on the measures thought necessary to curb the inflation to which that boom gave rise. Those who argue like this, in the second way, tend to be preoccupied with the somewhat sinister tendency, at least since the late 1960s when the economic cycles of the major Western economies finally fell into close phase with one another for successive booms to involve more and more rapid inflation while the intervening recessions required to dampen that inflation became deeper and deeper.

But whatever the cause of the recession, its impact has been deep and prolonged in Western Europe. And on either side of the Atlantic, only the United States has shown any real signs of emerging from it. Unemployment in virtually every Western European country has been on a continuously rising trend – from a total of $4.7 million in 1975 to about $7 million now. Although industrial production did rise quite well in certain periods after 1975, it declined again throughout Western Europe in the second quarter of this year. And as I have said, there are serious misgivings already about the prospects for next year.

Quite apart from the recession itself which has been a common experience of the whole of Western Europe, there have been serious other imbalances between one economy and another. The traditionally strong currency countries like West Germany, the Netherlands, and Belgium successfully overcame the threat to their balance of payments of higher oil prices and managed to absorb much of the potential impact of higher oil prices on their domestic price levels by making very little initial effort with fiscal or other homemade stimuli spending to offset the deflationary effects of the OPEC action.

By contrast, countries with traditionally weaker currencies like the U.K., France, Italy, Ireland, Denmark, Finland, Austria, and lately Sweden and Spain, have suffered very large balance of payments deficits and more persistent inflation, although in the British case, we now have a payment surplus, I'm glad to say, and inflation in the months of this calendar year at last converging on the single digit threshold.

Whatever the rights or wrongs of it, the effect was undoubtedly to aggravate the normal imbalance between the countries with stronger currencies and balance of payments on the one hand the rest on the other. Moreover so, the United States was also at that time acting like the comparatively strong currency country that it has traditionally been. The reaction of the Japanese to the huge increase in their import bill was to export more than ever to those very weak currency countries in Europe which were already heading into deep balance of payments difficulties. Both of these influences, of course, only made the world imbalance worse still.

Fairly early in the process, during the first half of 1975, we in Britain realized that there was no way that one country – particularly one with a large balance of payments deficit, very rapid inflation and a traditionally weak currency – could stand out alone or in limited company against the forces of a world recession. If the stronger currencies like the United States, Japan, and West Germany preferred to absorb the impact of higher oil prices in a sharp recession – rather than as we had first advocated in consciously expansionary domestic fiscal and monetary policies – then we in Britain would have to adjust to that, and we did. Our own money supply growth was already being brought sharply down by 1975 from the giddy rates of 1970 to 1974, during which period we had in fact doubled our money supply at least on one measurement of it in three and a half years for the sake of what turned out to be a very moderate fall in unemployment.

And in 1975, a new and tighter grip was imposed on our fiscal or budget balance and new methods were introduced to close certain loopholes which had become serious in a period of very rapid inflation in the control of government expenditure. At the same time, our trade unions voluntarily imposed on themselves and very effectively policed a limit on pay increases which meant that for over two years, their members took a measurable absolute cut in living standards thereby limiting the rise in unemployment that might otherwise have developed.
These measures both bore fruit this year – indeed all three bore fruit this year – reinforced as

they were by the endorsement of the International Monetary Fund a year ago and by the arrival on schedule of enough oil from the North Sea to satisfy half our domestic requirements this year. And they bore fruit in the dramatic turnaround in our financial position which everyone has noticed and which has given us the third largest reserves of any country in the world.

But, sir, I don’t want to be sidetracked too far into talking about Britain’s particular circumstances, although you will perhaps not be entirely surprised that I should mention it at slightly greater length than other countries about whom I am less qualified to speak. Considerable progress is at last being made in many of the Western European countries in grappling with inflation and in curbing the balances of payments deficits, although again one must not forget that this has been done and only done at the price of a deep and continuing recession.

In Italy, a severe austerity program has produced a sharp decline in industrial production but also a turnaround in the balance of payments current account. The rate of inflation has come down but it’s still high. France has made some inroads into her balance of payments current account deficit but has had a mixed performance on inflation. France, however, has less of a problem with the government’s deficit, the budget deficit, than the rest of Europe and moderate growth next year should be sustainable. The initial success of the Swedish and Finnish authorities in avoiding the major effects of the recession gave way by 1977 the need for balance of payments problem. And following a realignment of exchange rates, more balanced growth is now to be expected, but it probably will be insufficient to prevent further rises in unemployment in those two countries.

Greece, Turkey, and Portugal, as well as the other countries I've mentioned, have in different ways experienced difficulties in maintaining reasonable growth rates and development in the face of continuing deficits on their balance of payments current account. For Portugal, the influx of refugees from former colonies has compounded the problems of restructuring the industrial and agrarian sectors of the economy. Despite fiscal and monetary tightening over the last year plus import restrictions, the current deficit remains stubbornly high at over 5% of its gross domestic product. Unemployment is nearly 15% and inflation is severe. Further restraint is envisaged and an IMF loan is now being negotiated.

Similar negotiations have taken place with Turkey where a high growth rate was achieved through the world recession but only by rising public sector deficits and monetary expansion. The resulting inflation and balance of payments deficits have caused acute financing problems and further restraint is being considered.

Together with these economic problems most Western European countries face the kind of structural imbalances that are recognizable from American experience – sluggish, private fixed investment and in fact sluggish private demand in general, large public sector or government deficits, sometimes only being reduced because political and technical restraints are preventing expenditure from being carried out and with swiftly expanding labor forces, a concentration of unemployment on the young.

The outlook is not in fact particularly promising. For the world as a whole, we've been looking during the last year for the locomotive economies – that's those large economies with strong current account positions and reasonable inflation rates – to pull the rest of the world, including most of Europe, out of the recession. For Western Europe, this meant essentially Germany with some contribution from the Benelux countries. But German growth has so far been disappointing with private demand, especially fixed investment sluggish, and further falls being registered in the aggregate government sector deficit.

Despite the stimulus programs proposed by the federal government of Germany in September, the measures likely to be adopted will probably not be sufficient to raise the growth rate of the German economy above that of productive potential. The downturn in business confidence and the poor recent performance of investment and forward indicators suggest that little buoyancy can be expected from the private sector while the large increase in the public investment plans may be slowed by environmental and other concerns. The fact that much of the output which is produced will continue to go into the current account surplus indicates that little spinoff for the Western Europe or the world can be expected.

The question may be asked whether some of the hitherto financially weaker countries, particularly Britain, France, and Italy, can do much to lift themselves out of the continued recession. Well, the U.K. may now be in a position to make a very cautious start on this process. But it's as important that countries with serious structural problems be allowed to balance their recoveries so as to allow continued as well as merely temporary growth. The potential amongst these countries for sizable increases in demand over the next year or so is not, in fact, great.

Despite a large amount of slack in their labor markets, the response to swift upsurges in personal consumption would tend to be very large increases in imports which the current accounts are still not strong enough to bear and which would not encourage the process of internal restructuring which these economies still have to undertake and also a real danger of renewed inflationary pressures where bottlenecks in production and skills developed and where undue advantage was taken of improved bargaining opportunities for labor.

The need for this restructuring that I mentioned comes from two basic causes. One is the radical rise in the relative price of energy and the change in consumption and production patterns which it demands. And the second is the rapid underlying increase in the potential volume of world trade and the specialization of production on which this is based.

Europe has come to terms quicker than the United States with the need for energy conservation measures. But long-term energy production and the adaptation of the capital stock to the requirements of supply limitations and cost changes are problems which are only just being seized. The increasing propensity to import manufactured goods of most Western countries and the vitality with which the developing nations of Southeast Asia and Central and South America are expanding their manufacturing industries for export mean that the whole pattern of world trade is changing. And the health of many Western European economies will depend on how their industries can adapt to this new competition and whether the required change in industrial mix toward industries in which a genuine comparative advantage can be maintained will be achieved.

The speed with which such a transition can be made will depend on the strength of current movements towards protectionism. If the momentum of the multilateral trade negotiations can be kept up, there should be short-run gains for world growth and longer term ones for industrial location. This is why, subject to necessary safeguards against flagrantly disruptive imports concentrated on particular industrial sectors, the U.K. attaching such high importance to rapid progress in the MTN discussions.

So, sir, to sum it up, the Western European economy faces a combination of inflation and unemployment, both actual and potential, which would at any time in the 1950s, the 1960s, or even the early 1970s have been thought both jointly and individually to be quite outside the political tolerances of post-war societies. At the same time, it faces a number of structural imbalances in divergent rates of inflation, in new patterns of world trade, in adjustment to high energy costs, in youth unemployment, in low profitability, and in the impact of perennial large

OPEC surpluses and indeed it seems Japanese surpluses too which will be quite hard enough to overcome even if basic economic stability were achieved.

Moreover, Western Europe shares virtually all of these problems in greater or lesser degree with the United States which is therefore much less able and probably less willing than it was in the 1950s and the 1960s to float Western Europe off the ____ on the basis of a benignly overvalued dollar, massive capital outflows to Europe, and a large enough balance of payments deficit to accommodate the surpluses to which the Western European economies aspire. The United States still, of course, has a deficit, and a large one, but it's nowhere near enough to neutralize the OPEC and Japanese surpluses, let alone to accommodate the Western Europe, the surpluses which Western Europe would like to have. The strains which these economic afflictions cause are visible both in the rise of beggar-thy-neighbor protectionism and in the greater political precariousness of governments and regimes throughout the area. The challenge is indeed, sir, to our political stability in the West as well as to our prosperity.

I believe personally, sir, that the crux of the matter in all of the problems which I've discussed – unemployment, youth unemployment, inflation, profitability, low investment, adaptation to changing patterns of world trade – all of them, that is with the exception of high cost energy which is rooted simply in the OPEC cartel pre-figuring an objective scarcity – that the root of all the other problems lies in the way in which rewards are set in our Western economies.

So long as collective bargaining, professional cartels, and government-backed market rigging of various kinds, enables or indeed compels so many groups in our societies to post prices for our labor which are above the market value of what we are producing at current market prices, there just is no way that governments individually or together can prevent substantial numbers of people from being priced out of employment. Government can, of course, sometimes for a brief period cut the real level of those posted rewards by accelerating inflation beyond what the reward setters had expected, but that cul-de-sac is obviously getting shorter and shorter.

From that central flaw, sir, in our present arrangement, almost all of our economic agonies follow. That is the pin that is holding the butterfly of Western political economy to the paper. That is the problem to which thinkers and policymakers, citizens, and statesmen have to find the solution before it's too late, and before in a fit of misguided frustration and disappointment, our people turn to the false God's of protectionism, autarchy, and the deceptive simplicities of the command economies. Just how deceptive the command, the simplicities of the command economies are is something which I'm sure Admiral Turner will be telling us about very shortly.

Despite this daunting outlook, I, sir, believe that we shall in the West, in fact, rise to the challenge as we've risen to even greater ones in the past. And here, if I may say so with due modesty, I believe that Britain has a special role to play. Perhaps just because we have suffered first and worst from the malaise I've described, we've had the incentive to think hardest and longest about it. I believe that we have developed the diagnosis and mustered the national will, the realism, and the determination to tackle first the financial and then the structural faults.

Just as for too long we did serve to the rest of the Western world as an awful warning, now, sir, I believe we are beginning to show the way with our social contract and our industrial strategy, by our restraint to overpay, our priority now for wealth-creating activities, and by our prudence over oil and energy aligned to continuing social compassion and greater industrial democracy. We know what is needed. All together we must find the joint political will and public support to control our fate. Thank you. (Applause)

Chairman Tim Dunleavy: Thank you Mr. Ambassador. Our second honored guest is equally adept at charting a course in the murky waters of global economics – Admiral Stansfield Turner, our next speaker, who last March became Director of Central Intelligence. Admiral Turner's career in the United States Navy began with his 1947 graduation from the Naval Academy and it spans three decades of service.

Few people know that as a Rhodes Scholar, Admiral Turner attended Oxford University for a master's degree – better known are the credentials which he earned in his naval career – initially, which include command of a minesweeper, a destroyer, and a guided missile frigate. Onshore, he headed the Politico-Military Division in the Office of Chief of Naval Operations and served as the executive assistant and naval aide to the Secretary of the Navy.

Named a Rear Admiral in 1970, Admiral Turner took command of a carrier task group of the Sixth Fleet and then he regained his land legs again to direct the Systems Analysis Division of the Office of Chief of Naval Operations. In 1972, he became the 36th President of the Naval War College at Newport, Rhode Island. In 1974, Admiral Turner was named Commander of the U.S. Second Fleet and the NATO Striking Fleet Atlantic. And in 1975 was promoted to the rank of Admiral and named Commander in Chief Allied Forces Southern Europe.

And now, as head of this country's intelligence community, Admiral Turner is here tonight to give us a look at the other side of the coin – economics in a Communist world. And speaking from his own considerable insight and those of the agency which he heads, I proudly present to you, Admiral Turner. (Applause)

Admiral Stansfield Turner

United States Director of Central Intelligence

Mr. Chairman, Mr. Midshipman Jay...(Laughter), Ambassador Richard, ladies and gentlemen, as the Ambassador, I too am honored to be here. And with one exception, I am pleased to be here. The exception is that I believe it shows an amazing lack of good judgment for a simple sailor turned intelligence officer to come to talk to an economic club and then to follow on the podium one of the world's leading economists. Mr. Ambassador, we are all stimulated by your remarks and very grateful for them.

What I would like to try to do is to talk about the international economic scene as perceived from an intelligence viewpoint and specifically from the increasing interplay today in your American intelligence community with the international economic picture. When 30 years ago last September the Central Intelligence Agency was founded, we were an independent and dominant world economic power, and the focus of intelligence was largely in the military and in the political spheres. I need not say today how interdependent we have become economically, but I can say that the intelligence world is trying to keep pace and trying to shift its focus, not neglecting the military nor the political, but increasing attention in the economic sphere.

Some of the major efforts of this past year or so have been in this area and let me mention just a few as examples. In March, we published a study of the international energy prospects for the next seven or eight years. And what we projected was that the world as a whole is not going to be able, in our opinion, to pump out of the ground as much oil as we would like to burn on the surface. We have not said that the world's reserves of oil are running out and that the lamps and candles will not burn in the future. We have simply said that it will be difficult to find a way around either major conservation or major pressure on prices of energy.

A few months after that we produced another study about the world steel situation. And we put it out that there is overcapacity in all of the major steel-producing countries. We operate at some 78% of capacity, the Japanese at 72%, the European Economic Community at 60%, a country like Sweden at only 48%. And it is our view that in the next four to five years the increases expected in demand for steel are not going to fill those excess capacities in part because there are lesser developed countries of the world today who are continuing to add to their steelmaking capacity. And we expect that the exports to these lesser developed countries are going to decrease by 60% in the next three or four years as some of those countries like South Korea, Mexico, Brazil, turn into exporters rather than importers of steel.

Early in the summer we produced another public study on international terrorism – a subject which I'm afraid must be of concern to many of you here engaging in international business. And we had to project, of course, that over the last four or five years the amount of bombing, arson, terrorism of one sort or another has been on the increase – 400% in the last four years increase in bombings, 160% increase in arson in the last year, and unfortunately the number of incidents involving United States citizens and firms abroad has increased from 2 out of 5 in 1975 to 3 out of 5 today. We produced this study in the hope that it would also have particular value to international businesses and we've tried to make it particularly available by issuing it through the Department of Commerce and to their contacts in your business community.

In July, we published still another public study on the outlook for the major economy of the Communist world – the Soviet Union. We've made this kind of a study periodically and heretofore we have felt that the Soviets had the capability with their economy to achieve three principal goals. First, to continue their high accent on military strength towards achieving parity with us. Second, to improve – if not dramatically – the quality of life in the Soviet Union. And third, to continue to infuse enough new capital into their economy to have it grow at a reasonable rate.

Our review this last summer was startling in its change to us and we happen to believe that some time in the next four or five years, the Soviet economy is in for a more bleak prospect than at any time since the death of Stalin. Why? Because the Soviets have maintained a policy of sustaining productivity largely by continuingly increasing their infusions of capital and labor and we think they're coming to the end of the line.

First, because in the 1960s, they happen to have had a very low birth rate. In the 1980s the rate of growth of their labor force is going to drop from a present 1 ½% a year to about half a percent. And some of that is in the Central Asian areas where it's tough to get them down off the farm and into the cities. And as far as capital, they, as many of the rest of us, are facing the prospect of going and looking for resources that are more and more difficult and more and more expensive. Iron ore is further into Siberia. And our energy study made particular effort; our energy study particularly emphasized the fact that the Soviets are not developing the reserves of petroleum at the correct ratio for their current production. They're simply putting the emphasis on today. And even then, some of the ways in which they're extracting the oil, like excessive water flooding, is going to hurt their long-term reserve position.

Where does this leave them? Well, it seems to me it leaves them with some difficult pragmatic choices not far ahead – maybe at the turn of this decade. For instance, can they continue to afford the same large military force when they are manpower short. Can they continue to afford the same investment in military power? Can they continue to afford their promise to delivery of 1.6 million barrels of oil a day to their Eastern European satellites? Will they have to enter the foreign exchange markets and borrow more in order to obtain the hard currency to sustain the infusions of Western technology that are helping to keep their economy moving ahead?

And let's look interestingly at the high probability that by the time these decisions are upon them, they will be confronted with a major change in leadership and none of us can really speculate on how that country will effect a change of leadership. I'm not saying that they will not make the right decisions, but I'm saying that that may be a difficult time to take difficult decisions. They may do it very well and they may make the sacrifices that are necessary and come out fine. But it's going to be of great interest to each of us how they do it.

If they decrease the size of their armed forces, it surely has an impact on our level of investment in ours. If they don't deliver oil in great quantity to Eastern Europe, what impact will it have on stability there? If they enter the world market for borrowing of hard currency in large quantities, what will our policy and our reaction be? Now I can't give you answers to these, and I can't even of course assure you that our basic analysis is going to hold up. I can only say we have done our best and that we hope in the process of sharing these views with you – the public – we are at least helping to focus national debate on the right issues.

In addition, in the process of sharing with the public, we are gaining stimulus for ourselves and assurance that we are not going down completely dead end tracks. Now if it surprises you that an intelligence officer is standing here suggesting that he wants more dialogue with the public, it is new. It is not the tradition of intelligence to want to be as open as possible and to share as much as possible. The tradition clearly is one of maximum secrecy. But when you look at this information – I'll get to that in a minute – when you look at this information on economics in the international sphere and see how much of it can be made available, and when you look at how valuable it can be to the country, one has to give some consideration to a policy of openness.

And so today what we do is we complete a major study or estimate. We look at it and say whether it's classified secret or top secret or destroy before reading. (Laughter) Can we extract from this those elements that are essential to protecting the sources of how we got the information or that information which is uniquely valuable to our decision makers and still have enough substance left to be of value to you, the public. And if the answer is yes, we will publish and make it available through the government printing office.

Now let me say – I don't want to exaggerate, I don't want to over-whet your appetites – there's no way we can share everything. There's no way we can be completely open. So much of what we have to do in intelligence cannot be done if it is not done in secret. But in balance I would say that a policy of greater openness under control can...(AUDIO ENDS AND CONTINUES)

Ambassador, it's reputed that Winston Churchill once said, if everything is secret, nothing is secret. And we hope by decreasing the corpus of classified information to engender greater respect for that which remains. And ladies and gentlemen, there is not today in our country sufficient respect for that which is properly classified and withheld from the public for good cause.

I'm in the papers today with respect to a young man, a disaffected member of the Central Intelligence Agency who has recently published a book on the agency's activities in Vietnam without fulfilling either his oath or his personal promise to me to submit the book for a security review. And I suggest to you that a continuation of this Ellsberg Snip Syndrome has a logical extension only that each one of us, each of the 215 million Americans is to be authorized to declassify information. And we cannot tolerate that, it is nothing but chaos. I believe we've come far enough from Watergate that it is time for the public to begin to place a modicum of confidence again in its elected officials and in the public servants whom they appoint.
(Applause)

Now I'm not asking you just to trust us blindly because secrecy is a dangerous thing and it must be treated very carefully. And there is no way we can have complete public oversight of our secrecy. So what we are evolving in this country, in addition to openness on the one hand in intelligence, is greater oversight and control on the other – a system of checks and balances analogous to our entire governmental process. The first surrogate for public oversight is the

President of the United States and the second is the Vice President. And I can assure you today that they take a very active and positive concern on intelligence and that I keep them informed of what we are doing fully and regularly.

Another new surrogate for public oversight are the intelligence committees of the Senate which we have had for a year and a half and of the House of Representatives which we have had for three months. And these are excellent organizations for both overseeing my activities and for being a sounding board to whom I can turn to find out what the American public wants, expects, and demands from its intelligence operations.

I believe we are entering a period of two or three years in which an entirely new model of intelligence, an American model will emerge – a model in which we find a balance between openness on the one hand and preservation of necessary secrecy on the other and oversight and control on the one hand and sufficient initiative and risk-taking on the other to satisfy the legitimate needs of our country. And as this evolves, as these rules and these surrogates for oversight settle down into a process which I'm optimistic that it's going to be done and it's going to be done properly, we are going to need the understanding and the support of you, the American public. That is why I am grateful of your concern and your interest as evidence in asking me to be with you tonight. Thank you. (Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN TIM DUNLEAVY: Thank you Admiral. Now we'll turn the evening over to our two interlocutors – George Malone and Leo Cherne. We'd ask that these gentlemen step to the microphones in the back of the podium here. We think it will be much easier for all of you to see them and also for them to handle the questions with separate microphones.

LEO CHERNE: Admiral Turner, I think the first question is expected from me. And let me say that having had some significant contact with the process by which intelligence is acquired, the depth of study that goes into the analytic and estimating process, the dedication of the staff involved – and I'm come to know a number of them – it is not easy for me to quickly ask some critical questions, and yet they must be asked. The two studies you referred to, or two of the studies you referred to that are of particular significance to this evening's discussion – the outlook for Soviet oil production and the rather remarkable Soviet economic prospects and problems – both have a common thread. They both anticipate, and in the very short term, some very significant difficulties. The difficulties are interrelated but not completely so. And in the case of, for example, the outlook for Soviet oil, the expectations are as the agency has presented them, that Soviet oil production will peak in the early 1980s and sharply drop off immediately thereafter, and that this fact becomes one of the elements contributing to a very bleak and also rather short-term aggravated outlook for the entire Soviet economy. My question is this. (Laughter and Applause) There have been disappointments in past estimates. Some have been wrong. We've had swings in our anticipation of what the Soviet economy would do. Our expectation now for them is bleak. What reason is there to believe that these estimates will be as accurate as they're closely reasoned.

ADMIRAL STANSFIELD TURNER: One of the advantages I've mentioned of making the estimates like this public is that they are then subjected to your scrutiny. We got a lot of adverse press on the energy study when it came out. I personally wrote to each sensible critic...(Laughter)...and asked for further elaboration of their positions of doubt. And those who responded with reasoned replies, I invited to come and spend the day at the CIA and I personally met with them and our analysts met with them and we went over it up and down. And we've now established more contacts with people of that nature – think tanks, oil companies, independent oil consultants – and we're trying very hard to stay abreast of what they think and their good criticisms. And their criticisms lead me to now have a better feel for where to focus the future intelligence effort to find out if we're right or if we're wrong. And if we're wrong, I'll be happy to admit it because we never will be 100% right.

GEORGE MALONE: Admiral Turner, perhaps I can follow up on that point while we're on the subject. You mentioned in your talk that the CIA's estimate did not have so much to do with actual resources but with how much oil, and I assume gas, could be brought out of the ground. Do you mean by that that you don't feel that we are exhausting – or the CIA doesn't feel – that we are exhausting the world's resources – it's simply a matter of capital expenditures?

ADMIRAL STANSFIELD TURNER: George, all I'm saying is that we only looked as far as 1985 because the glass becomes pretty murky beyond that as to what reserves will be uncovered, and you can get into infinite debate and dispute. But we did think it was quite relevant to forecast that with the amount of drilling equipment existing today and the known reserves that are being employed and the time it takes from discovery of an oil field until substantial production, and the rate of growth of demand, that at least until about 1985 we could predict that the demand curve was going to pass the supply. We are not really capable at this point of looking much further than that and seeing when those reserves will dry up to the point where we must simply shift to alternatives.

LEO CHERNE: I wonder if I may ask a question of Ambassador Jay which is related to this. With the description you gave so brilliantly of the eager and urgent need for trade in major industrial nations, for markets in addition to those which they enjoy, and with the enormous opportunity the Soviets provide for investment in joint participations or simply in the sale of pipe, of drilling equipment, of the needed technology, what reason is there to believe that with the adverse balances which we are – a number of us – suffering, we will not rush, in fact, to assist the Soviet Union to make up for this difficulty which is, let's almost certainly assume, accurately portrayed?

THE HONORABLE PETER JAY: I'm not sure that I entirely understand the question. (Laughter and Applause)

LEO CHERNE: Let me then, let me put it in simpler words which were attributed to Lenin. When the time comes to hang the capitalists, he will rush to sell us the rope. Now since there's going to be some shortage of rope in the Soviet Union needed to achieve its economic objectives, what reason is there to believe that some of this rope will not eagerly be sold by countries which are eager and really find it desperately necessary now to have trade, additional trade?

THE HONORABLE PETER JAY: Well, so far as defense sales and sales bearing directly or indirectly upon defense, that, as you know, is a matter which is covered by international agreements and conventions amongst the Western countries. So far as the rest of your question is concerned, I'm sufficient of a free market liberal economist to believe that if you've got something that you want to sell and somebody else wants to buy it and the price is reasonable, there's no reason why you shouldn't go ahead and sell. (Applause)

GEORGE MALONE: Ambassador Jay, some of us in this country are quite interested in the debate which we understand is taking place in England right now about how the revenues from North Sea oil will be used. We've been reading in *The Economist* that this debate mainly involves Dennis Healy and Tony Benn. Tony Benn might like to use this money to invest in private industry or social programs whereas Mr. Healy perhaps would like to use it for reducing the government's debts and perhaps trying to open up international capital exchanges. Could you give us some insights into how you think the debate is going and how you think it might turn out?

THE HONORABLE PETER JAY: Well, I think it's going very well and I think it's a very good sign that it's going on because it's going on under the general premise of the clearcut and unambiguous pledge which the Prime Minister and the Chancellor and indeed all political leaders in Britain, whether they're in power or out of power, have given that the fruits of North Sea oil must be invested and not consumed. And that is a clearcut and unambiguous statement of policy and intention, a pledge by all of our political leaders; we're going to be self-sufficient in oil from 1980 until the late 1990s with production tailing off after then. If we were to use that, once and for all capital asset to sustain current living standards, we should confront ourselves with a double disaster. At the end of that period, we should no longer have the oil. We should no longer, therefore, have that reliable source of indigenous energy. And secondly, we should have rendered a substantial slice of our other industries internationally uncompetitive because under that regime the exchange rate for the Pound would tend to be forced up in such a way as to make them uncompetitive – a phenomenon sometimes known as the Dutch disease. And we have made it absolutely clear that we're not going to tread that route. Secondly, the debate is conducted under the other major premise of the government's industrial strategy. And simply stated, the government's industrial strategy which is a commitment of the whole government and the cabinet is that overriding priority in the allocation of national resources in the period ahead must go to industry, and particularly to the manufacturing industry and the overwhelming majority of manufacturing industries in fact, for your information, in private hands. Now, having committed oneself to invest the money, there are very important choices to be made as to what form of investment should be made. There are available investments in strengthening one's international financial position, either direct investments overseas or investments in portfolio assets overseas, building up one's reserves – although as I said ours are already the third highest in the world – and paying off debts. There are then also investments at home, investments in re-equipping some of our older industries, investments in developing new industries, and investments of course in developing alternative sources of energy for the period after the oil has run out. And it would be absurdly bigoted to say that no investment which technically arises in the public sector can be counted as a virtuous investment. There's no point in putting down factories and installing plants and machinery if there are no roads affording access to that plant, if there are no telephones and communications, if there were no ports, if there are no airports. There are important aspects of public investment, public sector investment which are complementary to increasing national productivity and strengthening the national economy. There are also important investments in retraining manpower and assisting and lubricating the mobility of manpower which are relevant to that objective. But the debate is going on, as I say, under the control and constraint of those two basic major premises. And I personally regard that decision that the oil must be invested and the priority must be given to industry and manufacturing industry as the basic guarantees that wise decisions will be made in the use of the windfall which North Sea oil has brought to us.

GEORGE MALONE: Let me just narrow that down a bit more. Of course, assuming that the money will be invested, then we come down to the question of who will make the investment choices of course. Will they be made by the government? Or will they be made by private industry, simply by virtue of tax cuts or some other way of passing this money along to private industry for capital investment on the basis of its own choices?

THE HONORABLE PETER JAY: Well, I think it follows very clearly from what I said, that the great majority of it is almost bound to be made by private industry. If you're investing all of the money and you're committing yourself to giving overriding priority to industry and manufacturing industry which is overwhelming privately-owned, it follows necessarily that the great preponderance, I would imagine, of the investment must be made in the private sector. The decisions which the government has to make is how to ensure that a revenue which initially arises in the form of a, as to the greater part of it, a tax revenue, finds its way back into this investment process. And there are important and complicated problems of mechanisms involved in making sure this happens. If you just do it by dishing out the money in generalized tax cuts, then you will wind up with precisely the Dutch disease that I described. You'll wind up living off the oil, consuming it, drinking it if you like, and not having invested it.

GEORGE MALONE: Well, let me pursue this just a bit further. The question here, you seem to be implying that there is going to be increased private investment, but could you tell us a little a bit about the rate of growth in private investment right now and then why are you optimistic about this increasing?

THE HONORABLE PETER JAY: The rate of increase in private investment at the moment is extremely low as it is in the United States because the United Kingdom economy is in the grip of a recession as compared with what was normal in the 1950s and 1960s. The United States is, by comparison with what's going on in Western Europe as I described, in not so deep a recession as those areas are, but it is still not so buoyant as to be calling forth the rise in private investment which many people believe to be necessary. Now I think, myself, that there are fundamental problems in your economy and ours which are very closely parallel, of basically low profitability. I've had occasion on a number of meetings, while I've been here in the United States, to draw people's attention to the fact that if you look at the Dow Jones Industrial ordinary share index which is a sort of proxy for the value which the greatest capital market in the world places upon the capital assets of the greatest economy in the world, and you make proper adjustments for inflation, you find that if 1965 is, for the sake of argument, 100, the level now stands at under 40, which means that over 60% of the market capitalization of the assets of the greatest economy in the world appear on that valuation to have been wiped out in 12 years of rapid investment. And you also find, if you look closely, and I'm grateful to Mr. Reginald Jones of GE here for supplying the explanation to me over dinner, that the rate of return on capital investment during that period, also if you make correct adjustments for inflation, has fallen from 9.9% to 4% which is exactly the same ratio of 10 to 4. Now we too have that problem. We have it in a more acute degree because we had a more rapid inflation in the period of 1973-'75. These are very fundamental problems which we have to overcome and which you have to overcome.

And we have given the first priority to controlling inflation and getting it down because we believe that is the fundamental cause of the low investment, low profitability, and therefore of low investment.

LEO CHERNE: Ambassador Jay, during the period when undeniable and visible difficulty in the U.K., it was possible for you to achieve, and you still do have the consequence of what you described as mustering the will, the discipline, and the restraint. But with the infusion, and it's increasingly visible, of new wealth, what reason is there to believe that the restraints which have already caused a real decline in the cost of living of organized labor will be sustained by them?

THE HONORABLE PETER JAY: Well, the reason is the experience we went through between 1973 and 1975 and the profound widespread impact that that opportunity to look over the brink and assess what was on the other side has had throughout our society which is visible, in my judgment, from the top political leadership right the way down to the grassroots. We saw very clearly during that period where the way we used to go on, and I may add most other Western industrial nations are still going on, was leading. We saw the fallacies and dangers in the assumption that you could guarantee permanent full employment simply on the basis of deficit finance. The recognition of this, that this was an illusion was very clearly and vividly spelled out by our Prime Minister when he addressed his own party conference in September of 1976. And I believe his remarks have been quoted quite widely on this side of the Atlantic. The guarantee that 50 million human beings will not do foolish things in the future can never be absolutely, can never be gilt-edged. But I would say that on the evidence of what has happened over the last three years during which we have progressively brought down the increase in the money supply in line very much with what Professor Friedman, with whom I discussed the matter, was recommending at that time, the way in which we have got a grip on our government expenditure and controlled it, the way in which our trade unions have voluntarily, without any law or government edict, for two years proposed very painful restraints on the increases in pay that could be afforded and policed it themselves with 100% success, the way in which during the period since last August when we have been moving back we hope towards freer collective bargaining. The ordinary working people themselves on the shop floor have on more than one occasion rejected proposals that they should take action in support of claims which were outside and beyond the government's guidelines. The fact that we have met the first four months of settlements during this period without a single case exceeding those guidelines. All of these things are evidence of a realism and a common sense which I think tends towards answering your question. But as I say, there can be no absolute guarantee. It's a matter of confidence and a matter of willpower, and a matter to some extent of faith.

LEO CHERNE: Can I switch you to another subject and address this question to you, Admiral Turner. It appears evident that there's been a miss-estimate of the nature of the Soviet harvest this year. This will have been twice in five years that there appears to be a significant miscalculation of the prospects of Soviet food production. In each case, in addition, the Soviet Union also appears to have been quite successful in hiding its deficiency for an interval of time sufficient to replenish its stocks at favorable prices with benefits which did not accrue, by and large, to the U.S. farmer. There are two questions. This is an area in which the CIA has properly prided itself – the ability to estimate food production. Is there a satisfactory explanation for two failures in that interval of time? And secondly, is there not an associated failure in the inability to perceive the Soviet's purchase of grain during a period when it was still believed that their harvest was going to be large?

ADMIRAL STANSFIELD TURNER: There is no adequate excuse to missing the target. We have pride that in these five years, since the 1972 Great Grain Robbery, we have developed techniques for estimating the harvest of a closed society. But we are not infallible, and if Mr. Brezhnev's prediction is right, we were off by 10%. I note everyone in the country believes Mr. Brezhnev more than us. I'm kidding; he's probably being very honest. We find that even in the United States it's hard to hit 5% when you have all the data. We think we missed this year because of an exceptionally wet September in the Soviet Union. And I will only pledge you to keep trying better. But with regard to your second question, we did not fail to perceive the Soviet's buying grain and to predict the amount of grain they were going to buy. We did not feel that that was sufficient cause to predict the lower harvest because they may well have either been taking advantage of the price and storing grain for the future, but the fact that there was not a precipitous rise, there was not a precipitous change in the price of grain once Brezhnev made his announcement was indicative of the fact that the grain market knew that they were in the market for 20 million tons.

LEO CHERNE: This is a very difficult question to follow up with but I think it requires an answer no matter how speculative that answer may be. Our ability to approach an estimate of Soviet food production in any given year now is aided substantially by recognizance capability. To what extent human intelligence plays a role in that, I certainly am in no position to know. The technical means of estimating such activities as food production were obviously deficient. I believe there's now to be a fairly sizable cut in the staff of the agency devoted to human intelligence. Are we in the process sacrificing a capability essential to supplement the scientific and technological means if we are indeed to remedy these occasional failures?

ADMIRAL STANSFIELD TURNER: No, we are not. We are not shifting the emphasis from human intelligence to technical or vice versa. They are still absolutely essentially complementary and I would say, if anything, the need for human intelligence is increasing. The reductions which I have ordered in the Central Intelligence Agency's human collection effort are all being taken in the headquarters. They are all fat, they are all overhead. They are not intended to reduce the cutting edge of the people out in the field. It was my firm conviction when I was told by the agency people shortly arriving there that we were overstaffed, but when you have capable, dedicated, ambitious, young people as we are fortunate to have in the Central Intelligence Agency, people of as high caliber as I think you will find in any organization, you cannot over-manage and underutilize them and motivate them to stay. I'm trying to build for you a Central Intelligence Agency not just for 1978, but for 1988 and 1998, and I must motivate those young people. (Applause)

GEORGE MALONE: Admiral Turner, in the meantime you do seem to have a morale problem if I can believe *The Washington Post*.

ADMIRAL STANSFIELD TURNER: Well, that's a questionable assumption.

GEORGE MALONE: Do you feel that there are any risks inherent in this kind of – the CIA is a very special kind of organization and manpower cuts of this kind are a little different from the ordinary type of manpower cuts – do you feel that there are morale risks in a reduction of the type you're undertaking?

ADMIRAL STANSFIELD TURNER: Well, if you're implying, George, the things that have been said in some of the media that some of the people being dismissed are likely to go out and sell themselves to the KGB or print books that will disclose classified information, I would say absolutely no. It has never crossed my mind. We've had disaffected people who have left on their own – Agee, Snepp, Stockwell, and so on – who have gone out and breached their security agreements. But these people in the agency are dedicated, patriotic Americans who have sacrificed in their lives and they're not, in my opinion, going to be that traitorous. I don't have any concern about that. We actually asked 212 people to leave over and above normal attrition in this first half of the two-year operation – 150 of them are eligible to retire. We are already placing a number of others, either in our intelligence agency in other places where there are vacancies or in the other intelligence agencies of the government. We are doing our very best to see to it that they are well taken care and I think the majority of them will be so taken care of.

LEO CHERNE: Admiral, it's in the nature of the Russian culture, and aggravated by the nature of Soviet society, that deception and concealment play a significant role in their intelligence arsenal. And in fact, deception and concealment are the traditional instruments in intelligence. In our kind of open society, deception is abhorrent and concealment very difficult. Now is it possible that we are in fact missing some of these estimates as a result of an effective use of disinformation which we're absorbing?

ADMIRAL STANSFIELD TURNER: There's no way I can positively state that we are not being taken in. I would only say that we do make strenuous efforts to check that. And, in fact, in this grain situation we had question about some of the data we were receiving, and we have developed several models, each of which is dependent on different kinds and quantities of data. And I think what happened in the long run is because some of the data was suspect because we were concerned about what you are saying. We picked the wrong model this year.

GEORGE MALONE: Admiral Turner, this grain problem does, of course, raise some questions about the effectiveness of satellite surveillance. Another question was raised not long ago when it was discovered that, or presumably discovered, that South Africa has an atom site which hadn't been picked up on our satellites, so I'm told. Do we have a problem in satellite surveillance? And does this have implications on such questions as verification of arms control efforts?

ADMIRAL STANSFIELD TURNER: It is unfortunately not our policy to discuss whether we do or do not engage in satellite surveillance. Within the limits of that – and there is good reason for that – let me say that I am confident that the sum total of technical intelligence collection systems available to us are by far superior to those of any other country. Whether they will be adequate for all the forms of treaty negotiation that are going on today is a very, very difficult question and a lot depends upon what the terms are when they're negotiated. We are, in my opinion, pushing thresholds which will demand closer and closer approximation of on-site verification as opposed to what is euphemistically called national technical means.

LEO CHERNE: Admiral, there's a report within the last week from, or attributed to, the Swedish Defense Research Institute which is an arm of the Swedish Defense Department, that they have detected evidence that they can only associate with Soviet efforts to achieve what in the press is popularly called a death ray – the scientific means of disabling missiles and recognizance instruments, civilian or any other kind. Is there anything to this? Can you say? Or is this just hogwash?

ADMIRAL STANSFIELD TURNER: It is our opinion that the Soviets are not on the verge of what is known as a particle beam weapon to do this. The Soviets do have an extensive laser weapon program which is quite effective, behind ours but moving along nicely.

LEO CHERNE: I didn't assume it was a particle beam weapon because I've been impressed by remarks attributed to Secretary of Defense, Harold Brown, that you'd have to repeal two of the laws of physics in order to perfect a charge particle beam weapon. But the reports from Sweden do not suggest that. They do suggest some other scientific breakthrough which is not, does not involve charge particles, that has this capability.

ADMIRAL STANSFIELD TURNER: At this point, I do not agree with the Swedish estimate.

GEORGE MALONE: Ambassador Jay, we've been neglecting you here a bit. I have seen some signs that the money growth in England has been speeding up a bit recently. Is this just an aberration or has the government perhaps shifted its policy a bit towards what you call a reflation in England?

THE HONORABLE PETER JAY: No, the government hasn't shifted its policy, though it made an adjustment in November in order to compensate for a shortfall in the budgetary position as compared with what was planned in April last year. It is, as you say, an aberration in the sense that it's a byproduct in the statistics in very recent months of the very rapid increase in our reserves associated with the big inflow into, our funds into London as a result of the turnaround in the confidence and attempts were made to ward that off by dropping interest rates to a very low level in order to discourage too much investment when it was found that there was still a danger of the money supply beginning to, the money supply rate of increase beginning to ease up outside the very strict guidelines that the government has laid down. As you know, the Pound was allowed to find its own level in the foreign exchange markets and since that time this danger has been removed. Now this will continue to throw its shadow onto the monthly statistics, I would guess, for a month or two now but there is no change of intention. And if you take the trend over the last three years since that period when we doubled the money supply in three and a half years and we were having rates of increases of 30%, you will find that with a couple of blips – one on the downside in 1974 and one on the upside in the third quarter of l976 – we have been working steadily down towards a non-inflationary rate and shall, I hope, get there within a year or two.

LEO CHERNE: Do you agree with Chancellor Smith who said yesterday that, or in so many words implied, that the U.S. is exporting inflation to Europe through its own monetary policies?

THE HONORABLE PETER JAY: I don't believe – I speak here personally and as an economist – that there is such a thing as exporting inflation nor indeed importing it. It is within the power of any sovereign state to manage its exchange rate and manage its money supply in such a way that there is no such risk. Obviously, if you build certain extra constraints into your policy, you may then be forced to allow inflation to occur by your monetary policies in reaction to what is happening elsewhere. But our general view – and here I can speak for our government – is that the United States is the one economy really, a major economy, that has played the game so far as the strategy which was jointly adopted by the seven heads of government at the time of the London Summit and it looks like achieving the growth target which was established at that time. And in the course of doing so, not surprisingly it has, as any major economy would, that became the sole pacemaker of world expansion when other economies were lagging, it has experienced a very substantial balance of payments deficit. As we see it, it is reacting to that deficit in absolutely the right way by taking the strain on the exchange rate and refraining from any direct action to affect that deficit. That deficit is the one really benign thing in the world economy at the moment, the one source of stimulus to world trade. Any anxiety we would have, I think, would be that somebody would be misguided enough to try and do something about it.

GEORGE MALONE: Why do you think Germany and Japan have chosen not to play the game?

THE HONORABLE PETER JAY: I think there are different reasons in different cases, but they both have to do not with economic theory and economic policies and convictions, but with very deep institutional factors in both political and otherwise in both of those economies. I have no doubt myself of the sincerity of the Japanese Cabinet, both the previous one and the present one, in wishing to run a reasonable balance of payments balance. I have no doubt that when they said at the beginning of this year that they thought they would have a deficit of $750 million this year, they were not actually expecting a surplus of $10 to $15 billion which is what it looks is happening. There are very deep institutional problems in Japan and in any economy which has become export-oriented over a long period of time, about turning around that kind of position. There has been something like a 22% appreciation in the value of the yen against the dollar this year and I personally would expect that to be a pretty powerful force. There are, as you know, other discussions going on in the course of international economic cooperation between governments to see whether or not there are other steps that might be taken and we, in Britain, are fully behind the positions which the United States is taking on that. So far as Germany is concerned, again ambassadors should be careful about commenting on the affairs of other countries, but one thing which is quite clear is that there is a very high degree of sensitivity to inflation in Germany after the experiences which Germany experienced between the wars and that is a folk memory which is comparable with the folk memory here and in Britain of unemployment between the wars. That affects the way in which people behave. There is also there an economy which is highly oriented to exports and the natural place for German policymakers to look for economic expansion is in exports. But, of course, if it takes the form of exports at a time when world trade is depressed, then instead of stimulating the rest of the world economy, it will actually further depress it. What we hope will be possible, though it must be for the government of Germany to decide what is best for their own economy, is that it will be possible progressively to stimulate domestic spending within Germany.

LEO CHERNE: Admiral Turner, the danger of terrorism has, as you've said, grown. There remains, we hope in the distance, the possibility that terrorist activities may involve more lethal means than have thus far been employed. Has our ability to apply intelligence methods, techniques, especially within the United States, foreign intelligence conducted here, been weakened in any manner which reduces our ability to deal with the possibility of terrorism?

ADMIRAL STANSFIELD TURNER: I think the answer to your question is no. But I speak really for foreign intelligence in foreign countries. The FBI handles the issue of terrorism, or the local police authorities inside the United States. We, however, are very active and have put a great deal of effort in the last few years on becoming knowledgeable about international terrorism and clearly we feed over to the FBI if it is being transmitted to this country. And I'm proud to tell you, without being able to go into detail, that we have been active in almost all of the major terrorist events of recent times. We've played a very constructive role. And there is a very cooperative arrangement today with the principal intelligence agencies principally in Western Europe and Japan in sharing information and instantly transmitting material that comes in, in the case like the Lufthansa highjacking recently. And better than that, I can tell you there have been definite instances in which United States intelligence has prevented terrorist operations in recent months. (Applause)

CHAIRMAN TIM DUNLEAVY: Thank you gentlemen. We're grateful to our questioners and also to Admiral Turner and Ambassador Jay for another great evening at the Economic Club. And we expected to adjourn at 10:00, gentlemen, this meeting is adjourned. (Applause)