Interview: U.S. Special Trade Representative

Brock: 'We don't know how to bring down interest rates'

A comment by U.S. Trade Representative William Brock on interest-rate policy during an exclusive June 29 interview with *Executive Intelligence Review* illustrates how the Reagan administration traps itself into carrying out Carter-era policies that have results opposite to what the administration wants. Brock told *EIR* he agrees with the contention that continued high interest rates may prove a bigger security threat to the West than the Soviet Union. Yet, he continued, the administration does not know how to bring the rates down. Moreover, as Trade Representative, Brock has carried out many trade policies, often designed by others, made "necessary" by the high interest rates. This includes, as he told this correspondent in an earlier conversation, pressuring Japan to raise its interest rates (see *EIR*, June 29).

Similarly, Brock worries that high levels of economic friction, combined with a perception of declining American economic and political power, could divide the West. Yet, this concern does not seem to square with administration policy on the one issue—aside from high interest rates and bilateral trade friction—that has done more to divide Tokyo and Washington than any other in recent memory: the administration's June 19 extension of anti-Soviet sanctions to Japan's oil and natural gas cooperation project with the Soviet Union in Sakhalin, Siberia. Washington disregarded several personal appeals from Prime Minister Zenko Suzuki, who pointed out that this was a "natural project" for energy-short Japan. Washington not only forbade American firms from taking part, but is also trying to prevent Japanese firms from using American-licensed equipment in the effort.

Upon hearing of the decision, Tokyo announced it would file a diplomatic protest and would go ahead with the project anyway—the first time in postwar history that Japan has embarked on a major economic cooperation project with the Soviet Union against American wishes.

Brock told *EIR* that the administration's decision will not be reconsidered, and said he doesn't "think it will be a source of division in the long term. . . . Our lack of agreement on the issue of trade with the Soviets has had a negative impact on Western security in recent years. We have been asked to lead for a long time, but when we do, it seems people don't like the direction. Well, that's a matter of disagreement that I hope is temporary."

In fact, this issue, along with high interest rates, led Economic Planning Agency Director Toshio Komoto to declare July 8 that Japan "should keep in step with the European Common Market [which faces analogous sanctions against their natural-gas pipeline deal] and not follow Washington blindly," extremely unusual language in postwar Japan.

In the following excerpts from the June 29 interview with Mr. Brock, *EIR*'s Richard Katz raised the issue of what these policies and America's economic decline meant for continued American world leadership.

Katz: A major issue between the U.S. and Japan is the question of credit and interest rates. I remember after your discussions with the Japanese last year on restraining auto exports here, you repeatedly said that Japan's restraint was not going to help our auto industry at all unless U.S. interest rates came down. It has proven to be a fully accurate forecast, and one which *EIR* also made at that time. Yet now, it seems that you're saying the opposite. You charged in your National Association of Manufacturers speech that the Japanese have a managed credit system which keeps their rates artificially low. When we spoke the next day, you said they should eliminate this and allow their interest rates to rise to be equal to rates here. This seems to be opposite to what you said last year. What accounts for the difference?

Brock: Not at all. I have suggested that they fully open their capital markets to the extent that ours are open, that we be allowed to borrow, loan, buy, and sell freely on the Japanese capital markets. If that were to occur, the short-term impact would be that American borrowers would borrow in the yen market, and that would further depress the value of the yen, and make our competitive situation even worse. At least, that's the conventional economic argument.

The reason I argue for freeing the capital market is not to achieve any short-term gain or loss. Rather, I fundamentally believe, the most important aspect of a free-flowing commercial relationship is a free-flowing capital system. To the extent that we are fully equal in Japan as they are here, we will measurably reduce our trade problems and barriers, both cultural and governmental, and we will closely intertwine these two countries that mean so much to each other. That is worth a short-term price. But I do not see what I have suggested as either contrary to what I said last year, or being said to gain short-term interest. It might be somewhat damaging in the short-term, but the long-term implications are fundamentally important because they allow a much closer interweaving of these two countries economically.

Katz: With the Euromarket system in Europe, and the offshore banking system here, there seems to be a "multinationalization" of credit as well as of manufacturing concerns. Is that something you see as a goal, or as a tendency?
Brock: I see it as a goal, yes. It is part and parcel of Japanese industrial policy to control the allocation of credit, just as they control the allocation of other resources—government support, governmental emphasis, pricing policy, purchasing.

Japan has a marvelously sophisticated talent to select certain industries for emphasis. How they get away politically with the consequences of ignoring other areas, I don't know. Politically it would not be possible to do that in this country. But they have been succes

The problem so far is that—and this is particularly obvious in the high-tech areas—by selecting certain segments of industries, or even whole industries, for special treatment, they effectively are skewing the resources of the entire society—governmental and private—to highly critical industrial areas. These areas then become supercompetitive in the world industrial system. As a consequence of their desire to take all of their market, they have created negtive responses in other countries, here and in Europe. This is not healthy for the trading system.

If they opened up their system, if they let the market dynamic work, and not simply governmental determination—a true market dynamic—you would have much less potential for the kind of trade tension that we now see in the high-tech area.

Katz: They get away with it politically because it works. . . .
Brock: Of course it works.

Katz: They've raised the living standard of their population, and they've raised the skill level of their labor force. Though there is a fascination here with free enterprise at the current time, the U.S. has done similar things. NASA is similar, though perhaps we were less conscious about what we were doing. I think the Roosevelt pre-war mobilization was similar. Particularly the 19th-century industrialization of our nation was similar. The Japanese say—and I agree—why can't the U.S. do similar things, both in cooperation and healthy competition with Japan and our other allies, for the benefit of both?

On the interest rates, Japanese I have talked to said they view the high interest rates as a greater security threat to the West than the Soviet Union, because of what it is doing to the economy, and the industrial base.

How do you respond to the comment that the interest rates are undermining the West in a way that the Soviet Union is not even capable of trying?
Brock: I think that's quite possibly so. The problem is that those who are so quick to point out the hazard of high interest rates are remarkably tardy in suggesting how to get them down. There doesn't seem to be the same alacrity in providing answers.

This administration has done what is traditionally necessary to bring interest rates down. We've brought down the rate of inflation by 60 to 70 percent in the period of 18 months—an incredible accomplishment. I can't think of another country that has done so well. Interest rates haven't fallen. We've cut our discretionary spending by a third. I don't know of another country in the world that's done that.

You can't charge us with a lack of political will. There is no economic reason for interest rates to be at this level in real terms. Maybe there's something happening that we just don't understand yet. We don't know. We think they will come down.

I don't think any of us would argue that the continuation of this level of interest rates could do more violence to our ability to sustain our economic growth than almost any other act other than war.

Katz: *EIR* has pointed out that at least about $75 billion of the budget deficit can be directly or indirectly attributed to the effects of high interest rates. Moreover, the same thing happens with corporate budgets. About 60 to 70 percent of the new money supply being created in this country is being used by corporations just to pay off past debts, not to invest in new production or new investment. And therefore, the high interest rates have become a sort of self-feeding spiral. This is why the high rates have remained. I wouldn't say inflation has come down. I would say corporations can no longer pass along their costs. So, we're seeing a wave of bankruptcies we have not seen since the Depression.

It would seem to me that a political decision has to be made to change Fed policy—and some of the managed credit policies that the Japanese use, which you criticize, might well be done in the United States. That would help production and productivity.

Brock: What changes in Fed policy would you suggest that would bring rates down? I'm not trying to debate. I'm curious.

Katz: I think what you have now is a Fed policy which directs—by nature of the high interest rates themselves—incentive for credit away from productive investment into non-productive. . . .

Brock: I don't disagree at all. How would you change that?

Katz: First, simply cut the discount rate, ease the tight money. You would bring down interest rates in the very short-term.

But I think also you would need a managed two-tier credit system in which the Federal Reserve, through decisions of the administration and Congress, would be willing to supply credit at very low interest rates, 2 to 4 percent interest rates—i.e., low by current standards but normal by the standards of the 1960s—toward productivity-enhancing types of investments or normal production: housing, steel, etc. And maintain penalty levels of interest rates for non-productive types of investments. I think there are also things that can be done in terms of

Brock on the Japanese computer espionage case

Seven days before *EIR's* interview with Mr. Brock, blaring newspaper headlines announced that 16 employees of the Japanese giant firms Hitachi and Mitsubishi had been charged with attempting to steal computer software secrets from IBM. In this case the FBI used against the Japanese firms the same entrapment tactics it had used to set up Congressmen and Senators in the "Abscam" affair. In separate incidents, Hitachi and Mitsubishi employees were allegedly offered more than $600,000 to buy IBM secrets in meetings with an FBI dummy corporation named Glenmar Associates and a former FBI agent serving as a security consultant to IBM. Hitachi had been induced to hold the meetings by Max Paley, a former IBM employee, who, as head of Palyn Associates, had been Hitachi's paid consultant for eight years.

The Japanese press charges that the case was a politically motivated entrapment operation; *Mainichi* labeled the case "Japscam." In private comments to both *EIR* and the U.S. State Department, Japanese government officials charged that the entrapment was linked to the current economic frictions surrounding high-technology trade. By making Japanese firms look like thieves in the eyes of the world, the incident would be used to put Tokyo on the defensive in its trade negotiations with Washington.

Even an American software firm executive in California's Silicon Valley commented, "Everybody here buys secret information from other companies. They don't ask how you got it. What people here are wondering is why the Japanese firms were the ones that they decided to catch."

Since this is the first case of industrial espionage brought against a non-Comecon nation, the issue of political motivation will no doubt increase if, as reported in the July 11 *Detroit News,* the Japanese pharmaceutical firm Green Cross is about to be charged with trying to steal secrets on the manufacture of the anti-cancer drug interferon.

In his June 29 *EIR* interview, Mr. Brock flatly denied the political entrapment charge. "It would be extremely dangerous and unwisely self-serving of persons in Japan to view this case as being politically motivated. That simply is not the case. . . . The danger with that kind of response is that certain individuals might then make the mistake of believing that the business practices are the same in the two countries. Obviously they are not if this sort of thing is acceptable in Japan."

Brock said the case "may make it slightly more difficult for us to stop protectionist legislation. It will increase the temptation for somebody in Congress to take punitive action." However, Brock added, "in the final analysis, it won't change anything this year. The administration is committed to stop protectionist legislation. We are convinced we have the political will and the political strength to achieve that purpose."

Nonetheless Brock seemed to fuel the tensions by implying that "cultural" factors may have had an effect. "Apparently, industrial espionage is not considered with quite the same view in Japan as it is here. I'm not sufficiently familiar with the Japanese mores and practices to comment; I will simply say that in this country, it's considered a crime . . . and people go to jail for it. . . . The loss of proprietary trade information is a matter of real concern, particularly in the national defense area. If we cannot maintain any security in this country, then not only are we at hazard but so are the people of Japan, because we are their umbrella, by their choice."

tax-law incentives, both to the company that invests in new-technology, productivity-enhancing investments and to the stockholder.

Brock: We've done that. We've cut the corporate taxes, we've given a much faster write up on depreciable equipment; we've given 25 percent tax credit on R&D; we've done everything which we can frankly in conscience do, or politically do with the Congress, on the tax side.

I guess no one in this administration feels that this government is wise enough to allocate credit. The hazard to our personal freedom which would occur would be greater than we would be willing to accept. Because that's the right of life or death.

Katz: What about simply lowering discount rates, ending tight credit, lowering the policy of managing bank reserves which currently keep interest rates high? Simply having a Fed policy which lowers interest rates such that you are going to encourage, makes it possible. . . .

Brock: Any step which would have the effect of lowering interest rates without restoring inflation would be welcome. The question comes to that caveat: Will it have an inflationary impact? Because if in fact we falter in our fight against inflation, we will have lost the war. The real cause of high interest rates was the rate of inflation. Interest rates are simply a discount value. They put the price on money when it is repaid, that's all. And the market has made a judgment that inflation can return, and until they are convinced that it won't, they are discounting for that prospect. I'm not really sure it is as much Fed policy as it is basic market psychology, which is creating the most horrendous rate of interest we have ever seen in this country.

Katz: So you're saying you don't see what steps can be taken to bring down interest rates?

Brock: I'm not saying precisely that. I'm trying to be very careful about what I'm saying.

Katz: Treasury Secretary Donald Regan is doing a study on Fed policy, and we have elections coming up. You are a former Republican Party chairman. I think the Republicans are going to get clobbered unless these interest rates come down.

Brock: It will not be a comfortable election for any politician this year, because of the rate of unemployment, the rate of interest, and the rate of economic stagnation. I'm not sure that it's necessarily going to have its total impact on one party. Congress is yet to measure up to the mandate that they were given in 1980.

Katz: Do you think this Donald Regan study will produce some sort of decision, that involves the administration going to the Fed and saying we want you to change your policy?

Brock: I can't make a prediction on that. I've been involved in looking at the operations of the Fed since the first day I came into Congress. The first two years I was in the Congress I did a two-year study of the monetary system. I have very strong views on the subject. But at the moment that is not my area of jurisdiction.

Katz: When I speak to Japanese officials, businessmen, etc., what is uppermost in their minds is not even so much the bilateral trade frictions but the following fact: There are only two superpowers in the world, the United States and the Soviet Union. If the United States—through economic weakness, through military weakness—ceases to either be or act like a superpower, to manage affairs such as the Middle East, Argentina, then this is the uppermost worry in the minds of the people of Japan. They are very seriously worried that we face the prospects of another depression. They are concerned about where U.S. policy is going, what is the direction? That's why they are saying that interest rates are a bigger threat than the Soviets.

Insofar as the United States seems to show a lack of leadership, I think there is a tendency in Japan to seek a certain amount of accommodation with the Soviet Union. Not that they are going to join the Soviet bloc or something, but they will want to avoid being in a confrontationist situation with the Soviet Union, even if the United States is in such a situation. This is also true of Europe. I think we see this in the reaction to the pipeline and Sakhalin situations.

Does it ever occur to you that the level of economic friction, the trade friction, between the U.S. and Europe and Japan, combined with what is perceived as a U.S. economic weakness, in fact has an effect opposite to what you seek? Rather than uniting the Western camp, it in fact divides it, leads other nations to seek a *modus vivendi* with the Soviets.

Brock: Constantly. I am extremely sensitive to that, and I've not been reluctant to talk about it, as a number of my colleagues will attest.

That is not really the germ of U.S. policy though. The fact is that we—and I'm talking now in the collective sense of the free world and primarily the industrial powers of the free world—for virtually a decade ignored what was happening as a consequence of two events, one, internally generated and one, externally generated, on our financial systems. The external generation we had discussed adquately and that was the energy crisis, and the drain of our productive resources that that entailed. But we did not address, until the advent of Ronald Reagan, the domestic drain, our governments' inability to live within their means, for the last couple of decades in most of the industrial world.

What happened was that we had already stretched our financial capability, our capital formation, our capital pool. We had already stretched those resources too much when the energy crisis hit, and what most governments did in the past nine years since the crisis began was to buy political stability by increasing debt. Rather than face the problem and deal with it, we tried to buy time, and to postpone having to do the tough things.

The administration felt, and I think feels today, that a continuation of that pattern could only result in a collapse of the free world. We had come to the point where we could simply not afford to borrow in excess of our capacity to repay. We had to put constraints upon the growth of government, and to restore incentive, and the prospect of capital formation through savings and investment.

We have taken some very difficult steps. It may be that we are not precisely perfect in the definition of those steps, but at least we have taken them. If we fail in this regard, it will not be for doing the right thing, it will be because not enough others have been willing to exercise the same kind of political courage. There are shifts of a tactical nature that could be made that might make the situation better. We are certainly not perfect, but we are doing in a fundamental sense the things that have to be done to restore our basic opportunity for economic growth.

If we lose this battle, and if inflation does in fact return, then there is a matter of time, and a very limited amount of time, before our system simply cannot sustain itself. We will see a depression, and one that will be in greater magnitude than any we have experienced before, because we have built a larger house of cards.

I personally am extremely sensitive to what we do and its impact on our trading partners and the possibility of division. By the same token, if we don't lead the effort to correct that which we have not adequately dealt with heretofore, then nobody will.

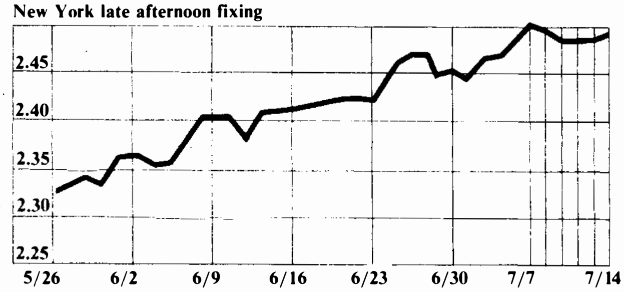
The same applies to our quest for keeping our markets open. We've done some very tough things. We are still doing some very tough things. We are fighting the protectionism that is rampant, at least in the Congress, but if we collapse in the face of that political diversity, the world system will collapse. Nobody else can lead the world in the cause of free trade. We have to do what we have to do. And we have to expect our trading partners to understand that, and to try to share some of that burden.

The full text of the June 29 interview with William Brock is included as an appendix to a new 95-page EIR *Special Report, "Outlook for U.S.-Japan Economic Relations." Contact Special Services Director Peter Ennis at (212) 247-8820 for further information.*

Currency Rates

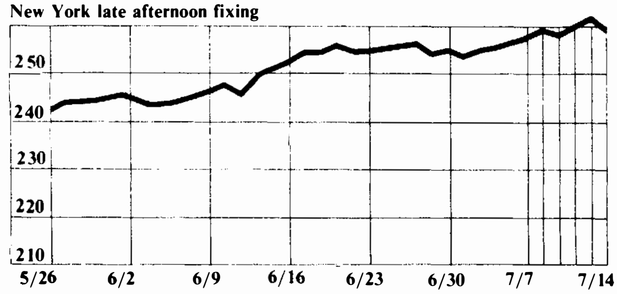
The dollar in deutschemarks

New York late afternoon fixing



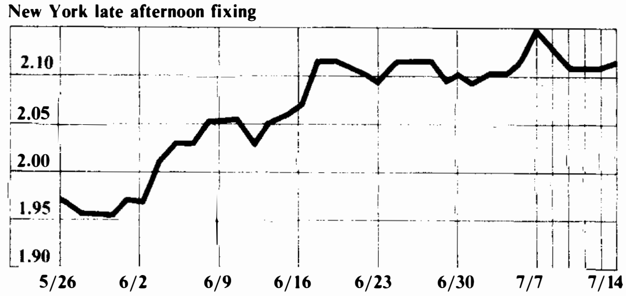
The dollar in yen

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing