

The Economic Club of New York

The Honorable Romuald Spasowski
Poland's Former Ambassador
to the United States

The Honorable Alan Greenspan
Chairman, Social Security Reform Commission
(Replacement Speaker for James Baker, III)

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Questioners: F. Ross Johnson
President, Nabisco Brands
Vice Chairman, Economic Club of New York

Thornton Bradshaw
Chairman, RCA Corporation

Introduction

Chairman Peter G. Peterson

Ladies and gentlemen, our program this evening, unlike most of our programs, does have a central theme. I guess you'd call it valor, heroism, courage. And first of all, before introducing our speakers, I would like to introduce a heroic guest that we have that I'm glad to say is a new member. He is the Canadian Counsel General in New York, but you may remember him as the Canadian Ambassador in Tehran a little over a year ago. (Applause) Mr. Ambassador, like many of my comments, this was going to be a superfluous one, namely that I didn't have to ask the Club to thank you. But for the one or two of you who do not remember the specifics, this great hero hid six American Embassy people in the Canadian Embassy. He got them out with Canadian passports and there's no way, Mr. Taylor, you could have possibly known at the time what the risks were to either your government or to yourself and that rare piece of gallantry gave us some of the very rare good news we had as I recall. And the applause says thank you, as I say thank you, and as every American says thank you.

Mr. Ambassador, Ambassador Spasowski, it's the tradition of this Club to attempt at least to make some levity with the serious purpose of the Club. And this chairman has made a number of attempts at levity – all of them I might add have been unsuccessful. (Laughter) But that total abject failure at humor has never dissuaded me from continuing, until tonight. And I think in introducing you, the audience will be greatly relieved that I will not even attempt humor.

Because it seems to me that with your heroic example, you too so lifted the spirits of our country, and I'm sure many of your countrymen, so as to transcend any feeble attempts at humor.

I think, Mr. Ambassador, all of us in life search for something very elusive that you might call costless integrity or costless courage. Most of us would like all the rewards and none of the risks. And alas, life is not made quite that way. When this great citizen of the world stepped up to that State Department microphone not too long ago, it was clear he was giving up a great deal. It was clear that he was risking nearly everything, except his integrity and his humanity.

The New York Times, at the time of that dramatic announcement, said that Ambassador Spasowski walked away from the most distinguished diplomatic career in post-war Poland. What you may not have known was both the Ambassador and his wife took this heroic action knowing that their mothers, age 86 and 90, were still in Poland. And Mrs. Spasowski, I'd like you to stand as another heroine this evening so we can thank you. (Applause)

This ambassador had a remarkable career. What you may have forgotten was that this was the second time he was Ambassador to the United States. The first time was in 1955, where at the really young age of 35, certainly the youngest senior ambassador by far, he was named Ambassador to the United States. He moved to the number two position in the Foreign Ministry in the early 70s when I first met this great citizen.

Mr. Ambassador, as I said to you this evening, perhaps there were two or three early warning indicators I had in 1972 and '73 when we used to talk and work with one another that Poland was different and that you were different. I will tell two very brief anecdotes. It was in the month of August of 1972 and the delegation of which I was a part had just returned from three arduous weeks in the Soviet Union. Anyone that has spent three weeks in the Soviet Union knows that isn't difficult. We had two experiences that I found interesting.

First, and I don't know how people find out these things, I am now and was then a modern art nut which I know many consider a redundancy. But I had asked the Soviet officials if they would be kind enough to show me the Soviet modern artists including the works of Kandisky. And that was one of the few things that they said it would be impossible to arrange to have happen.

A second experience that our delegation had in Moscow was that in enjoying, if that's the right word, the Soviet soft drinks that we were offered during these long sessions, what usually accompanied the soft drinks was a good deal of rhetoric about how unique each of the soft drinks were. This soft drink came from a certain unique root bark and this soft drink came from a special mineral water that was unique to the Soviet Union and so forth.

Well, with that trivial background I can recall vividly – at the time this gentleman was the number two man in the Foreign Ministry – landing at the Warsaw airport. And we were invited into the waiting room there and we were asked if we would like a soft drink or a drink of any

kind. It would not have been unnatural to be offered Polish vodka made with, you know, unique Polish potatoes or something of that sort. And instead of that, Mr. Ambassador, you may recall there was a very plain room and there were six king-sized bottles of Coca-Cola – nothing else in the room. All of us said, aha, interesting message. Poland is different. That evening, where we had the traditional exchange of gifts, the minister stands up and presents me with the most modern Polish painting I had ever seen. It is so modern and so abstract that my wife recently pointed out to me that there's a limit to what a person who had served his country could endure, and she didn't intend to endure that kind of modern art. But that isn't the point of the story. The point is that in very exquisite, elegant ways there were a few in the Polish government who were saying to the rest of the world, Poland is different.

A year later, as a private citizen, this unique man gave a private dinner that he hosted. It was a very civilized dinner. The wines were very civilized. But what was really civilized was the conversation. And, Mr. Ambassador, I'll never forget the discussion we had in the limousine one night in which you asked me the most deft, penetrating questions that anybody in Europe had asked about what Watergate was really all about, as though I had any idea of what it was all about.

Finally Mr. Ambassador, on a serious note, let me say this. I think history has been kindly treated by two great Polish leaders who left their homeland and who lifted our spirits and aroused our consciences. One of them is in Rome. He could not be with us this evening. The other is here

tonight. So, Mr. Ambassador, you honor all of us by this, your first appearance publicly in our great city. I present to you, ladies and gentlemen, the Honorable Ambassador Spasowski.

(Applause)

The Honorable Romuald Spasowski

Poland's Former Ambassador to the United States

Mr. Chairman, ladies and gentlemen, I would like first of all to express to you, Mr. Chairman, my wife's and my thanks for inviting us and for giving me the opportunity to speak this evening to such a distinguished and influential audience in New York. We are indeed honored by your kind and gracious invitation.

Exactly four months ago, on December 20 last year, I have protested against the military crackdown in Poland and broke entirely with my official past. Tonight I intend to share with you some of my thoughts on the Polish situation which unfolded during these four months. In the second part of my remarks, I wish to speak on international and historical aspects of the military coup in Poland.

As I stand before you, I have a feeling of serious responsibility. People in Poland are being silenced. I would wish that my words represent them as close as possible. I am sure they would wish me to say a little about their movement, about Solidarity. This movement represented 9

million people, and with their families, more than 90% of Poland's population of 36 million. During the 16 months when Solidarity dominated the Polish political scene, there was no violence. And in August 1980, when Solidarity was born in the Baltic city of Gdansk, no window was broken. It was not accidental. This was what the Polish Catholic Church expected from the people.

This genuine and spontaneous movement was also very disciplined – historically a very unique phenomenon. The Poles were animated. They searched for positive solutions and for renewal in their own lives. This movement was not without faults, but one has to remember that it emerged and developed in the most difficult, often dangerous and adverse conditions.

What was most important, Solidarity was spreading hope, goodwill, goodness, adherence to Christian values, and confidence among the people. During this 16-month period, the people wept of joy in hope that their dream of freedom might be finally fulfilled still in their lifetimes. This 16 months will be always remembered as a unique chapter of glory in the Polish turbulent history. This path of glory had no chance to be full-blown, but it will be never forgotten. This was, ladies and gentlemen, the true Polish Camelot.

Then, on December 13, came the dark forces. The state of war was declared on the Polish people. And the junta had two main objectives – primarily to destroy the organizational structure of Solidarity by eliminating the best, most patriotic and active men and women of the movement.

This objective was unfortunately achieved. Secondly, to make Polish people fear again. As in the Socialist system, Soviet edition, fear is inseparable component of life. People have to fear the authorities; the police knocking at the door at the nighttime has to be fearful. And in these 16 months, the Poles ceased to fear and were expressing their feelings freely and openly. This second objective has not been achieved.

And now, after more than four months of Marshall Law, the people do not fear the oppressors, they despise them. At present, about 4,000 Solidarity leaders remain either in prisons or in the so-called detention camps and the difference is practically in name only. The morale of the prisoners is high. They sing in their cells patriotic and religious songs. Frequent are the beatings and brutal interrogations by Secret Police. By acts of cruelty the police tries to break their morale. It is frequent that local people are joining in singing patriotic songs.

So the imprisonment of the whole Polish nation has not weakened the traditional Polish spirit, but it has cost the collapse of the system which, as you know, is built on one party, Communist Party rule. This party was inefficient, badly organized, disoriented and corrupt before. The blow delivered by the military paralyzed the party operators and discredited it entirely. Another consequence of the military coup is the continued fall of economy which was in very bad shape before. Recent industrial statistics which should be considered as not reliable indicate there's a decline of industrial production.

The military rulers of Poland tried to pretend that they are in control of the situation which is getting somehow normalized. They control the streets, yes, but not govern the country. By strict censorship and heavy jamming of foreign broadcasting stations, they try to screen the Poles from the truth. They wish to suppress any independence sought. They banned and dissolved the Association of Polish Journalists. They dismissed, at the universities, freely elected presidents and vice presidents. There are indications that a campaign to ban Solidarity is being prepared.

So when someone may say to you that some of the members of the ruling junta or their advisors or high ranking officials of the government are liberals or moderates, that they are motivated by some patriotic feelings, take it as a good joke. The crackdown on Solidarity was carefully arranged by some of them on Kremlin's orders. It was orchestrated and supervised by the Soviets from beginning to end. It was coordinated in advance with other Socialist capitals, specifically with Berlin and Prague. There is enough evidence now that the Kremlin spared no efforts to undermine the Polish will of resistance much in advance, morally by power demonstrations of Russian military might, and physically by postponing and preventing deliveries of various food stuffs. One may say now that Moscow engineered a very elaborate conspiracy – yes, conspiracy – against the Poles in Poland itself and also outside Poland.

I think that Polish people have the right to expect that the free world, and above all the United States of America, will assist them in a peaceful way. There are four areas of such needed assistance. Firstly, by demanding on grounds of human rights the release from prisons and

detention camps of the Polish trade union leaders. There should be no business as usual. No talks or exchanges or new trades. Lech Walesa and other leaders, among them women like actress Helena Makowska and elderly people are jailed already for four months. The military junta should feel strongly that the Polish signature under the Helsinki Accord puts them under strict obligation to honor human rights. We made the demand to honor human rights and we should demand. The Soviets should feel pressure on this question as a leader of the conspiracy against the Polish people.

Secondly, the Soviets and the junta spread a curtain of silence over Poland. In a way one can imagine that the war of ideas is raging over the country. On the one side, forces of darkness, silence, and jamming, and lies and distortions. On the other side, forces of truth and justice and news. The free world should do whatever possible to break through this curtain and to make sure that the Polish people do not feel isolated. This war of ideas must be won by the West, by more funds for broadcasting stations like Voice of America, like Radio Free Europe, by stronger transmitters and more and more modern equipment. I am not calling for hardware or military equipment. There should be never hardware again. I am calling for best weapons in the war of ideologies.

Thirdly, the living conditions of the Polish people are very difficult. In the cities, in industrial areas, and in small towns there is a real scarcity of foodstuffs, and the food is very expensive. Old people and large families suffer most. In the hospitals, the conditions are tragic. The misery

brought by the Communist system is enormous, by the way, after borrowing \$27 million dollars from the West. There is a very real need for foodstuffs index. I would like to appeal to you to render assistance to the Polish people, but only under one condition, under full control so that it reaches directly the people. There are already established channels through Catholic Relief Services or through CARE or through Project Hope which is giving very successful medical help for Polish children. Saying this, I would like to express on behalf of all those silent in Poland, if I may, their thanks to the Catholic Relief Services of this country, to Project Hope, and to CARE, and to all those generous Americans who contribute to such programs for Poland. Polish people should never forget helping hands extended to them in times of their most cruel ordeals.

I would like also to say words of warm thanks to the American government and, above all, to President Ronald Reagan, for his friendship to the Polish people. The Poles will never forget that at the White House and at the American homes all over the continents, a candle was twinkling on Christmas Eve. The Poles will never forget that television program, Let Poland be Poland, was transmitted all over the world, and that hundreds of millions of people saw this program on all continents, a program about people who are forcibly silenced.

Fourthly, do not assist the oppressors – that means military junta – in any way. Any economic assistance given to them, to the hands of the junta, would be considered by the Polish people as a mistake which is prolonging the time of the oppression.

Mr. Chairman, I would like to talk now about some international and historical aspects of the Polish situation. Soviet and Warsaw's propaganda is trying to make other countries believe that the events in Poland are of purely domestic character. They say even that the Polish "problem" resulted from Western interference in the Polish internal affairs – what a hypocrisy.

The Polish tragedy is caused, as I said before, by broad Soviet conspiracy. But let's have a look at this question from historical perspective. After the Second World War, the fate of Poland was decided by the Yalta Conference of 1945 without consent of the Polish people. This conference envisaged free elections in Poland, and such elections were never held. And the Soviets, exactly like today, played skillfully, politically, and forcefully by threats of military power a very cunning and coordinated game to outmaneuver the Western countries.

In 1945, I was young and believed that the cause of Socialism is superior to anything else. Today, after 37 years, the Polish people have still enough strength and spirit to fight against the verdict of Yalta. The present situation in Poland is nothing else than a most striking evidence that the Poles never accepted Yalta. So from historical perspective, Polish tragedy is also an international issue.

Now, let me explain to you briefly the roots of Polish spirit of resistance. I am sure those Polish; those people in Poland who are silenced would like me to explain to you the roots of their spiritual strength. The Poles never tried to convert other people by force to anything, including

Christianity. But once being Christians in the 10th century, they defended their faith with all their strengths. Poland became thus the bulwark of Christianity in Eastern Europe.

Century after century, generation after generation, we fought with the savage Mongols who invaded us from Russia and with the treacherous _____. Then to our broad borders came the Turks who took Constantinople in 1453. This was just shortly before the last Arabs left Granada in Spain. We fought with the Turks for more than two centuries. These wars were very bloody and Poland stood alone. And with the Battle of Vienna in 1683, when Polish King Sobieski rescued Austria and maybe Europe, this war terminated. At that time, Poland became the strongest, one of the strongest European powers.

This was the time of splendor of our Jagiellonian University established in Krakow as early as 1364. This university gave education to two students in old times, to Nicolaus Copernicus, the astronomer, in our times to Karol Wojtyla, the Pope, John Paul II. This was a remote past but in our genes we feel the indomitable spirit of freedom.

In the last two centuries, Poland, exhausted and overran by powerful neighbors, one of them Russia, witnessed enormous sufferings. My country was partitioned and humiliated. The best sons of Poland who fought for freedom were systematically deported to Siberia. The first such deportation of bishops and members of the Polish Diet took place in 1768, the last one in 1939 when also my family was forcibly sent to some very faraway place north from the Ural

Mountains.

Many times we tried to regain independence. There were five major uprisings. In the first, before the partitions, a young officer named Pulasky took an active part and then he sailed to America to become a hero of the American war of independence and was killed in the Battle of Savannah. In the last one, in the uprising of Warsaw in 1944, hundreds of thousands of Poles died in desperate struggle with Hitler's _____ when the Soviet army waited on Kremlin orders on the other side of the Vistula River.

May I also recall two dates – the year 1920 and the year 1939. In 1920, the Poles fought with the Soviet armies and their Marshal, Tukhachevsky, who led the Red Army to join Red Germany. The question, what would have happened at that time if the Polish spirit of freedom would have failed? In 1939, the Poles alone faced the Germans while the Soviets were joining forces with Berlin. Question, what would have happened if the Polish spirit of freedom would have failed at that time and no country would fight the Germans on the continent leaving Britain completely alone? And when after Yalta, Poland was under Soviet domination and the ruthless Stalinist regime spread over the country, the people never lost hope.

Remember, in 1956, we reached for freedom and Soviet tanks were rolling towards Warsaw. In 1968, unrest was deeply felt when the students revolted against the regime. In 1970, the workers of _____ demanded more freedom and bread. In 1976, deep unrest was felt again over Poland. And

in 1980, Solidarity was born. How the present situation looks from this perspective? Would the Polish people agree to alien domination after the military coup of December '81? Never.

Let me now dwell very briefly on two questions having international ramifications. Firstly, the question of sanctions. In my opinion, the application of sanctions should be very diversified, but strict. Real sanctions should be applied to the Soviets. The effectiveness of the sanctions depends on the unity and coordination of the Western major countries. The question is, if these countries are able to agree on common controls and licensing of trade with non-market economy countries?

There are three areas in which sanctions could be really effective – grain, gold, gap in technology, the three Gs. In that case, the major Western countries should agree on controlling commonly the export of grain to the non-market economy countries. They should agree not to buy Soviet gold which is a product of slave labor. And they should adopt strict controls on exports of some advanced technology and equipment. Such strict controls commonly agreed could have very good effects, believe me.

Second, the economic catastrophe of Poland became an international issue. Poland's debt to Western countries amounts now to a huge sum of about \$27 billion. And the big question is how Poland will be able, if Poland will be able to pay the debt back. I see, ladies and gentlemen, only one way that Polish people may repay so large amount of money – when the Poles will feel at

home in Poland and when they will know full well that they are working only for themselves. Oppressed and exploited people will never repay the principal and will not be able to pay even the interest.

The only acceptable solution of the crisis in Poland which is engineered by the Soviets is a peaceful solution. The junta, isolated and despised, does not really know what to do. The Poles should have enough maneuver room to reach real and not tricky accommodation – an accommodation between the nation, that means Solidarity, and the junta, or any authorities. For this, the authorities must have the permission, permission from the Kremlin. So the ball is in Moscow. I hope that Moscow will be enough realistic to make it possible and avoid thus a real trouble which 36 million people can make.

Of course, major role in such accommodation will be performed by the Catholic Church of Poland. The Polish people trust the church which enjoys tremendous prestige. Historically you know why. Let me stress, the Polish people know from their own experience that the worst advocate is fear and the worst advice would be to knuckle under alien force.

Now, if I can read the Polish minds and souls, I think that all my friends in Poland would like me to say to you in conclusion, we shall never reject our faith and our country. We earnestly hope that truth and justice shall prevail finally on our soil. We believe in freedom. Help us. Long live Poland. Long live America. Thank you. (Applause)

Chairman Peter G. Peterson: We have another heroic figure this evening, Alan Greenspan. And I'd like to explain the circumstances. For several days, your president, Eddie Locke, and I have been in constant communication with Mr. Jim Baker. We have reviewed every method of transportation known to man and perhaps some not known to man as to how he might get here this evening. But as of 4:00 this afternoon, it became clear that the negotiations that are perhaps, as I needn't tell anybody in this Club, perhaps the most important negotiations in the world are going on as we speak. And therefore, another hero, Alan Greenspan, agreed to stand in his place.

I would like to read to you a letter from Jim Baker to Alan and myself very briefly.

Dear Alan and Pete, I hope that you will convey to the members of the New York Economic Club my deep regret that the budget talks in Washington prevent me from joining all of you this evening. The only saving grace is that Alan Greenspan has so kindly agreed to speak for me. I can't think of a finer pinch-hitter, although I must confess, Alan, that my opening remarks included one of the president's favorite anecdotes about the economy – a story that you may not really enjoy so much. It recalls a great baseball manager that some of you may remember, Frankie Frisch. One day Frisch sent out a rookie to play centerfield. The rookie dropped the first fly ball that was hit to him. He then let a grounder scoot between his feet, and when he did get his hands on the ball, he threw it to the wrong base. Frankie stormed out of the dugout, grabbed his glove and said, I'll show you how to play this position. The next batter slammed a line drive right over second base. Frankie came in on it, missed it completely, and fell down when he tried

to chase it. Well, Frankie threw down his glove and hollered as loud as he could to the rookie.

You've got centerfield so screwed up that nobody can play it anymore. (Laughter)

This is now Baker, not Reagan speaking.

There are days when President Reagan and others of us here in Washington feel the same way about the economic policies of the past. In recent weeks, the president has concluded that the most important step we can take to revive the economy is for the administration and Congress to come up with a balanced bipartisan package on the budget. He believes that if Washington can only send out credible signals that it is serious about steadily reducing the deficits, that would have a healthy impact upon interest rates and in turn would unleash the recovery.

The process of reaching a balanced package has been anything but easy. And over the past few weeks, at the president's direction, I have attended more than a dozen meetings with Democrats and Republicans from the Congress. There have been some days when we thought a consensus hovered just over the horizon and other days when it seemed like a mirage. As of this afternoon, I must tell you that the chances of an accord are still about even. I can assure you; however, that there was no one more determined to do everything he reasonably can to foster a good atmosphere for these talks than the president himself.

In recent days, he has repeatedly signaled that he wanted those talks to go forward and that he

approached them in a constructive spirit. This morning, he called Tip O'Neill and then this afternoon he met with reporters in the Rose Garden to deliver the same message that he is prepared to go the extra mile. The president is not about to abandon any of his fundamental principles, far from it, because he does want to be reasonable and forthcoming in these proceedings. In my view, that augers well not just for the future of these discussions but for the future of the country.

Once again, please accept my apologies that I'm unable to be with you tonight. Perhaps you will consider a rain check for the fall. By that time, if Alan's economic forecasts are right, I trust that centerfield won't be so screwed up anymore. With every good wish, Jim Baker. (Applause)

Very briefly, I told the group the other night that one of my favorite new words is an oxymoron which perhaps a few of you don't remember. It's an old English word that is intended to convey what happens when two words are used in juxtaposition to one another that are in fact a contradiction. I guess an oxymoron might be something like military intelligence (Laughter), a powerful Secretary of Commerce, or even a relevant Secretary of Commerce. But perhaps the oxymoron of all times would be a coherent economist. (Laughter)

Now this evening, I want to present to you a great oxymoron, Alan Greenspan, who is the most coherent economist I know. I might say, however, that whether he will remain coherent as an economist or even as a person after he finishes his job as Chairman of the Social Security

Reform Commission remains to be seen. Your acceptance this evening, Alan, under the circumstances, and your acceptance of that assignment are two of the most heroic acts of your life. The subject of general entitlements and the special problem of Social Security, certainly this Club appreciates, is at the very heart of this country's out of control budget.

Alan, as you will recall, was President Ford's Chairman of the Council of Economic Advisors. He justly received the Thomas Jefferson Award for the greatest public service performed by an elected or appointed official. He is a Director of a number of great American institutions, Alcoa, J. P. Morgan, Mobil, General Foods, Automatic Data Processing. He is on President Reagan's Economic Policy Advisory Board. And it is with special gratitude and appreciation that I present to you our fourth hero of the evening, the Honorable Alan Greenspan. (Applause)

The Honorable Alan Greenspan

Chairman, Social Security Reform Commission

Peter, if I could pronounce the word that you had just uttered a few minutes ago, I would indicate that that's what I thought the closing remarks of your introduction really were. You know I think that Jim Baker, in a sense, is speaking to us today in a way which perhaps is more important than most anything that we can imagine.

What they are doing down there is by any stretch of the imagination an unprecedented process.

What we're seeing is a number of politicians during an election year debating what to take away from their constituents. And cynics like myself don't really believe anything can happen having been down there and watched what happens as you roll towards November in an election year. And yet I must say I'm terribly impressed at the extent to which very extraordinarily avid attempts are currently being made to do things in the size of dimension which back as recently as 1976 we would have ruled out as utterly inconceivable. I don't know if it will succeed and I'm not sure that anybody really does. It really is a truly extraordinary and unprecedented procedure that is involved in these negotiations. And I think perhaps Jim Baker is right that it's even money despite the fact that the process at this stage seems to be moving towards some form of resolution.

I suspect, however, that the reason why we're getting this application by the leadership of the Congress and of the White House is that everyone is beginning to recognize that something has got to be done. That the economy's future basically depends on it, and that as we stand today with the existing structure of fiscal affairs, projected indefinitely into the future, creates a view of the future of the American economy and the nation as a whole which as, I suspect, is utterly unacceptable to most everybody. And I must admit I'm surprised to see people whom I've seen to be 110% political and view everything in an extraordinary political way begin to become very interested in finding some form of accommodation which essentially will lead to success. The reason is that the current economic situation requires it because it is as unprecedented as our current politics.

This is not a typical recession. In many respects we see the typical numbers. We see industrial activity falling. We see unemployment rising. We see a general softness in price levels. And yet something is fundamentally missing because at this particular stage in a, what I would call a normal or historic recession, we should begin to see some major forces pushing towards recovery. Because as you look at the data today, what we have even as of late March, perhaps even into early April, is inventory continuing to liquidate meaning shipments are running under consumption. And as of late March, or through late March there was just no evidence of any pickup in new orders, in a sense new orders were running under shipment levels meaning in a sense of course that backlogs continue to recede. And what we had is the typical pattern of the bottom of a recession where new orders are down here, consumption is up here, and shipments are somewhere in between. And that usually is the triggering mechanism when inventory levels recede to a point where liquidation can no longer proceed.

At that point, you get a tremendous rise in new orders in which the new order level, not only rises to the shipment level stopping backlogs from continuing to fall, but it also jumps through the consumption level and we get all of the momentum of a turnaround. That was the scenario which if one were to write the normal turnaround was scheduled for three weeks ago. It hasn't happened. To be sure, we are getting certain ambiguous signs now about forces of recession. One of the typical indicators in the past which is now resurfacing as a major sensitive indicator, scrap metal prices, is beginning to show at least partial evidence that perhaps at least in a couple of

areas, maybe, and I say maybe, something is happening. The trouble is it's difficult to know whether or not, say the marginal upturn in copper scrap prices, for example, is a function of the Falkland Islands problems and potential crises or the beginnings of some bottoming in the order structure and recovery.

I must say, however, when you begin to grasp at little straws of minor little jiggles in a chart to find evidence of recovery, I think that it is a clear indication that something really quite different is going on. There's just no doubt that at this particular point, we should be looking at, for example, a major expansion in steel orders. We should be getting delivery schedules for May and June at this stage loading up. We should be getting some fairly broad indications in a lot of the building materials areas that inventories have turned because we're so low in so many areas; the question is how in the world do you keep these things going down? And yet we're not. And the answer as to why not is also very clear. That is, for the first time in an American recession we have interest rates which are essentially suppressing the forces of recovery.

One must wonder, of course, why? Because with the economy obviously weak, and with inflation coming down and clearly inflation, as we all know in recent period, a very critical issue, that one would expect some really significant downward pressure on the interest rate structure. Certainly, the process of disinflation that is currently going on is not some will-o'-the-wisp. It's real. I mean if one looks at the underlying weakness in the price structure, it is extraordinarily pervasive. You see it not only in the basic materials, prices, and in fact working its way through

intermediate products and final goods, but you also see it in the underlying cost structure. We are getting a very pronounced slowing in wage increases and it is not strictly the issue of give-backs in the fairly well-media covered events in steel and autos, trucking and the like. It's showing up very broadly throughout the non-union area which as you know is the dominant element of our labor force in this country. And it's not something which began with the recession.

I can't honestly say to you I know exactly what is the process which is bringing it down.

Economists have been trying to build sub-econometric models which explain wage price behavior for the last four or five years and the only thing we succeed in producing are new models every year mainly because the one we produced the year before doesn't seem to explain anything. And I think we got very much the same process going on here. We don't really fully understand – we understand in part what's happening, but it's a mistake to assume that all we have got is a recession, weakness in demand, weakness in labor markets, and therefore a weakness in the general wage structure.

Part of the downward pressure is clearly coming from the monetary area and there is no question that we are seeing at least in part a classical disinflationary process. Part surely is the advent of various forms of deregulation. Clearly we are getting a very significant increase in open shop laborers. We had a very substantial rise in the construction area in the 1970s and that suppressed the rise in construction wages. We're now getting it in trucking and in airlines. We have it in an odd way in steel and autos although the open shop, that is the non-union employment, is in

Tokyo and Seoul rather than in the United States. But the process is the same. And what we are observing is a general suppression of wages, a general suppression of wage growth, and as a consequence, coupled with the worldwide oil price slowdown and basic material structure, we truly have, for the first time in a decade, processes of disinflation which do not appear to be short-lived. In fact, it's quite likely that when the consumer's price index is released on Friday, it's going to be zero. And there's even a possibility that the level may go down for the first time since 1965.

As a consequence of all of this, one should wonder what in the world is creating the problem on interest rates. And the answer is not very difficult to find. The problem simply is that the financial markets for good and sufficient reason see our fiscal processes hemorrhaging, see a process of basic breakdown in our ability to constrain the growth in federal outlays, and these whopping deficits which are being projected at an ever-increasing level, week in and week out, are merely a reflection of this extraordinary change in our budget processes which are perceived to require accommodation by the Federal Reserve in the out years, 1984, 1986, '88, which means a rate of growth in money supply which will exceed the rate of growth in capacity and therefore engender inflation at a rate which we haven't seen for several years.

In effect, I would say that looking at the structure of long-term interest rates; I find no credible explanation other than what we are looking at is a market's perception of a very significant acceleration in inflation, going up close to double digit for a period of nine, for a period, say 10

or 15 years. In a sense, the markets as I see them, are implicitly, even if not consciously, assuming that what we have out there is an inflation rate of approximately 9 or 10% for the maturity of the debt instruments out there. I don't believe that what we are observing, as many people have discussed, is a rise in real interest rates. That is, the level of long-term interest rates that would prevail in a non-inflationary economy. As far back as we can read our records, and they go back all the way into the early part of the 18th century with the British Councils, it is very difficult to find a riskless rate of interest, that is a government bond in a non-inflationary environment exhibiting anything in excess, much in excess of 3% as an annual yield. On occasion, it will go to 4. Oh, I think the Councils once went over 5 for a short period of time. But the average is 3% or less, and I know of nothing that has changed either in post-World War II United States or post-1979 United States. I think that the process is in effect all a long-term inflation expectation.

And what they are in effect saying is to be sure the inflation simmering down is not something which is real in the longer term sense. It may exist for six months. It may exist for a year. But eventually the re-emergence of financial forces, the re-emergence of excessive growth in money will trigger a new inflation cycle. And the reason why the markets perceive that is, again, no great mystery. They largely have heard and have been exposed to a considerable amount of rhetoric on the question of balanced budgets and constraining budgets and budget deficits don't matter and rhetoric of that general dimension. They're also acutely aware that the on-budget deficit is not the only source of preemption of credit by the federal system that we have evolved

and developed with a great deal of sophistication over recent years, mechanisms of federal borrowing which don't appear directly on the books and have a very significant financial impact and as a consequence are very much an element in the long-term inflation outlook.

The secondary effect of all of this is that what you create is a basic attitude which in a sense essentially stipulates that we are going to have inflation rates of very substantial dimension, very high long-term interest rates. And yet without getting into the abstruseness of the distribution of expectations, it turns out that even though the average inflation expectation is probably around 10%, the majority of people involved in the financial community expect the inflation rate to be somewhat less than that and as a consequence they believe that long term interest rates will eventually come down and hence there is a significant majority in the business community which has decided to borrow short rather than long when it normally would have. And that in effect has added rather significantly to short-term credit demands as a share of the total. And this, in my judgment, is perhaps the major factor which is moving short-term interest rates.

I don't deny that the Fed, in its current stance is a key factor in maintaining double digit, short-term rates. But I'm also convinced that if the Fed were to do everything other than what it is doing, it might temporarily reduce short-term rates. Obviously it could drive the federal funds rate down to almost whatever it wanted to for a short period of time, but only by suppling reserves to the system, and that eventually would create a new upward notch in money supply growth and a new upward notch in inflation expectations and long-term interest rates and

ultimately would turn out to be self-defeating.

So that essentially what we have got is a situation in which, while I don't deny there are other elements involved, is an interest rate structure which is predominantly a political phenomenon. That is, an interest rate structure which for the first time in American history is dominated by inflation expectations of a very virulent kind. In fact, prior to 1979, perhaps even prior to 1980, there still was the general expectation in this country that inflation was essentially a phenomenon which visited us only during wars and their immediate aftermath, and that it was by its nature a transitory phenomenon. And as a consequence even if there were a high degree of inflation in the short run, over the long run it would simmer down and as a consequence the inflation premiums embodied in long-term interest rates – that is, the inflation forecast that is in those numbers, would basically be, and indeed was, rather nominal. This, then, is really historically for the United States unprecedented. And in that sense, probably requires as in fact we are engaging in now an unprecedented politics. This is what these negotiations are all about. There is a general awareness that something fundamentally different is going on and that something fundamentally different in the way of remedies must be applied.

The key question I think we all have is what type of program will be passed or will eventually get through this process? But perhaps more importantly, what type of program will work? Is there any way in effect that one can construct a credible set of proposals which in fact will convince the cynical financial community which has been exposed to extraordinarily unreliable

and rather seriously questionable forecasts for much too long?

I think there are several principles involved which must be met by these proposals which are now being discussed. The first is that anything that is done to reduce the deficit has got to be perceived as something which will in fact reduce it. I say that in the sense that you may recall for virtually every year that the budget comes out, there is always a balanced budget projected out there by the budget document and the various people who comprise the Office of Management and Budget, the Executive Branch, the Congress and the like, and nobody has believed it and for good reason. Therefore, the only thing that will basically alter that view are changes in law which are perceived to be of a permanent nature.

I'm not, in and of itself, against increasing taxes per se. It's just that I do not believe that one can fundamentally address a budget deficit from the tax side in the sense that our experience which is all too long in the political process clearly indicates that if you increase taxes you will reduce the deficit only modestly and in fact over the long run probably not at all, essentially because spending will rise to the level of receipts, revenues available. This means that you must basically come at the reducing budget deficit exercise from the expenditure side or find a means by which by a combination of tax increases and expenditure reductions you can tie them together so in effect you prevent the tax increases from supplying revenues to be spent. Now in a way this is the type of process which is currently going on. That is what they are endeavoring to do is to put together an all or nothing package.

In other words, we're not dealing with, as indeed we cannot deal, with a simple set of expenditures and taxes one by one because one thing is certain. If you do it that way, you will never succeed in fundamentally coming to grips with this question. That's the reason why it's an all or nothing type of process they're now currently engaged in and why they are looking for a specific vehicle as they had last year to in effect get an up or down vote by both houses of the Congress on a budget which the president can sanction and which can have a reasonably good chance of passing. It is a very difficult political process. It has never been done before. No one is sure it'll work. The people involved in it are basically alternately hopeful and skeptical of its success.

And yet the pressure continues to solve it, to solve the problem, because the payoff is so tremendous. The payoff is tremendous basically because if a credible set of budgetary proposals can be passed in a manner which essentially reduces the real expected long-term deficit in the out years – remember, what we're talking about is inflation expectations not next year. We're not talking about budget deficits for fiscal '83. In fact, I'm convinced that if we were somehow, by some magical procedure, to be able to reduce the deficit from let's say \$130 billion in fiscal 1983 to \$50 billion in '84, and zero in '85, that is true fantasy land, but if that became a credible view of the near-term future, I think interest rates would fall very sharply.

Now obviously that's a little much to take, but something a good deal short of that would have

enough of an impact on reducing long-term inflation expectations, long-term interest rates, enough to induce a significant amount of funding of short-term liabilities so that you would get short-term rates beginning to fall, short-term credit demands eased. I don't believe that the funding of short-term liabilities would make very much of a dent in long-term rates meaning I think the inflation premiums coming down would bring the rates down significantly and perhaps the demand for long-term funds on the funding may bring them back a notch but not very much.

Under those conditions, I think we would get a major revival in housing, a major revival in capital goods in the context in which these disinflationary forces which we've been observing for the last year or so would continue. It's the type of outlook which is really extraordinarily different from the outlook that would occur if these talks fail. In other words, the difference between a win and a loss here is extraordinarily large – the dimension of which I suspect we cannot really overemphasize.

What is at stake is the outlook for the American economy in the 1980s. Perhaps more than any particular single event of the years immediately ahead, what has been going on for the last three weeks and what is going on tonight is up amongst the most critical. If they succeed, centerfield won't be screwed up anymore. Thank you very much. (Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN PETER G. PETERSON: Thank you Alan. You may be an oxymoron but you're coherent nonetheless. I'd now like to introduce our questioners. On my left, Ross Johnson, President of Nabisco Brands, Vice Chairman of the Club. On my right, Thornton Bradshaw, Chairman of RCA. We will rotate questions. Brad, why don't you take the first one. And don't throw any curve balls please.

THORNTON BRADSHAW: Mr. Ambassador, I find it very difficult to ask you any questions after such an impassioned defense of the spirit that we all want to share. And there really is nothing more to say. There's nothing to question after that statement of what we all treasure greatly – a spirit of pride and freedom. So if you will take my questions purely as an invitation for you to expand upon your theme rather than questions of what you have said. So in that spirit, I would ask you, is the popular support for the Communist system really as weak as it appears to outsiders? Could the Polish infection, and I realize that's not a good word except possibly from the point of view of the Soviets, that the Polish infection spread to the Soviet Union itself, and if so, what would that mean?

THE HONORABLE ROMUALD SPASOWSKI: Well, I would say, and I have I think indicated in my remarks that practically speaking, one cannot talk about popular support in Poland for the Communist system. The Communist system is just being, is staying there in Poland because it's

staying by force and there is no other alternative for the time being. There is no popular support whatsoever and I think that there is much doubt about the system and its efficiency among the members of the Polish Communist Party. Well, just to indicate how bad is the system, one should say only this. The country borrowed \$27 billion and the economy is in tragic shape and there is no food. And the agriculture which should have produced enough, not only for Poland, but much for export, is hardly producing some fraction of what is needed by the Polish people. So what kind of system it is? I think that Poland is the best proof that this system does not work. Of course, when one talks about system, one has in mind primarily two phases of the system – political and economic. The economic system is not working at all and political system is being kept by force. Now the question about the infection, well, Poland is very much isolated from the other Socialist countries. You know that the Poles could not travel to, let's say to the Soviet Union, to Germany, to GDR, or to Czechoslovakia freely, specifically to Russia because they would need, not only passports given them by the Polish authorities, but special invitations were needed, not visas but special invitations by some relatives, by somebody who could be checked and approved. So there was no traffic at all. I think that much has been done in Russia, in Czechoslovakia, in Germany, specifically in Soviet Russia, in Soviet Union, to convey to the people that the Poles are bad, that they are born reactionaries, that they hate other countries, that they hate Russians, that they are nationalistic. That one should be careful with them, which is of course absolutely untrue. We have no prejudices whatsoever, but we shall judge our neighbors and everybody else on the facts, on their deeds. And unfortunately, the facts are there which I have explained to you. That is what I wish to say.

F. ROSS JOHNSON: Yes, Mr. Chairman. Alan, could you comment on the Ambassador's suggestion re: economic sanctions. In your opinion, is this practically possible? And if so, would it be effective?

THE HONORABLE ALAN GREENSPAN: Well, I certainly would agree with him that the issue of granting support to the Polish junta is clearly playing into their hands. And I, for one, even though I am acutely aware of all of the problems involved in the issue of bankruptcy, I'm in fact in favor of it. On the question of, as he calls it, the three G's, I wish they could be effectively implemented. I have my doubts that there is sufficient support in the Third World which would in fact be required on the gold issue because obviously gold needs no endorsement or any signature. One can shift gold around at great length. The grain issue is one that has been obviously discussed at great length in the American government for quite a long time. And one would assume that with so few major grain producers, it shouldn't be too difficult to arrange a grain OPEC but we have succeeded not at all. I am, therefore, somewhat skeptical that in fact we would be able to implement much of all of the specific sanctions, although I must say in principle I agree that perhaps we should look much more closely into seeing whether they could in fact be implemented.

THORNTON BRADSHAW: I think in order to vary this menu a bit; I shall direct a question out of order here, and address one to Alan also, if I may. The administration tries to sell us

businessmen that the deficit really isn't all that large when it's considered in the context of the GNP. In fact, on a percentage basis, it is perhaps smaller than the deficit in West Germany and Japan. Why don't we believe the administration?

THE HONORABLE ALAN GREENSPAN: I'll give you an answer why I don't believe it. The deficit basically is a proxy for inflationary preemption of credit by the federal government, but it really stands for a much more complex mechanism which basically relies, one, to the aggregate amount of credit preempted by the federal system which includes credit guarantees, various forms of business regulation which induce the use of credit by private business such as, for example, mandating scrubbers in an electric utility. So that the aggregate amount of borrowing, if you added it all up first of all is rather substantially more than the size of the unified budget deficit. But more importantly is the question of the supply of funds, what we used to call savings. And there, the question really must be phrased in terms of the inflationary impact of a budget deficit is a function of the relationship between the deficit and the amount of savings. And what is predominantly different, for example in Japan where the issue of savings is most obviously substantially larger than the United States and West Germany, the issue there is that the Japanese save very substantially more than we do in part because of their cultural and financial institutions and it is not, it's no great mystery. I mean one can figure out exactly how it happens and why it happens, but, that they do, enables them to create much larger central government deficits as a percent of GNP than we can without inflationary consequences. So when somebody pleads that we ought to look at a statistic and that is all, I think that if they find that the business community

finds it difficult to believe, they should not be surprised.

F. ROSS JOHNSON: Mr. Ambassador, as you look back over the events of the past few years in Poland, is there anything the United States, or really any other Western country, could have or should have done to avoid the recent disruption and repression in Poland?

THE HONORABLE ROMUALD SPASOWSKI: This is a rather difficult question. What could have been done to avoid the situation? The Polish government, the Polish authorities in the 70s were very interested in obtaining as much as possible credit from the Western countries, and the Western countries felt that they could lend credits and that it might be beneficial for both sides. I think that it was in this system unavoidable that much of the credits would be wasted or very badly managed. It should have been known in advance. So I think that in this respect nothing could have been done really. But I think that it poses a broader question because Poland cannot be looked at in isolation. Actually nothing can be looked at in isolation. Everything is much interrelated nowadays and more and more. Therefore, this question should be addressed from the perspective of East-West relations in general. And in this respect, I have something to say that I think that unfortunately, this is the West, the Western countries, by supplying not credit, but supplying technology, know-how, and possible access to modern techniques, created the present situation, the present world problem that the Soviet Union became so powerful. Who did it? They have invented all these modern technology by themselves? To some extent, yes, but only to some extent. This is in cooperation with the Western countries. They were able to do as much as

they have done in the technology of warfare, not in other technology, not in agriculture. And they are also not producing good cars. (Laughter) But they have produced instruments to run around the globe, and this is to a great extent thanks to this cooperation. Therefore, I have appealed to look into this question because to my mind the continuation of the present trend, if it will be not checked, might have really have fatal results. This is a basic question. And if I may come back to the question concerning Poland, if the Soviets would be not that strong and that powerful in warfare, in military equipment, as they are now, most probably then it would be easier for the Polish nation nowadays.

CHAIRMAN PETER G. PETERSON: This will be the last question.

THORNTON BRADSHAW: Well, I'll come back to this, to the question, Mr. Ambassador; you did talk, of course, to the great military power of the Soviets. But from the outside at least I think we see many signs of internal problems in the Soviet Union and in Eastern Europe. And in view of these problems, is our administration, our government, overestimating the military threat? And does that in itself not provide some extreme dangers for the future?

THE HONORABLE ROMUALD SPASOWSKI: Well, one may sometimes overestimate. I think I am not able to say truthfully speaking what is overestimated and what is underestimated. And there is a big discussion now going on in the United States exactly on this subject. But there is no doubt that one cannot really overestimate the danger of atomic war and this subject should be

looked at extremely seriously. And actually this is the case between great powers, between the United States and the Soviet, Russia; the Soviet Union cannot be a limited conventional war. If there would be any war, there will be atomic war. And therefore, one should dedicate really, not overestimating anything, to look at this very, very, very carefully. But by saying this, I would say, and this was in a way message, a part of the message of my remarks, that the worst advocate is fear. One should look at their opponents even in such serious situation in a very consequent and a very straight way. They have also to fear the same. Everybody has to fear. Fear should be not on any side, on every side. And because of this situation, there is always a great danger that one of the sides might be blackmailing, might have poker face. And there should be no retreat before strengths. Whatever is the situation about the islands of South Atlantic, of the islands which are now the question of dispute between Great Britain and Argentina, there should be no retreat to my mind before force. Force is no solution. Force leads to another force. There should be put a limit to it. (Applause)

CHAIRMAN PETER G. PETERSON: (Audio stops...then resumes, no overlap)...and I feel or the Club feels for being such a great pinch-hitter who hit it beyond the centerfield as far as I'm concerned, so the question was moot. Thank you all and goodnight. (Applause)