

REMARKS
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TO THE
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WHEN PRESIDENT BUSH VISITED EUROPE IN THE SPRING, HE MADE THE POINT THAT A HISTORIC SHIFT MAY BE UNDER WAY FROM EAST-WEST MILITARY CONFRONTATION TO A GLOBAL EMPHASIS ON ECONOMIC CONCERNS.¹ ECONOMIC ISSUES ARE ALREADY A KEY PART OF OUR FOREIGN POLICY AND NATIONAL SECURITY AGENDA. AND AS THE 21ST CENTURY APPROACHES, IT IS CLEAR THAT ECONOMIC CONSIDERATIONS WILL PLAY AN EVEN GREATER ROLE IN OUR RELATIONS WITH OUR ALLIES AND ADVERSARIES ALIKE.

THERE IS NOW A UNIVERSAL RECOGNITION THAT ECONOMIC STRENGTH IS KEY TO GLOBAL INFLUENCE AND POWER. NATIONS ARE ADJUSTING, EVEN RESHAPING THEIR ECONOMIC SYSTEMS IN ORDER TO COMPETE IN THE GLOBAL MARKETPLACE. AND WE ARE SEEING THREE TRENDS:

-- FIRST, THE SOVIET UNION, POLAND, HUNGARY AND OTHER NATIONS WITH CENTRALLY PLANNED ECONOMIES ARE RECOGNIZING THE FLAWS OF THEIR SYSTEMS AND THE NEED FOR REFORMS;

- SECOND, THE WORLD'S FINANCIAL MARKETS ARE BECOMING INCREASINGLY INTEGRATED;
- AND THIRD, THERE IS GREATER INTERNATIONAL FOCUS ON DEBT, TRADE BALANCES, AND TECHNOLOGICAL DEVELOPMENT.²

TODAY I WANT TO DISCUSS THESE ECONOMIC TRENDS -- TRENDS THAT AFFECT OUR NATION'S POLICIES AND ECONOMIC COMPETITIVENESS. I ALSO WANT TO DISCUSS SOME OF THE IMPLICATIONS THEY HAVE FOR OUR NATIONAL SECURITY.

FOR QUITE A WHILE NOW IT HAS BEEN APPARENT TO THE SOVIET UNION -- AND OTHER BLOC COUNTRIES -- THAT THEIR CENTRALLY PLANNED ECONOMIES HAVE MAJOR PROBLEMS.

THE SERIOUS AND ONGOING ECONOMIC PROBLEMS IN THE SOVIET UNION HAVE CONVINCED PRESIDENT GORBACHEV TO UNDERTAKE BOLD REFORMS. PROGRESS ON THE ECONOMIC FRONT HAS BEEN SLOW. THE BUDGET DEFICIT HAS SPIRALED AND THE DEMAND FOR GOODS AND SERVICES HAS GREATLY EXCEEDED THE ABILITY OF THE REGIME TO

SUPPLY THEM. ONE MOVE THAT COULD EVENTUALLY HELP AND THAT GREATLY AFFECTS OUR SECURITY INTERESTS IS GORBACHEV'S PLAN TO CUT DEFENSE SPENDING.³

OVER THE PAST TWO YEARS, GORBACHEV HAS MADE A NUMBER OF CHANGES IN SOVIET NATIONAL SECURITY POLICY THAT REDUCE SOMEWHAT THE BURDEN OF DEFENSE ON THE ECONOMY. THESE CHANGES INCLUDE REACHING AN AGREEMENT ON THE I.N.F. TREATY AND WITHDRAWING SOVIET TROOPS FROM AFGHANISTAN. AND IN A SPEECH AT THE UNITED NATIONS LAST DECEMBER, GORBACHEV ANNOUNCED MAJOR UNILATERAL CUTS IN SOVIET MILITARY MANPOWER AND EQUIPMENT.⁴

THEN, IN JANUARY, GORBACHEV SAID THE SOVIET UNION'S ECONOMIC SITUATION WAS SO "ACUTE" THAT HIS GOVERNMENT WOULD ALSO HAVE TO CONSIDER REDUCTIONS IN MILITARY OUTLAYS. TWO WEEKS LATER, IN AN ADDRESS TO THE TRILATERAL COMMISSION, GORBACHEV ANNOUNCED THAT THE MILITARY BUDGET WOULD BE REDUCED BY 14 PERCENT AND THE PRODUCTION OF ARMS AND EQUIPMENT BY NEARLY 20 PERCENT.⁵

IF CARRIED OUT, GORBACHEV'S MOVES TO REDUCE DEFENSE SPENDING AND CUT SOVIET FORCES HAVE THE POTENTIAL TO GIVE A MUCH-NEEDED BOOST TO THE CIVIL ECONOMY. A 14-PERCENT CUT IN DEFENSE SPENDING WOULD RELEASE SUBSTANTIAL RESOURCES FOR INVESTMENT IN THE CRITICAL MACHINE-BUILDING AND CONSUMER GOODS SECTORS. THE SOVIETS THEMSELVES HAVE INDICATED SOME OF THE ECONOMIC BENEFITS THEY HOPE TO GAIN FROM CUTBACKS IN DEFENSE, INCLUDING USING SKILLED MILITARY MANPOWER IN THE CIVILIAN SECTOR AND CONVERTING EXISTING MILITARY EQUIPMENT TO CIVIL USE.

THE BIGGEST POTENTIAL BENEFITS TO THE ECONOMY, HOWEVER, WOULD COME FROM REDUCTIONS IN MILITARY RESEARCH, DEVELOPMENT, AND PROCUREMENT. REDUCING WEAPONS PRODUCTION WOULD FREE UP DEFENSE PRODUCTION CAPACITY AND CURB THE MILITARY'S DEMAND FOR HIGH-QUALITY METALS, COMPUTERS, AND MICROELECTRONICS NEEDED IN THE CIVIL ECONOMY.⁶

ACCORDING TO THE SOVIETS, THE DEFENSE REDUCTIONS WILL BE MADE THIS YEAR AND NEXT YEAR, BUT THE FULL IMPACT OF THE CUTS WILL NOT BE FELT IN THE ECONOMY UNTIL SEVERAL YEARS AFTER THAT.⁷ AND EVEN THEN, LONG-TERM BENEFITS WILL NOT MATERIALIZE WITHOUT A MORE DETERMINED EFFORT TO INCREASE THE ROLE OF MARKET FORCES IN THE ECONOMY.

THE NATURE AND EXTENT OF SOVIET CUTBACKS ON DEFENSE ARE OF GREAT NATIONAL SECURITY CONCERN TO OUR POLICYMAKERS. OUR GOVERNMENT WILL BE VERY INTERESTED IN HOW THE SOVIETS RESTRUCTURE THEIR MILITARY FORCES AND HOW THEY GO ABOUT TRANSFERRING RESOURCES FROM THE MILITARY TO THE CIVIL SECTOR.

ANOTHER NATIONAL SECURITY CONCERN IS THE IMPACT THAT CUTS IN SOVIET DEFENSE-RELATED RESEARCH, DEVELOPMENT, AND PROCUREMENT WILL HAVE ON SOVIET ESPIONAGE ACTIVITIES.

DESPITE GLASNOST AND PERESTROIKA, THE INTELLIGENCE ACTIVITIES OF THE SOVIET UNION AND ITS WARSAW PACT ALLIES HAVE

NOT ABATED.⁸ WE WILL BE LOOKING TO SEE IF THE SOVIETS COMPENSATE FOR CUTBACKS IN DEFENSE RESEARCH, DEVELOPMENT, AND PROCUREMENT BY INCREASING THEIR EFFORTS TO ACQUIRE WESTERN DEFENSE INFORMATION AND TECHNOLOGY.

THE SOVIET UNION IS BY NO MEANS THE ONLY BLOC COUNTRY IN THE MIDST OF A VERY DIFFICULT ECONOMIC SITUATION. THE NEW NON-COMMUNIST GOVERNMENT IN POLAND IS FACED WITH AN ECONOMIC CRISIS THAT WILL TAKE YEARS TO OVERCOME, WHILE HUNGARY FACES SERIOUS ECONOMIC PROBLEMS OF ITS OWN. BOTH NATIONS HAVE ASKED OUR GOVERNMENT FOR SIGNIFICANT ASSISTANCE AS THEY MOVE TOWARD REFORM.⁹

OUR GOVERNMENT'S POLICYMAKERS WILL BE FOCUSING ON THE WAYS IN WHICH POLAND AND HUNGARY DEVELOP MORE MARKET-ORIENTED ECONOMIES -- A TRANSITION THAT WILL NOT BE EASY. THESE COUNTRIES ARE FACING MORE AUSTERITY MEASURES, AND OBTAINING PUBLIC SUPPORT FOR AUSTERITY IS GOING TO BE A VERY DIFFICULT POLITICAL CHALLENGE.

OUR POLICYMAKERS WILL LOOK FOR WAYS THE U.S. AND OTHER WESTERN ECONOMIES CAN ASSOCIATE WITH THE DEVELOPING PRIVATE SECTOR ECONOMIES IN POLAND AND HUNGARY. OUR GOVERNMENT WILL ALSO BE LOOKING FOR WAYS TO HELP THEM MANAGE THEIR DEBTS.

THE ECONOMIC CHANGES WE ARE SEEING IN EASTERN EUROPE DO, IN FACT, HAVE GREAT BEARING ON OUR NATION'S SECURITY INTERESTS. ONE OF THE MAJOR CHALLENGES FACING U.S. POLICYMAKERS IS ENCOURAGING PEACEFUL CHANGE IN EASTERN EUROPE WITHOUT PROVOKING EXPLOSIVE INSTABILITY.

THE SECOND MAJOR ECONOMIC TREND WE ARE SEEING IS THE FURTHER INTEGRATION OF FINANCIAL MARKETS. THIS FINANCIAL INTEGRATION IS A REVOLUTIONARY STRUCTURAL CHANGE IN THE GLOBAL ECONOMY. TRADITIONAL DISTINCTIONS HAVE BEEN BLURRED BETWEEN DOMESTIC AND INTERNATIONAL MARKETS, BETWEEN THE DIFFERENT KINDS OF FINANCIAL TRANSACTIONS, AND BETWEEN WHO IS A MARKET PARTICIPANT AND WHO IS NOT.¹⁰

THE TRANSFORMATION OF INTERNATIONAL FINANCIAL MARKETS IS CLEAR WHEN YOU LOOK AT THE NUMBERS: FOREIGN EXCHANGE TRANSACTIONS NOW EXCEED 300 BILLION DOLLARS PER DAY, AND ONE WEEK OF FUNDS TRANSFERRED ON THE INTERNATIONAL MARKET IS LARGER THAN THE SIZE OF THE THIRD WORLD DEBT. THE NUMBER OF INTERNATIONAL BANKS IS NOW IN THE HUNDREDS, UP FROM JUST A HANDFUL IN THE 1970S; AND NEW FINANCIAL INSTRUMENTS, SUCH AS CURRENCY AND INTEREST RATE SWAPS, ARE GROWING IN THE MARKETS FASTER THAN EITHER THE TRADERS OR THE REGULATORS CAN FULLY UNDERSTAND THEM.¹¹

WE ARE ALSO SEEING A GROWTH OF INTERNATIONAL CORPORATE LINK-UPS. THIS IS DRIVEN BY EFFORTS TO ACQUIRE ADVANCED TECHNOLOGIES, DISPERSE FINANCING COSTS AND RISKS, AND GAIN ACCESS TO PROTECTED FOREIGN MARKETS. AS A RESULT, THE NATIONAL IDENTITY OF FIRMS IN MANY KEY INDUSTRIES -- SUCH AS ELECTRONICS, AUTOMOBILES, AND DEFENSE -- HAS BECOME BLURRED. TO SURVIVE,

COMPUTER COMPANIES THAT WERE ONCE FIERCELY INDEPENDENT ARE SCRAMBLING TO FORM ALLIANCES AND PARTNERSHIPS TO BROADEN THEIR PRODUCT RANGES.¹²

THE INCREASED CAPABILITIES OF THE WORLD'S FINANCIAL SYSTEM HAVE FACILITATED GREATER GROWTH AND EFFICIENCY OF THE WORLD ECONOMY. FOR THE UNITED STATES, THESE CHANGES HAVE MADE IT EASIER TO TAP JAPANESE AND EUROPEAN SURPLUS CAPITAL FOR FINANCING U.S. TRADE AND FISCAL DEFICITS AND HAVE BROUGHT PRODUCTIVE INVESTMENT TO U.S. SOIL. BUT THIS NEW FINANCIAL ENVIRONMENT IS ALSO CREATING SOME POTENTIAL RISKS.¹³

THIS "GLOBALIZATION" OF FINANCIAL MARKETS HAS CREATED A HIGHLY FLUID SITUATION IN WHICH POLITICAL AND ECONOMIC DEVELOPMENTS IN ONE AREA ARE QUICKLY AND FORCEFULLY TRANSMITTED TO THE REST OF THE GLOBE. AS A RESULT, MARKETS ARE INCREASINGLY SENSITIVE TO NEWS. THE FIRST INDICATIONS OF BREAKING WORLD EVENTS ARE OFTEN SEEN IN THE IMMEDIATE MOVEMENTS OF INTEREST RATES, EXCHANGE RATES, AND CAPITAL FLOWS.¹⁴

EVEN RUMORS CAN SEND MARKETS REELING. SEVERAL YEARS AGO A RUMOR SPREAD THROUGH THE MARKET THAT THERE WOULD BE AN EMERGENCY "GROUP OF FIVE" MEETING TO STABILIZE THE U.S. DOLLAR. WITHIN 30 MINUTES THE DEUTSCHE MARK AND THE YEN DROPPED MORE THAN TWO PERCENT AGAINST THE DOLLAR. GIVEN THE SIZE OF OUTSTANDING FOREIGN EXCHANGE POSITIONS, THE DROP REPRESENTED A SHIFT IN WEALTH OF ABOUT 1 BILLION DOLLARS ON THE MARKET.¹⁵

SUDDEN SHIFTS IN EXCHANGE RATES AS A RESULT OF POLITICAL EVENTS CAN STIMULATE FURTHER SPECULATIVE ATTACKS ON A COUNTRY'S CURRENCY -- QUICKLY DRAINING FOREIGN EXCHANGE RESERVES IF A GOVERNMENT CHOOSES TO INSULATE ITSELF FROM CURRENCY CHANGES.

ALONG WITH THE GLOBALIZATION OF INTERNATIONAL FINANCE HAS COME THE GREATER USE OF THE FINANCIAL SYSTEM BY GOVERNMENTS AND GROUPS WHOSE OBJECTIVES THREATEN OUR NATIONAL SECURITY INTERESTS. THE INTERNATIONAL NARCOTICS MONEY LAUNDERING INDUSTRY -- AS WELL AS TERRORIST ACTIVITIES, GRAY ARMS

PURCHASES, TECHNOLOGY TRANSFER, AND NUCLEAR PROLIFERATION -- ARE OFTEN FUNDED THROUGH THE WORLD'S FINANCIAL NETWORKS.¹⁶ PARTICIPANTS IN THESE ACTIVITIES FIND THE SPEED, EASE, AND ANONYMITY ASSOCIATED WITH THE USE OF THE SYSTEM ATTRACTIVE FOR THEIR PURCHASES.

DURING THE NEXT FEW YEARS, U.S. POLICYMAKERS WILL BE LOOKING AT THE IMPACT OF INCREASED FINANCIAL INTEGRATION ON WORLD ECONOMIC STABILITY. THEY WILL ALSO BE LOOKING AT THE WAYS IN WHICH THE INTERNATIONAL FINANCIAL SYSTEM CAN BE USED BY GOVERNMENTS AND GROUPS WHOSE OBJECTIVES THREATEN OUR SECURITY INTERESTS.

THERE ARE A NUMBER OF OTHER ECONOMIC ISSUES THAT AFFECT OUR OWN SECURITY AS WELL AS THE STABILITY OF AN INCREASINGLY INTEGRATED GLOBAL ECONOMY. AMONG THESE ISSUES ARE THIRD WORLD DEBT, TRADE IMBALANCES, AND RAPID TECHNOLOGICAL DEVELOPMENT.

DESPITE THE ACHIEVEMENTS OF THE BRADY PLAN, SUCH AS THE RECENT MEXICO AGREEMENT, THIRD WORLD DEBT IS STILL A MAJOR CONCERN.¹⁷ WHAT HAPPENED IN VENEZUELA EARLIER THIS YEAR SHOWS WHAT CAN HAPPEN IF THIS ISSUE IS NOT CAREFULLY ADDRESSED. YOU MAY RECALL THAT THE VENEZUELAN GOVERNMENT'S AUSTERITY MEASURES ANNOUNCED IN MARCH CAUSED WIDESPREAD RIOTING IN CARACAS AND OTHER MAJOR CITIES, RESULTING IN MORE THAN 300 DEAD.¹⁸

BECAUSE ECONOMIC PROBLEMS SUCH AS THESE COMPLICATE OUR POLITICAL RELATIONS OR CAN LEAD TO POLITICAL INSTABILITY, THEY ARE CERTAINLY ON OUR NATIONAL SECURITY AGENDA.

DURING THE NEXT FEW YEARS, U.S. POLICYMAKERS WILL BE CLOSELY LOOKING AT THE STRATEGIES THIRD WORLD NATIONS PURSUE TO MEET THEIR FINANCIAL OBLIGATIONS. CERTAINLY AN IMPORTANT PART OF U.S. POLICY IS ENCOURAGING DEBTOR COUNTRIES TO WORK WITH THE WORLD BANK AND THE I.M.F. TO DEVELOP SOUND ECONOMIC PLANS. OUR GOVERNMENT WILL ALSO HAVE GREAT INTEREST IN THE REFORM MEASURES

THESE COUNTRIES ADOPT -- MEASURES THAT COULD SIGNIFICANTLY AFFECT POLITICAL STABILITY.

THE OTHER ECONOMIC ISSUES I MENTIONED -- TRADE IMBALANCES AND TECHNOLOGICAL DEVELOPMENT -- ILLUSTRATE A POINT THAT IS BECOMING INCREASINGLY CLEAR: OUR POLITICAL AND MILITARY ALLIES ARE ALSO OUR ECONOMIC COMPETITORS.

TRADE IMBALANCES HAVE FOCUSED ATTENTION ON THE TRADE BARRIERS THAT EXIST IN COUNTRIES WITH WHICH THE UNITED STATES HAS LARGE TRADE DEFICITS -- PARTICULARLY JAPAN AND THE NEWLY INDUSTRIALIZING COUNTRIES IN EAST ASIA. LAST YEAR, OUR TRADE DEFICIT WITH JAPAN ALONE REACHED 52 BILLION DOLLARS.¹⁹

AS WE APPROACH THE 1990'S, U.S. POLICYMAKERS WILL BE VERY INTERESTED IN IDENTIFYING PROTECTIONIST MEASURES AND OTHER IMPEDIMENTS TO REDUCING TRADE IMBALANCES. THEY WILL BE INTERESTED, AS WELL, IN THE REACTION OF ECONOMIC COMPETITORS TO MEASURES THE U.S. MAY TAKE TO CORRECT IMBALANCES.

PERHAPS THE MOST FORMIDABLE ECONOMIC CHALLENGE WE FACE IN THE NEXT DECADE IS IN THE AREA OF HIGH TECHNOLOGY. TECHNOLOGICAL ADVANCES CAN REVOLUTIONIZE MAJOR INDUSTRIES IN A FEW YEARS OR EVEN A FEW MONTHS -- AN EXAMPLE OF THAT IS THE IMPACT MICROELECTRONICS HAS HAD ON THE COMPUTER INDUSTRY. AND JUST AS IMPORTANT AS DEVELOPING A NEW TECHNOLOGY IS BRINGING IT TO THE MARKETPLACE QUICKLY.

THE NATIONAL SECURITY IMPLICATIONS OF A COMPETITORS' ABILITY TO CREATE, CAPTURE, OR CONTROL MARKETS OF THE FUTURE ARE VERY SIGNIFICANT.

DURING THE NEXT FEW YEARS, JAPAN AND SOME OF OUR OTHER ECONOMIC COMPETITORS WILL CONTINUE TO MAKE TECHNOLOGICAL STRIDES IN HIGH-TECH INDUSTRIES IN WHICH THE UNITED STATES HAS LONG HELD THE LEAD. TELECOMMUNICATIONS AND DATA PROCESSING ARE JUST SOME OF THE AREAS IN WHICH THE JAPANESE AND OTHER INDUSTRIALIZED NATIONS ARE GROWING INCREASINGLY COMPETITIVE.²⁰

THIS IS CLEARLY A CHALLENGE FOR AMERICAN BUSINESS. AND AS SECRETARY OF COMMERCE MOSBACHER HAS SAID, IF AMERICAN BUSINESS SACRIFICES RESEARCH FOR SHORT-TERM PROFITS, THE UNITED STATES WILL END UP TRYING TO LIGHT THE ROAD TO THE FUTURE WITH LANTERNS, WHILE OUR COMPETITORS ARE LIGHTING IT WITH LASERS.²¹

IN HIGH TECHNOLOGY AND IN VIRTUALLY EVERY OTHER ECONOMIC AREA, U.S. POLICYMAKERS WILL BE INCREASINGLY FOCUSING ON WHERE THE PLAYING FIELD IS NOT LEVEL AS FAR AS U.S. INTERESTS ARE CONCERNED. THEY ARE LOOKING AT THE STRATEGIES OF OUR ECONOMIC COMPETITORS, AS WELL AS THE EFFORTS BY FOREIGN GOVERNMENTS TO TARGET MARKETS AND FINANCE RESEARCH, DEVELOPMENT, AND PRODUCTION.

AS THE ECONOMIC TRENDS I HAVE DISCUSSED TODAY UNFOLD, THE CONNECTION BETWEEN ECONOMICS AND NATIONAL SECURITY WILL BECOME EVEN GREATER. THE INTELLIGENCE COMMUNITY LOOKS AT THESE DEVELOPMENTS FROM A STRATEGIC PERSPECTIVE, EXAMINING WHAT IS OCCURRING, THE FORCES AT PLAY, AND THE WAYS THAT ACTIONS TAKEN

ABROAD CAN DIRECTLY AND INDIRECTLY AFFECT OUR NATIONAL SECURITY INTERESTS.

INTELLIGENCE ON ECONOMIC DEVELOPMENTS AND OTHER ISSUES HAS NEVER BEEN MORE IMPORTANT. POLICYMAKERS ARE TURNING TO US FOR TIMELY AND OBJECTIVE ASSESSMENTS ON BOTH FAST-BREAKING EVENTS AND LONG-TERM GLOBAL TRENDS. I ASSURE YOU THAT THE MEN AND WOMEN OF AMERICAN INTELLIGENCE WILL CONTINUE TO SUPPORT OUR GOVERNMENT AS IT DEVELOPS AND CARRIES OUT POLICIES THAT NOT ONLY ADDRESS OUR NATION'S CONCERNS BUT MOVE US ALL TOWARD A BETTER AND A SAFER WORLD.