The Trilateral Commission was formed in 1973 by private citizens of Europe, Japan and North America to help think through the common challenges and leadership responsibilities of these democratic industrialized areas in the wider world. The leadership tasks of the Trilateral countries need to be carried out with others to an increasing extent, and the 1997-2000 triennium of the Trilateral Commission reflects this changing context and the opportunities it provides.

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THE TRILATERAL COMMISSION

INTRODUCTORY NOTE

The Trilateral Commission held its 1998 annual meeting on March 21-23 in Berlin, about to become once again the capital of a unified Germany. Much of the meeting took place on what had been East Berlin. German Chancellor Helmut Kohl spoke to us (see Section 6) in the Kronprinzenpalais. Berlin’s Governing Mayor Eberhard Diepgen received us in the old “Rotes Rathaus,” once again the City Hall of unified Berlin, where Polish President Aleksander Kwasienski spoke. The meeting hotel was the rebuilt Adlon, just east of the Brandenburg Gate. The only event in old West Berlin was German President Roman Herzog’s closing reception in Schloss Bellevue, the official seat of the Presidency in Berlin. Just after the Berlin meeting, a number of participants went on to Dresden for an additional program hosted by Trilateral member Kurt Biedenkopf, Minister-President of the Free State of Saxony, the most populous of the new Länder in what was East Germany.

The Berlin meeting is the first of the three annual meetings in the triennium to be completed in 2000. In the 1996-97 discussions which framed this new triennium, a central conclusion was that the leadership tasks of the Trilateral countries need to be carried out with others to an increasing extent—and that the Trilateral Commission needs to reflect this more complex context and the opportunities it provides. Thus a range of individuals from other areas of the world have been invited to participate throughout the triennium, and a number of these individuals were key participants in Berlin whose remarks can be found below. The session on Russia (see Section 5) was led by Grigory Yavlinsky and Sergei Karaganov. Part of this publication drawn from the session on global capital markets and the Asian financial crisis (see Section 1) includes, alongside speakers from the Trilateral areas, the remarks of Victor Fung from Hong Kong, Narongchai Akrasamee of Thailand and Jusuf Wanandi of Indonesia.

Also participating in Berlin were individuals from the five Central and Eastern European countries—Poland, the Czech Republic, Hungary, Estonia and Slovenia—which are at the front of the line in negotiations for membership in the European Union, and thus from which Trilateral Commission members will be added in the course of 1998. The May 1998 elections in Hungary led to one of these individuals, Viktor Orban, becoming Prime Minister-designate of Hungary as this is written.

1998 is the 25th anniversary year of the Trilateral Commission. This anniversary was noted at the forward-looking session on “Meeting the Leadership Challenges of the 21st Century” which concluded the Berlin meeting on March 23. The session was prefaced by David Rockefeller, Founder and Honorary Chairman, who received a standing ovation after his remarks (see Section 3). The tone of the ensuing presentations and discussion was far from congratulatory. Yoichi Funabashi dwelt on Japan’s “leadership crisis.” Uffe Ellemann-Jensen, putting the highest priority on consolidating a liberal order across an ever-wider European Union, cautioned his fellow Europeans to “be careful that deeper economic integration does not undermine the liberal order it is intended to support.” Richard Holbrooke argued that in “all the Trilateral countries, institutions have become more bureaucratic in recent years, just as the issues they confront have required more imagination.” A special publication was released in Berlin commemorating the 25th anniversary. Entitled The Trilateral Commission at 25: Between Past...and Future and edited by European Press Officer François Sauzey, it combines current contributions and a number of items from earlier years.

Rounding out this Berlin meeting publication are excerpts from the four brief essays published separately as Advancing Common Purposes in the Broad Middle East (see Section 2) and the presentations which led off the session on “Europe’s Challenges” (joined with President Kwasienski’s remarks in Section 4).
SECTION 1
GLOBAL CAPITAL FLOWS
AND EMERGING ECONOMIES

STANLEY FISCHER

The Asian Crisis
Countries and
International
System
Improvements

We are now experiencing the second major emerging market financial crisis in three years. This fact, together with the extraordinary ferocity of the Asian crisis, raises questions about the nature of the evolving global capital markets. I’ll come to that at the end of this talk. Before that, I want to talk about the three Asian crisis countries—Thailand, Indonesia and Korea; about how their crises arose; about the nature of their IMF-supported programs; and about the prospects for each country. Then I’ll turn to what is becoming known as the institutional architecture—namely, what can be done to reduce the frequency of crises, and what can be done to mitigate the effects of the crises that inevitably will occur.

Thailand, Indonesia, Korea
How Their Crises Arose. This particular crisis started in Thailand, which was forced to devalue last July and reached an agreement with the IMF in early August. The crisis worsened in the region through the summer and then took a dramatic turn for the worse in late October when the Hong Kong dollar was attacked. A day later Wall Street fell sharply; and for a few days it seemed that we faced a worldwide conflagration in which the crisis would spread to Latin America and to Eastern Europe and to Russia.

Fortunately, as expected, Hong Kong defended its currency very strongly; and at the last minute Brazil took the tough measures it had to and stopped the spread of the crisis to Latin America.

But in Asia the crisis intensified, weakening Thailand—which was already weak—and Indonesia and Korea, and also Malaysia and the Philippines. In early November, the IMF signed a program with Indonesia, and a month later a program with Korea. That was the sequence of events.

The crisis that started this, the Thai crisis, was a classic—that is to say, of a country running a very large current account deficit that was sustainable so long as its exports grew fast and so long as the international capital markets stayed friendly. But the large current account deficit left the country extremely vulnerable to a change in circumstances or sentiment.

The Thai crisis, because it was a classic crisis, was widely foreseen. The other two crises were not. Indeed, Korea managed to have a foreign exchange crisis the extent of which was kept well-hidden until the country had essentially run out of reserves. There is no question that contagion played a major role in both the Indonesian and Korean crises.

Although the dynamics of these crises differed, the three economies had some characteristics in common—not all of them adverse. They had long periods of successful growth; that’s a positive factor, of course, but it is also a factor that led to some complacency. They had all pursued responsible fiscal policies. They all had fixed, or relatively fixed exchange rates. And most critical in this crisis, they all had extremely weak banking and financial systems. All three had very large short-term debts. All three had close relations among governments, corporations, and financial institutions—so-called cron capitalism. And they all had central banks that were not willing to defend their currencies by raising interest rates—in the cases

THE THAI CRISIS, BECAUSE IT WAS A CLASSIC CRISIS, WAS WIDELY FORESEEN. THE OTHER TWO CRISIS WERE NOT.
of Thailand and Korea to the extent that they had essentially used up all their reserves by the time they turned to the IMF for assistance.

The IMF-Supported Programs. The IMF-supported programs for these three countries have aroused a great deal of controversy. The most efficient way of describing the programs is by dealing with the three main criticisms that have been made of them.

First, it is often asserted that the programs are too tough in that they require countries to raise interest rates and tighten fiscal policy—the usual IMF austerity. The answer to that criticism is that all these countries have exchange rates which by any rational calculation are way overdepreciated. If their exchange rates at the turn of the year had been maintained, these countries would have faced a lot of inflation and would—not by their intention—have engaged in competitive devaluations against other countries. The IMF, as a systemic lender, has an obligation to worry about exchange rates between countries, about excessive devaluations. We therefore put a very high premium on getting the exchange rates back to more reasonable levels. That means that monetary policy has to be used to defend and to seek to appreciate the exchange rate—something you now see happening in both Korea and Thailand. It is for that reason that monetary policy has been kept tight and interest rates high. You do not defend your currency by cutting interest rates and encouraging your people—in these crises it is primarily local residents whose actions are important—to send their money abroad. The defense of the currency that the IMF is recommending for these countries and that is being criticized in these countries is the same defense that has worked in Brazil and Russia and the Czech Republic, and for a hundred or two hundred years around the world. That's how you defend against a collapsing currency.

Fiscal policy was tightened slightly in Korea and Indonesia at the beginning of the crisis—by "slightly" I mean by one percent of GDP (or one-and-a-half percent in the case of Korea)—with the goal of making a small down payment on the enormous costs of restructuring their financial systems. It is fair to assume that the cost of restructuring financial systems in these countries will be between 15 and 20 percent of GDP. That's how much the government will have to borrow in one way or another to restructure the financial system. We ask for a budget adjustment that, in essence, reflects the interest costs of making those payments. That was a very small and appropriate adjustment. In Thailand the adjustment was larger because Thailand had a large current account deficit. Since then automatic stabilizers have been allowed to work in all three countries. In other words, fiscal policy has simply not been particularly austere.

The second criticism is that structural policies—things like banking and corporate sector reform—are too intrusive. These, it is argued, are matters that should be left to the country to settle. This charge is often made along with the complaint about the IMF dispensing its traditional medicine for these countries. Actually these programs differ from traditional IMF programs—precisely because financial sector restructuring and other structural reforms lie at the heart of these programs. And the reason they do is that the problems they deal with—weak financial institutions, inadequate bank regulation and supervision, and the complicated and non-transparent relations among governments, banks and corporations—lie at the heart of the economic crisis in each country.

Because these problems are at the roots of this crisis, it would not serve any lasting purpose for the IMF to lend to these countries unless these problems are addressed. Nor would it be in the countries' interests to leave the structural and governance issues aside. Markets—and again that means domestic residents as well as foreign parties—have remained very skeptical where reform efforts are per-

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1 Incidentally, there is a fourth IMF program in the area, in the Philippines—which has been in a program for some time and which was hit less hard. There has not been much controversy about that program.
ceived to be incomplete or half-hearted. Market confidence has not returned in those countries.

The third charge, from the other side, is of moral hazard—that by lending to countries in crisis, the IMF (1) encourages member countries to take excessive risks because they will always be bailed out by the IMF and (2) encourages investors to take excessive risks for the same reason, because they'll always be bailed out by the IMF.

The first idea—that because the IMF safety net is there, policy-makers will take excessive risks—is far-fetched. The problem is the other way around. IMF conditionality is usually too tough from the viewpoint of countries, and they are too reluctant to come to the IMF. I have never seen a finance minister happy to see us darken his doorstep, and I've never seen a finance minister or central bank governor survive a crisis of this magnitude either. So the personal incentives are certainly not there.

The moral hazard issue on the side of investors is more complicated. There are countries where I do believe the investment community's first question is, "Will the IMF be there?"—Russia is certainly an example. Now provided the IMF only lends when policies are good, that's all right, that's a reinforcement of IMF conditionality. In the case of the Asian crisis countries, almost everyone who has lent to these countries has taken a big hit. This certainly applies to equity investors, and it certainly applies to many who have lent to corporations and banks. With stock markets and exchange rates plunging, foreign equity investors had, by the end of 1997, typically lost about three-quarters of the value of their equity holdings in these Asian markets—though those who had the guts to hold on since then have done rather well. Many firms and financial institutions in these countries will unfortunately go bankrupt and their foreign and domestic lenders will share in their losses.

Some short-term creditors—mainly the banks lending in the inter-bank market—were protected for a while in that policies aimed to ensure that these credits would continue to be rolled over. But in the case of Korea, where the bank exposure is largest, the creditor banks have now been "bailed in"—with the operation to roll over and lengthen their loans having been successfully completed last weekend. That is also happening now in Indonesia.

Further, we should not exaggerate the extent to which the banks have avoided damage in the Asian crisis. Fourth-quarter earnings reports indicate that, overall, the Asian crisis has been costly for foreign commercial banks. Now none of this is to deny the existence of moral hazard. It's a characteristic of any situation in which insurance is provided; and the need to minimize moral hazard has always to be borne in mind; and we certainly need to find better ways of bailing in the private sector. But I would be surprised if investors conclude from this crisis that they need not worry about the risks of lending because the IMF will show up to bail them out.

Prospects. What about the prospects? The tide has probably turned in Korea and Thailand. That means that the financial crisis is probably past its worst in both countries. That is a necessary part of the solution of their problems, but it's not the whole story, for the real adjustments still have to be made. Each of these countries faces possibly a year or a bit more of tough going as the real economy makes the adjustments called for by the programs they have agreed with the IMF and by the situation they face.

It is reasonable to believe that the path of output in these countries will look a lot like the path in Mexico—that is to say, a deep recession for about a year, followed by very rapid growth, a V-shaped pattern of adjustment and growth and a return to health. I believe it's reasonable to expect that these countries will be back growing at rates well above world averages within two or three years. The Asian miracle of eight or nine percent annual growth may be over for these countries, but six or seven is certainly reasonable to expect; and
that's pretty miraculous when combined with the powers of compound interest.

Indonesia is a much more difficult situation, and we are at a very delicate stage in the negotiations. They are going much better than expected, but they are not over. The President of Indonesia faces a very clear choice. If he goes with the IMF program, the currency will strengthen and hyper-inflation will be avoided. With a worse recession than in the other countries because of the delays in implementing the program, the country will come back to growth. If the program is rejected, it is very difficult to see a good outcome in the next couple of years. We'll simply have to wait and see how that turns out.

System Design and Crisis Response
We heard yesterday the complaint, "Surely there's a better way of doing all this, and with less pain." Yes, there is a better way; and the first and most important way is for countries to run their policies better. You cannot run down your foreign reserves to zero—that is essentially what Korea did, very close to what Thailand did—and expect to emerge with little pain, unless the international community is willing to replenish your reserves and the amounts needed to service your short-term debt. I'm sure that $100bn given to Korea would have solved its problems better. But there's certainly no one around who wants to do anything like that even if they could. Nor if we did that for Korea once, would it be reasonable to assume that that would be the end of the story. That really would produce moral hazard.

But there is another question: "Can the international system be designed to run better?" Here I will have to be very brief on the question of what is becoming known as the institutional architecture.

To make the system run better—that is, to avoid crises of this magnitude and to reduce their frequency—we need, first of all, action on the part of countries. That means better macro-economic policies. It means understanding that actions have consequences; that if you're not willing to defend your currency, the markets will understand that and attack—and you will then be left with a much worse situation later. It means the strengthening of financial sectors all over the world—this is not a new theme, not something discovered in this crisis.

In the international system itself, let me mention five headlines which I could develop at greater length if there's time later in the session.

• First, further improve the provision of data. That is important for two reasons. Better data makes for better-informed investors. But in addition, this is less obvious, better data makes for better policies. Why? If the government of Korea or the government of Thailand had had to publish its off-balance sheet transactions—or, in the case of Korea, clarify what it was doing with its reserves—I do not believe that they could possibly have gone as far as they did with those transactions. We would either have had a crisis when the countries were in much better shape, or far more likely, they would have realized that they couldn't go down that path and would have done something better and less destructive for their economies.

• The second item is to improve IMF surveillance and make more information public. We watch countries closely; we see some crises (we saw Thailand); we didn't see the depth of the others. Making more information public is a very complicated issue. Management of the Fund believes that we could make more information public, if our members would agree to that, without necessarily creating the crises we seek to avert.

• Third, we need an international effort to improve the strength of financial sectors all over the world.

• Fourth, we need an international effort to improve capital markets all over the world. One idea getting a great deal of attention is to establish international standards—for
instance, for the quality of the banking system, for bankruptcy codes, for securities regulation, for corporate governance, for accounting—and to have these international standards monitored and to allow these standards to be used to guide investors and possibly (I think this is more important) to guide regulators in the countries which lend to other countries. That is a very complicated set of ideas; it would be very difficult to do; it is probably something that’s going to happen over the next few years.

- Fifth, a country liberalizing its capital account has to do this with great care—particularly on the short end. Vulnerability to short-term flows has been a factor in every one of these crises. There is a need for prudential controls on short-term inflows and possibly for other controls on short-term—but not long-term—inflows.

Those, briefly, are changes that are likely to be put underway in the international system in the coming months and years.

Finally, we need to find ways of improving crisis response. We in the IMF have done that in two ways. One is the Emergency Financing Mechanism. This enables us to get loans done in a very short time. It’s been used in all three of the Asian crisis cases. Second, we’ve invented, very importantly, something called the Supplemental Reserve Facility—much closer to a lender-of-last-resort facility than anything we’ve had before. It enables us to make very large loans at penal interest rates—350 basis points above LIBOR—to help countries to face a more short-run problem than is traditional. This has been used in the case of Korea, which received the largest and the shortest-term loan the IMF has ever made. It will be repaid between twelve months and three years after being made.

We need to work on the question of “bail-ins”—of how to get the private sector to share in the financial costs of dealing with crises because, as the scale of capital flows increases, the ability of the official sector to deal with them decreases. This is the most complicated of these issues. There has been talk of international bankruptcy procedures, of allowing countries to impose stays on payments. These are all worth exploring, but as we explore them, we have to bear in mind an issue that has been on the mind of the IMF throughout this crisis, which is contagion. If you bail in investors in one country—if, for instance, you tell those who have lent to Korea, “Congratulations, you are stuck for the next two years”—what happens to all the other countries around it, what happens to investments in those countries? How can you do this without spreading the crisis further?

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KIICHI MIYAZAWA

Understanding and Addressing the Asian Financial Crisis

1.

In a nutshell each of these countries failed in their national portfolio management of assets and liabilities. Deregulation of capital markets in these countries allowed massive inflows of short-term capital, much faster in the 1990s than the underlying rate of growth. Because of the region’s excellent economic growth record over many years, investors from North America, Europe and Japan were eager to invest in the region, often without careful research into the risks involved. Why did international banking institutions lend so heavily? They relied on rating companies such as Moody’s and Standard and Poor’s. These gave investment-grade ratings to many Asian companies. Korea had a higher credit rating than IBM. The banks did not believe they were at risk.
2. There were also eager borrowers. Keen to hold down costs, private businesses in Asia could borrow in dollars, taking on credits with short-term maturities, often unhedged. Much of this money went into long-term investments such as manufacturing facilities and property investments. The assumption of the borrowers was that the loans could be rolled over almost automatically.

3. Excessive and risky lending and borrowing might have been prevented had there been better monitoring institutions at either the global or national level. Generally, the developing Asian economies did not have adequate financial supervisory systems or dependable data and information about the money markets or the condition of borrowers. The governments concerned often did not know how much the private institutions had borrowed.

4. Another factor is that the currencies of many of these countries were pegged to the U.S. dollar. As a result, Asian exports gained competitiveness in the late 1980s and early 1990s as the dollar depreciated against the yen. But since 1995, the dollar has appreciated in value against the yen and European currencies. The dollar-pegged currencies became overvalued and the terms of trade deteriorated, yet central banks were unwilling to abandon their pegs. External shocks affecting their trade and current accounts included the devaluation of the Chinese yuan in 1994 and a drop in semiconductor exports in 1996.

5. Once market uncertainties were rumored, money fled the region. Local companies and individuals panicked and sought to move assets overseas. International banks wanted to reduce their exposure, demanding payments and refusing to roll-over loans. With much of their income in local currencies and their debts in dollars, local banks, investment companies, real estate enterprises and other businesses found themselves unable to pay their debts. And now no one was willing to lend new money. Interest rates had gone sky-high, creating a credit crunch.

6. In assessing Asia's future prospects, it should be remembered that these Asian governments had maintained favorable macroeconomic fundamentals. Growth rates and savings rates were high, and inflation was low compared to the Latin American countries. Nonetheless they experienced drastic and sudden falls in their foreign exchange rates in a very short time. In a way, the market's violent swing can be said to demonstrate the failure of the market.

7. It will be very difficult for the developing Asian economies to attract significant new investment for some time, except perhaps for the purchase of now undervalued assets. The financial crisis is thus generating new pressure on East Asian countries to export, especially to the United States, and their reduced currency values make them highly competitive. Like the United States and Europe, Japan also should expect to absorb increased imports from East Asian countries, but slow growth in the Japanese economy is depressing imports. Other countries, worldwide, expect Japan to stimulate its economy to absorb exports from these countries. Because Japan is an Asian country, its Asian neighbors have high expectations of Japan.

8. The Japanese Government has had several stimulus packages, and is considering sizable additional public expenditures and tax reductions. However, we should be realistic about the immediate impact of these measures in view of Japan's deep-rooted economic problems.

9. While Japan needs to do more to stimulate its own economy thus indirectly helping Asia, it is playing the role expected of it in direct-
ly helping its Asian neighbors, thanks mainly to its ample foreign currency reserves. Japan is the largest contributor to the IMF packages to Thailand, Indonesia, and South Korea, $19 billion in all. Japan is also ready, as agreed upon at the G-7 meeting in February, to implement such measures as expanding trade insurance programs and the rolling-over of existing credits. Japan’s Export-Import Bank is considering a several billion dollar loan program. Structural loans are being provided to Indonesia, and Japan will also be giving food to that country, which has also been hit by a severe drought. Prime Minister Hashimoto’s visit to Indonesia last week reflected the seriousness with which Japan takes the situation there and its concern about the possible impact of developments in Indonesia on neighboring countries such as Singapore and Malaysia.

10. These countries now exhibit differing degrees of difficulty. Some may see their currency and stock markets regain stability relatively quickly. However, political complications in Indonesia make this important country’s early recovery especially difficult. It is inevitable that the Asian economy as a whole will enter a deflationary phase.

Much depends upon what Hong Kong and China will or will not do in the near future. Hong Kong pegs the Hong Kong dollar to the U.S. dollar. Defending the peg has caused interest rates to rise pretty high, depressing stock and real estate markets. The Hong Kong authorities say that they will adhere to the U.S. dollar peg.

11. China faces an increasingly competitive export environment, since export prices of other Asian countries are being lowered in dollar terms. But the Chinese authorities, Prime Minister Zhu Rongji recently in particular, repeatedly made an explicit pledge that they will not devalue the yuan. China has issued and plans to issue stocks of their privatized state corporations in the Hong Kong market.

This practice will be affected by the present monetary and stock market situation in Hong Kong.

12. For these developing Asian economies to return to a high and sustainable level of growth, several additional conditions are necessary:

- First, in addition to restructuring their financial sectors, each of the affected economies needs a satisfactory level of financial supervision.
- Second, private creditors should work closely with governmental agencies and relevant international institutions on loan roll-over agreements as well as measures and mechanisms whereby they can restructure their debts, like converting short-term loans into longer-term instruments.
- Third is a stronger network of consultation and support that would include expanded swap agreements and repurchase arrangements among the governments and central banks in the area, including Japan.

13. Lastly, and I think this is the real purpose that we are discussing this problem today, we should consider the construction of a currency mechanism which will allow small and medium-size economies to cope with drastic currency upheavals like the one the Asian countries are experiencing now. Countries in Europe, the United States, and Japan should work together to develop effective means of resolving the current crisis and help prevent another one from happening again.

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...WE SHOULD CONSIDER... A CURRENCY MECHANISM WHICH WILL ALLOW SMALL AND MEDIUM-SIZE ECONOMIES TO COPE WITH DRASTIC CURRENCY UPEHAVALS...
Lessons of the Asian Crisis

When asked the meaning of the French Revolution, Zhou Enlai, China's erstwhile prime minister, is reported to have said, "it's too soon to tell." If so, it is far too soon to tell what the East Asian crisis means. Few people predicted anything like the turmoil that has followed the devaluation of the Thai baht last July. I was not among them.

If we are to design new policies and institutional arrangements that minimize the chances of disasters on this scale every two or three years—and I believe we should—it is necessary to ask what went wrong. I intend to pose three questions:

- First, who or what bears responsibility for the crisis?
- Secondly, was the international response, orchestrated principally by the IMF, in very close coordination with the U.S. Treasury, appropriate?
- Third, in what ways might the global financial system and the policies of vulnerable emerging countries be changed in the light of this crisis?

Who Bears the Blame for the Crisis?
The five countries most damaged by the crisis—Indonesia, Malaysia, South Korea, Thailand and the Philippines—had net private inflows of $41bn in 1994. By 1996, this had jumped to $93bn. Then, in 1997, the net inflow turned into an estimated outflow of $12bn. The swing in the net supply of private capital was $105bn in just one year, a staggering 10 per cent of the combined pre-crisis gross domestic product of the five economies.

Notwithstanding net official flows of $27bn in 1997 and $25bn forecast for 1998, combined current accounts are expected by the Institute for International Finance to shift from a deficit of $55bn in 1996 to a surplus of $18bn in 1998—a swing of about 7 per cent of combined GDP. If a comparably large shift were forced on the United States, its current account deficit of $148bn in 1996 would become a surplus of more than $400bn this year. Imagine the howls of pain this would cause.

Let us look a little more closely at how the underlying flows changed. Direct equity investment has been chugging along in a pleasingly stable manner. Flows from non-bank private creditors are stable too, with a net inflow of $18bn in 1996 and $14bn in 1997. Portfolio equity is more fickle, shifting from a net inflow of $12bn in 1996 to a similar outflow in 1997. The real villains are the commercial banks, whose net lending jumped from $24bn in 1994 to $56bn in 1996, before turning into net repayment of $21bn last year.

Furthermore, between the beginning of last July and their troughs, the Korean won lost 55 per cent of its value against the US dollar (by December), the Thai baht 56 per cent (by January) and the Indonesian rupiah 83 per cent (by January). Despite modest subsequent recoveries, the currencies remain hugely depreciated.

The question obviously is: What crimes, what mistakes did these countries commit to deserve so savage a punishment?

Look, for a moment, at Indonesia, with the eyes of somebody who did not know what has happened to it. This is a country whose current account deficit was less than 4 percent of GDP throughout the 1990s; its budget was in small surplus; inflation was below 10 percent; the ratio of domestic bank credit to GDP hardly rose. The banking system admittedly had mountains of bad debt, but foreign lending was largely directly to Indonesian companies. Yes, of course, there were structural flaws in Indonesia and the other afflicted countries, but there are also flaws in many which were not so affected. It is impossible for anyone to say...
these are figures for a country one would expect shortly thereafter to lose 83 percent of the value of its currency.

It is impossible to explain what has happened without looking closely at the international environment within which these countries have operated and, above all, the behavior of the capital markets themselves. In the international environment, relatively poor investment opportunities in Japan and continental Europe, low interest rates in industrial countries, the volatility of the yen/dollar exchange rate, the yuan devaluation, and the shift in the position of the semiconductor market—all generated economic instability; and some of these factors obviously fuelled the capital inflow. The capital markets, when they were euphoric, simply ignored bad news. And when depressed, they have simply ignored the good news. Either way, they have overshot wildly, and have destabilized the host economies in the process.

The greatest single benefit of openness to international capital markets as far as lending is concerned (I leave aside here foreign direct investment and equity flows) should be the opportunity to invest more in a country than domestic savings permits. This can only happen if there is an appreciable current account deficit. And the way a current account deficit emerges is, of course, a real appreciation in the exchange rate—which brings about a reduction in the relative profitability and competitiveness of the tradable goods sector, and just the sort of boom in the non-tradable sector (including property) that we’ve seen. So the crisis in which these countries find themselves is directly the result of the way their economies interacted with the capital markets.

This can also be seen by looking at the countries in the region that were not so badly affected by this crisis. If you compare the countries that have gone down with the countries and economies that have done relatively well—China, Singapore, Taiwan and Hong Kong—what you find in these latter cases is that all of them had gigantic currency reserves. To give you the figures, last October China’s reserves were $141bn, Taiwan’s $83bn, Hong Kong’s $79bn and Singapore’s $74bn. All of these are at least twice as large as the reserves of the United Kingdom. And none of these countries, leaving aside Hong Kong, has been running significant—or indeed any—current account deficits. The view of capital flows taken by these successful governments was just like President Bill Clinton’s view of marijuana: One can smoke so long as one doesn’t inhale.

So I conclude that:

- The policies of the world’s biggest economies bear significant responsibility for the onset of this crisis.
- The way capital markets behave played a significant role in creating and exacerbating the crisis.
- And, given the risks, one has to ask what purpose openness to global lending serves?

**Did the Crisis Receive the Right International Response?**

I have enormous sympathy with the IMF. It had an almost impossible task before it. It had to deal with a private sector debt-deflation fuelling—and being fuelled by—a currency collapse, itself being driven by a panic. Its theory was that the countries were suffering from a crisis of confidence which reflected deep financial weaknesses—themselves the result of structural flaws in their economies. The IMF approached the task by demanding, as Stanley Fischer has explained, a mixture of macro-economic tightening, financial restructuring and structural reform.

It is right and appropriate to question some aspects of these packages. I do so without suggesting that the world or the crisis would have been better off without the IMF—or for a moment that everything it did was wrong.

**Financial Restructuring and Macro-Economic Policy.**

The things we need to question on financial restructuring and macro-economic policy are as follows: First, the IMF demanded immediate closure of insolvent banks, which appears in some cases to have worsened—severely—

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the domestic financial panic. Secondly, the IMF demanded immediate re-capitalization of banks, which ineluctably forced a reduction in lending and a consequent tightening of the ongoing credit squeeze. Third, the IMF demanded a modest fiscal tightening—as Stanley Fischer explained—which tended to exacerbate the contraction already bound to follow from the inevitable decline in investment, itself certain to shift current accounts into balance, or surplus, as is indeed happening. And finally the IMF imposed credit ceilings and high real interest rates, both of which further aggravated the domestic financial crisis.

I’d like to pursue fiscal policy and interest rates a bit further here. On fiscal policy I remain utterly unpersuaded that there was any case for tightening. These were countries which had no or virtually no domestic public debt. OECD figures—which may be wrong—suggest that the Korean government’s public debt was minus 26 percent of GDP. That is to say, it had net assets. I see no reason whatsoever why a government in this situation needs to put any downpayment on the interest needed to recapitalize its financial system. It would have been perfectly simple to take the additional borrowing on the government’s balance sheet. The British government doubled its own public debt for much worse reasons in the early ’90s without any serious consequences. Fiscal policy could have been a supportive element in countries that had long had stable and prudent fiscal policies.

On interest rates, whether or not an interest rate tightening will strengthen the currency depends on the circumstances. I have no doubt that it was right to insist on high interest rates in Indonesia and Thailand. The problem remains, I think, with Korea. This is a country in which the main challenge was to persuade foreign banks which had lent to Korean banks and non-banks to keep their money in the country. They were not going to be persuaded to leave that money because domestic won interest rates happened to be 20 per cent in real terms. On the contrary, the obvious effect of such high real interest rates on the solvency of their borrowers would make creditors more nervous about the viability of their position. The right solution, found a few weeks after the initial IMF agreement, was a rollover by the foreign creditors. (A further problem with the high interest rate policy is that, ineluctably, it punishes those companies and institutions that have been prudent in their management of foreign currency in order to defend those who have been imprudent.) So, sometimes it is right to tighten monetary policy in order to defend an exchange rate, but it is not always right. We’ve had experience of that in Europe. At least in the case of Korea, the wisdom of the high real interest rates imposed was doubtful.

Structural Reforms. There are criticisms to be made of the structural reforms demanded by the IMF. As Stanley Fischer has explained, some were needed to deal with the underlying problems of the economies. But some of the structural reforms seem to have nothing to do with these weaknesses, or at least very little, and are very difficult to defend, particularly in present circumstances.

First of all, in the case of Korea—and I’m looking at the Korean program—there was insistence on significant liberalization of trade policy and the labor market, which seem to me to have little or nothing to do with the underlying weaknesses of Korea that generated the crisis. (The biggest weakness of Korea was its willingness to accept, indeed to encourage, this short-term foreign currency borrowing.) Second, some of the reforms amounted to further significant liberalization of the capital account when (an admittedly partial and incompetent) liberalization had just caused a catastrophe. Some of the reforms called for a fire sale of Korean assets at a time of maximum economic vulnerability and incredible cheapness. And, taken together, the demands as a whole inevitably appeared to amount to the suggestion—forbibly made—to transform the economic system in an Anglo-Saxon direction.
The question is simple: Is this what the IMF and the international community it represents is entitled to demand in such conditions of a serious sovereign government?

Conclusions. So my conclusions with regard to the international response to the crisis are:

- There have been significant difficulties with the IMF programs. They certainly didn't work initially as intended. That is in part because of the failures of governments to implement them, but not entirely so.

- Second, the macro-economic and financial restructuring packages have elements which are clearly questionable.

- Third, some of the demands for restructuring and reform go beyond what was needed to deal with the crisis and the structural flaws that led to the crisis. And they may lead to permanent and unnecessary resentment.

Lessons for the Future
I hope these countries will end up healthier in the end. I believe they probably will. But the traditional case—which I believed strongly—for complete liberalization of the capital account has to be reviewed. What are the options before us in this regard?

First, we can proceed with what I call business as usual. We can proceed with full capital market liberalization; add increased IMF resources; and strongly suggest to individual countries that they reform their own policies in all the traditional ways—improving macro-economics; eliminating distorting incentives to inflows of the wrong sort of capital; opening the financial system; introducing improved supervision and regulation and transparency. This is all very well as far as it goes, but I am convinced that in a world characterized by extensive term- and currency-transformation across borders, an inevitable feature of this world will be periodic crises of the kind we have just seen.

The second possibility, which would go some way towards avoiding that, is to move towards a much stronger global regime, with a much stronger lender-of-last-resort and, corresponding to that, much greater supervision of national policies. I think now that there is a strong theoretical case for such a regime; unfortunately it’s not going to happen.

Finally, since there will be no lender-of-last-resort and since there are profound problems with the way capital markets seem to work (and they are profound given the scale of the adjustment these countries are being forced to make now), then countries have to consider how to defend themselves. There are things countries can do to defend themselves:

- They have to try to limit the scale of the current account deficits they run, however attractive they may be.

- They have to keep foreign currency reserves on a substantial scale, ideally equal to the country's short-term foreign currency liabilities.

- They have to impose very tight regulation of the foreign-currency liabilities and assets of their banks.

- They have to be incredibly careful to avoid strong commitments to adjustable pegged exchange rates.

- They will have to control—or preferably tax—short-term foreign currency borrowing.

- They will have to make their economies flexible enough to cope with sudden changes in the availability of capital.

- And finally, they need a bankruptcy regime capable of protecting companies and facilitating the renegotiation of debt when companies are bankrupt.

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My conclusion is this: This is a crisis for the countries concerned and they made serious mistakes. There is not the slightest doubt about it. But the punishment they have received is vastly in excess of the mistakes they made. And the punishment was incurred as a result...
of their openness to global capital markets—which have proved themselves, yet again, unbelievably fickle. The IMF, faced with an almost impossible task, has on balance improved the situation. But some of the things the IMF has done are difficult to defend. Finally, we do have to rethink, very carefully, the link between emerging countries and the global capital markets. At the very least, each emerging country has to realize that, if capital markets take flight, adjustments may be imposed upon them of a scale which—to anybody in developed countries—must seem incredible. That is what is now happening in Asia.

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VICTOR FUNG

Hong Kong, China and the Asian Crisis

PREVIOUS SPEAKERS have provided a good macro view. I'd like to look at the problem from a micro standpoint, from the standpoint of a businessman in the region. I'll focus on what is happening in Hong Kong and in China, and then on more general statements about the entire crisis. In the process I will focus on the two issues which I'm sure are on everybody's mind: Will the Hong Kong-U.S. dollar link hold at 7.8 to 1? And will the renminbi be devalued?

Hong Kong

Let me start with Hong Kong. Perhaps the way to start is to say that the transition from British to Chinese sovereignty on July 1, 1997, went extremely well. For those involved in the transition, I think it went better than we imagined possible. We have come through a potentially very destabilizing process, with strong confidence in the economy and in the future. Indeed in Hong Kong at least, everything was absolutely rosy until after the World Bank-IMF meetings which we hosted in September last year.

We have obviously been affected by this economic crisis, but not as much as the other parts of Asia, primarily because our economy is unique. For this year, we are still looking at a real growth rate of three percent. And for an economy which has more than US$26,000 per capita income, I suppose we should really be quite happy with OECD-type growth rates. Also trade is to grow at about three percent for this year, which is very important. This is slower than we've been used to, but our main trading partners—the United States, the EU and China itself, which account for more than 70 percent of our trade—are in good shape. That is a very strong factor that will help maintain our growth.

Despite the fact our costs are relatively high, Hong Kong is able to maintain its competitiveness because of three factors:

- First, the economy is extremely service-oriented. Eighty-three percent of our GDP is derived from services. We know of no other economy in the world, except the United States, that derives as high a percentage of its GDP from services. If you analyze the services, about half are trade-related. So, the fact that our external trade is strong impinges on almost half of the economy.

- The second major factor is that we have an extremely flexible economy. Hong Kong is the world's seventh largest trading territory. We do almost $400bn of total trade every year. For six million people, that's fairly amazing. But the flexibility is perhaps best illustrated by the fact that this trade is not done by a small number of large companies. All that trade is done by about 300,000 small and medium-sized enterprises. Perhaps even more noteworthy is that of those 300,000 small and
medium-sized enterprises—SMEs—40 percent have operations in more than one location, so they operate transnationally. We know of no economy in the world that has as vibrant a sector among the SMEs—indeed, SMEs that are transnational in nature.

- The final factor, which you all know about of course, is that Hong Kong maintains its position as the premier gateway to China at a time when the Chinese economy is liberalizing strongly and very much being integrated into the world economy. I will say a bit more about that later.

The government in Hong Kong is absolutely resolved to maintain the peg at 7.8 to US$1. This link has served us in good stead through the political transition. Over the last fourteen years it has been absolutely a measure of stability not only for Hong Kong, and for China, but for the entire region.

We are able to do this because of the fundamentals in the economy I have mentioned above. The basic competitiveness of Hong Kong has been maintained. But at the same time we are buttressed by $98bn of foreign exchange reserves, which put us number three in the world—again noteworthy for such a small place.

Also, we have extremely well-managed fiscal policies. In fact, over the last ten years the Hong Kong government has run an average fiscal surplus of about 2 percent of GDP. In 1996 the budget surplus was an astounding 3.8 percent of GDP. Finally, because we are a very tight and efficient administration, we are able to take whatever measures are needed to defend the currency—in terms of increasing interest rates, etc.—with very little political constraint. A very good example was during the height of the first attack on the Hong Kong dollar. Our interest rates actually touched 300 percent at a certain point. It was described in the papers as a nuclear attack on the speculators.

Obviously, for the stability in the currency, the Hong Kong economy has to pay a price. What has been used as an adjustment mech-

anism, when you hold the exchange rate fixed, are asset prices. So property prices have fallen—in fact, they’ve fallen about 30-40 percent over the last five or six months. And the stock market—the Hang Seng index—has come down from 16,000 to 8,000 and is now recovering to about 10,000.

But this is a price Hong Kong is willing to pay. Not only is the business community very solidly behind us, but a recent survey of the population in Hong Kong—which is all-important—shows that more than 70 percent of the people in the street are supportive of this particular policy. I think we have all seen the abyss. Before we had the currency linked in 1983, there was a run on the Hong Kong dollar. And it was a scary experience. People have remembered that. The fall in property prices—from another perspective—may not be such a bad idea for Hong Kong, because it is a very important factor in the total cost of operating in Hong Kong and allows us, in fact, to maintain our competitiveness. And if you look back in 1996, property prices actually rose 50 percent. So over the long sweep of things, coming down 40 percent over the last six months isn’t such a big deal.

China

If we broaden the picture to the Chinese mainland, the first thing to note is that China is undergoing economic reform which, in our view from Hong Kong, is epic in proportion.

The real nub of it is that, at the 15th Party Congress six months ago, Chinese leaders decided to tackle head on the problem of state-owned enterprises. That particular part of the state-run economy has already fallen from 98 percent to 50 percent of the economy over the last twenty years of China’s economic opening. Beijing is now dealing head-on with the residual 50 percent. What is basically happening is that of some 340,000 state-owned enterprises (that are really controlled and run by the state), they have decided to back the top 1,000 into conglomerates and let the remaining 300,000 plus become completely

...CHINA IS UNDERGOING ECONOMIC REFORM WHICH IS EPIC IN PROPORTION.
subject to market forces. So they will have to merge, be acquired, or go out of business. The Chinese are really opening up the floodgates as far as subjecting these people to market forces is concerned.

It offers tremendous scope for businesses from Hong Kong and from around the world to participate. Hong Kong will benefit greatly, primarily because of two reasons: (1) In this economic opening, China will be using Hong Kong’s global commercial network—both to import the technology and equipment and so forth that is needed for this modernization, and to distribute the goods around the world. (2) At the same time, the Hong Kong capital market will be used to raise funds for this exercise, in debt terms, in equity terms, etc. Willy Purvis, the Chairman of the Hong Kong Bank, has forecast that the Hong Kong stock market will be the largest stock market in the world by the year 2015—up from its fifth position now. That is a very, very big claim, from a very knowledgeable person. On what basis is he saying this? It’s primarily on the basis that China will focus on taking its state-owned enterprises public—and raising hard cash through the Hong Kong market. Going public in the Shanghai stock exchange, another domestic market, will not raise hard currency.

The Chinese leaders have said repeatedly that the renminbi will not be devalued, not only because of their resolve but because it is backed up by $140bn of reserves and a huge trade surplus (which exceeded $40bn with the United States alone last year).

There are a number of very good reasons for the Chinese leadership not to devalue the renminbi. First, I think they want to emerge as a responsible member of the world economy. South East Asia now is troubled. If you go around the region and you ask the troubled economies what is their main solution for getting themselves out of trouble, it will be to increase their exports. The United States and EU should have some tolerance to absorb additional imports from this region, but maybe not that much. Their actual tolerance for a larger trade deficit may be slightly limited. So frankly, it is up to the two large surplus countries in the region—i.e. China and Japan—to take the more statesmanlike approach and share some of their trade surplus in order to restock the economies in Southeast Asia. This is certainly the view of the Chinese leaders, and their willingness to keep the renminbi high is in fact indicating their willingness to share some of that trade surplus. Indeed, I expect China’s trade surplus to be moving down over time.

This also has a very important side effect for the Chinese. It would de-escalate U.S.-China trade tensions and hopefully lead to a smoother WTO entry—which is very important from our standpoint.

In addition, I think a very important factor in the Chinese leadership’s considerations is that they do not want to affect the Hong Kong-U.S. dollar link. There is concern that any devaluation of the renminbi would also affect the link. That, of course, gets at the heart of the one-country/two-systems arrangement and Hong Kong’s autonomous status as an SAR (Special Administrative Region). If there is a financial crisis and the central government has to come in to actually help Hong Kong (they have indicated the willingness to do so if asked), that would give a very, very serious blow to the whole concept of Hong Kong’s autonomy. The Chinese leadership’s anxiety to preserve that particular policy makes them very careful about the devaluation.

I should add that from Hong Kong’s standpoint, I see no technical reason why the Hong Kong dollar should lose the link should the renminbi be devalued. There is no direct linkage. What people are concerned about is a general loss of confidence and hence further

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1 I think the trade deficits of the EU and the United States will increase in the short run not because of a flood of imports from the Far East, but because the ability of the Far Eastern economies to take imports from the United States and EU will be very limited. So we should expect a fairly drastic fall in exports to these countries, and hence the trade deficits of the United States and EU will increase.
pressure on the Hong Kong dollar. We went through this experience during the renminbi devaluation in 1993-94. It went down about 30 percent; the Hong Kong dollar link was completely untouched through that process.

There is a lot of talk around that there is a lot of pressure on Chinese trade and Chinese exports as a result of China maintaining the value of the renminbi. I don't think that is happening—at least not yet—and let me give you a view on the ground. Our family trading company is operating in 26 countries in the region. We are actually exporting from the whole region; we can see some of the movements. I can tell you, while the Indonesian rupiah might have devalued 80 percent, we are not seeing any substantial decreases in Indonesian export prices at all. In fact, the initial reaction was that Indonesian suppliers came in for a price increase. What is happening there, at least in the short term. If you give the Indonesian factories an order for garments, for example, the first thing they have to do is to buy fabric from abroad using foreign exchange—which they don't have—which is 60 percent of the total cost. Then they are paying interest rates of 35 percent plus. And then finally, even by the government's reckoning, there is going to be 20 percent inflation—and the locals think it's much higher than that. So, all in all, they have a lot of trouble marshaling their forces for much more competitive prices. And as a result, I don't think China is actually experiencing any pressure yet, at least in the light manufactured consumer products competing with Southeast Asia. Maybe in a year or so, as the J-curve effect proceeds and people switch more to local content and so on, we will get some more competitive prices, but not yet.

Maybe the only pressure that is coming right now is from the Koreans. The Koreans have actually translated the devaluation of the won into pretty competitive prices—in things like white goods. So there is some pressure at the top end of Chinese exports.

There is one more issue in maintaining the value of the renminbi. If you look at the whole situation from Beijing's standpoint, they are undertaking a massive internal reorganization and restructuring. In this process there will be a great need for a lot of imports of know-how, technology, for infrastructure development, and so on. It would be good for them to maintain a pretty high value of the renminbi so as to facilitate these very important imports during this immediate period.

Broad Conclusions
So my conclusion is this that China is now under very strong leadership. It is able to actually face up to its own problems. The problems are obviously huge, but I think the Chinese leadership is now comfortable enough to tackle some of the most basic and serious problems of the economy. And they will act responsibly—stimulating primary demand and holding the value of the renminbi. The question in my mind concerns the second engine of growth—when will Japan come into this particular equation? I certainly hope it will be sooner rather than later. I also see from a geo-political standpoint an ever-so-subtle—or maybe not-so-subtle—shift, for example in American policy, away from Japan and towards China. In a sense, we are now going into a period in which there is a real opportunity for us to build a very strong relationship between the United States and China—hopefully it will be a tripartite-type relationship among the United States, Japan and China.

I think the Greater China region—Hong Kong, PRC, Taiwan—will be the island of stability in this whole period of turmoil in Asia. Hopefully, if we are able to maintain the Hong Kong dollar and the value of the renminbi in this island of stability, the rest of the region will be able then to rebuild. Another way to put it would be that, conversely, if we lose the Hong Kong dollar link and the renminbi devalues, there will be all hell to pay for the rest of the region. I then see another round, if not more, of competitive devaluations in the whole region.

Out of all this it is becoming extremely clear that all of Asia...Continued on page 20
NARONGCHAI AKRASANEE

After the four opening presentations, the first comments in the discussion were from Narongchai Akrasanee, former Thai Minister of Commerce and a leading figure in Thailand’s financial sector.

I have looked at the situations in Thailand and in Southeast Asia very carefully over these several months, and come to the conclusion that the crisis is really due to the interaction, to use the word of Martin Wolf, between a very sophisticated international capital market and a very poorly developed domestic financial sector. If we believe that is the case, then we must do something about the international capital market, and at the same time we must help in the development of the financial sector of the developing countries. Otherwise we will continue to have casualties.

I have found that the international capital market is characterized by the following: First, there is too much money chasing after too few projects, all competing for high returns. Second, we have too many investment bankers. They are competing all the time to get mandates, to sell papers, to sell money, and to sell projects. Sometimes I ask them, what is your mission in life? They say, “My mission is commission.” All the time we have all these investment bankers making propositions to us to borrow money, particularly when we become attractive. This is what I refer to as “the beauty queen syndrome.” Never become a beauty queen. You face all kinds of temptations.

The third important feature of the international capital market is the dominance of the U.S. dollar. At the same time, in developing countries, we have very underdeveloped financial sectors. By international standards we hardly have any so-called risk-management instruments. And the authorities are not capable of managing capital flows of the magnitude that we have had in Thailand. I was in the government, and we thought that the central bank was knowledgeable enough to manage. The central bank was very independent. They would not allow any cabinet minister to know anything about what they were doing. So, as Stanley Fischer said, we defended the currency until we nearly died; and the government did not know anything about that until we had nothing left. Then the central bank had to tell the government.

With this kind of international capital market and a very underdeveloped domestic financial sector, when we opened the capital account—at the suggestion of the IMF and World Bank—suddenly we had this influx of foreign money. In Thailand in 1994 and 1995, we had a net inflow of US$20 billion—per year. That is more than 10 percent of the gross national product at that time, way above the current account deficit. So much money came into the country. We could sell any papers. It was said in Thailand that even toilet paper could sell in the international market as long as it had Thailand stamped on it. Then when the signs of problems started to show, suddenly
the inflow stopped. And then we had rapid outflows.

What's being done? When the central bank came to the government and said that we could not defend the currency anymore, we had to let go. Then it took us so long, so many weeks of deliberation, to make the decision to go to the IMF. Stanley Fischer is right; the decision to go to the IMF was the very last resort, because it was a very unpopular decision. We went to the IMF, and accepted the IMF package, particularly to supplement our reserves. We did everything that the IMF wanted. Now politicians in Thailand refer to "Father IMF"—the new title for the IMF.

Of the packages that we have had from the IMF, the first one was tough. But the second one, after three months, became much more reasonable. The IMF has a review committee, which allows a country to talk with them and then the package to change. At the beginning, we had to have a budget surplus of one percent of GDP; now we can have a two percent budget deficit. That is an example of how flexible they could become, if we behave.

We try very hard at the moment to earn and save as much foreign exchange as possible. Fortunately, from September until now we have had a trade surplus. And from November until now we have had a current account surplus.

So we might be able to get out of this within perhaps a year. We try to rationalize and reform financial institutions as best we can. At the same time, we offer assets for sale—of course there is some political repercussion here, because people think that we are selling the country to foreigners. We are considering going back to regulating capital flows—I do not think the public at this moment believes that a completely free flow of capital is good for the country. Finally, we are trying to keep the real sector alive, and that is the most dangerous issue. We do not know how many companies will still be operating after this crisis. That depends very much on how soon we can get out of the financial crisis.

So these are the things that we have been doing in the country. We should also look at this at the international level, and here the developing countries will not be able to do very much. Tbilatateral countries can do a lot. I was pleased that Stanley Fischer talked about it, that Martin Wolf talked about it. I hope people in this room will support the idea of really doing something about the international capital market.

Finally, I would like to urge the meeting, the international community, to look at Indonesia. There is an urgency about the Indonesian crisis, because Indonesians do not have a currency and financial crisis only. They also have a food crisis and they have a political crisis. If the international community does not appreciate this, we will have catastrophe in Southeast Asia. I very much hope the world can understand the Indonesian situation and have some kind of program to help Indonesia.
is not the same. Asia is not one big homogeneous blob. There is a need to discriminate between the economies that are doing well and the economies that are not doing not so well, and the good companies and the bad companies within the economies.

For example, although the Hong Kong market has been rocked around in this crisis, we have been very, very fortunate and proud of the fact that we provided liquidity and tremendous depth of liquidity throughout this period. When the fund managers said, "Sell Asia," where do you think they took the money from? It's from the Hong Kong market. Although it's hurt us in the short term, you might say, I think we've made our mark in the long term—and one has to distinguish between the ability and the lack of ability to do so. Prudential supervision in Hong Kong has also stood the test. I don't know whether you noticed that, in this crisis, we lost one of the largest investment banks in Asia. It went under. I think it made news for three days in Hong Kong. The market absolutely took it in stride. Things like that don't happen if you are not fundamentally strong. So although we are in the eye of the storm, so to speak, and asset prices are dropping very fast, I look at that, frankly, as a long-term advantage. The speed of adjustment, to me, is a measure of the efficiency of the economy, the lack of stickiness in the adjustment mechanism.

One final thing: There is obviously a need to think about how we move forward from this point in Asia. I take the point whether Asian economies, as we develop, can afford to fully liberalize so quickly, especially with regard to short-term financial flows. I must say, as a lifelong free trader, it pains me to have to face this fact. But we in Hong Kong have to now face this particular reality. You can't just liberalize and liberalize without thinking hard about some of the consequences, especially in the financial market, and especially as it relates to short-term financial flows.

Victor K. Fung, based in Hong Kong, is Chairman of the Li & Fung Group, Chairman of Prudential Asia, and Chairman of the Hong Kong Trade Development Council.

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JUSUF WANANDI

Also commenting in the discussion was Jusuf Wanandi, Chairman of the Supervisory Board of Indonesia's Centre for Strategic and International Studies, based in Jakarta.

MY STORY is a little more gloomy than Narongchai's since both Korea and Thailand have laid down some base and are starting to turn around. We in Indonesia have still a long way to go.

In general in Indonesia, the role of the IMF has been accepted and is considered positive. You can argue about some aspects of their policies, but I think we need the IMF to re-create trust and credibility for government policies. The deal that we have agreed with the IMF should be accepted or not by the Indonesian government in the next week or so. I think the IMF is willing to be flexible on some aspects of the agreement, such as on subsidies for food and energy. It is very critical that the government accept this deal, because without this deal there is just no base for the government to be able to create trust and credibility again.

If they do agree, I think the government and the Indonesian people will be able
to muddle through for some time, with international help. The government also has to be nudged, with the help of the international community, to do some political reforms. Without more flexibility and opening of the system it will be very difficult for the government, even with the IMF deal, to create stability and development again.

If the government is not going to accept the deal with the IMF; then trust and credibility cannot be restored, and a meltdown of the economy is a real possibility, which means hyperinflation, the sinking of the real economy now already at a standstill, and a lot more unemployment, along with food shortages because of the long drought, the most severe in one hundred years.

If there is no base of a solution for the economy—the start is the IMF deal—I do expect that political upheaval could not be prevented in Indonesia. The middle class has almost given up their hope for reforms under this government. The students have been agitated. People are angry and desperate. I think we are in for a very critical period of six months to one year. The military at this stage is still united, but if there is a political upheaval and it becomes a cathartic event, then there is no certainty of unity any more in the armed forces.

Some nationalism has been stirred, of course, in response to this crisis. It is such a sudden crisis that has definitely come as a result partly of the opening of the economic system and of the globalization process. But on balance, the international community is still seen as having a vital part and an acceptable part in the development of Indonesia, in general among the elite.

I have to admit that the future is gloomy. As I said, the next six months to one year will be very critical. There is an effort on the opposition side to organize a grand coalition consisting of Megawati from the PDI (the daughter of Sukarno), the two biggest Muslim organizations in the country, some very respectable ex-generals, and some Christian groups, to be able to give an alternative in the medium term to this government. But inevitably suffering is going to increase before it will be better.

In the medium term, a better light can be put on the development of Indonesia. We still have some good fundamentals to start anew. Philosophically, we have to see this as part of the maturing process of the nation. We have gone through crises before and we have been able to overcome them. We have learned a lot in this crisis. We hope to have a better and much more balanced model of development to follow in the future—more inclusive, more attentive to sustainable growth, and with political development as a very important part. I hope that in the longer term, like the Latin American countries, we are going to come out leaner, stronger and more democratic.
SECTION 2
ADVANCING COMMON PURPOSES
IN THE BROAD MIDDLE EAST

This section presents excerpts of the essays prepared for the Middle East session of the Berlin meeting by Robert Pelletreau, Reinhard Schlagintweit, Yoshiji Nagami and Dominique Moïsi. The essays have been published separately in a brief volume entitled Advancing Common Purposes in the Broad Middle East.

ROBERT H. PELLETREAU

European-American Cooperation in the Middle East

In this time of uncertainty and stress, when little seems to be working, it is understandable and perhaps even fashionable to emphasize the differences in approach between Europe and the United States. Our press is full of the themes of containment versus engagement, sanctions versus free trade, D'Amato versus Total, Washington's monopolization of Arab-Israel peacemaking versus European co-direction....On the eve of the 21st century, the interests and purposes of Europe, the United States and Japan vis-à-vis the Middle East are broadly parallel....Within these broad purposes, I would submit, our differences are nuances, a different ordering of priorities among crosscutting interests, or an overflow of the competitive instincts of our largely capitalist economic systems.

The Middle East Peace Process
As the American diplomat who conducted the U.S. dialogue with the PLO in 1988-89 and participated in the productive peacemaking period between the Madrid Middle East Peace Conference in October 1991 and the indefinite suspension of talks between Syria and Israel in early spring 1996, I must confess to deep disappointment and a sense of lost opportunity in viewing the current landscape of mistrust....The combination of impasse in the region and constraint in Washington raises the question of whether a more direct European role might move the process forward. It is worth considering....But Europe, too, may have its constraints....

Iraq
As if the peace process weren't bleak enough, the latest defiance from Baghdad poses an acute challenge both to the region and to the West....Looking toward the future, more thought should be given to the kinds of help a successor regime would need to rebuild the country and reknit it together after this dark and disastrous chapter in its history. The unity and territorial integrity of Iraq are important to regional stability and must be preserved. Vindictive, Versailles-like reparations must obviously be avoided because they would only contain the seeds of future conflict....The bottom line, of course, will be an Iraq at peace with its Gulf neighbors and not a daily threat to their security and stability.

Iran
...In the United States, influential voices have begun to be raised in circles close to government pointing out the shortcomings of a unilateral containment policy....Within this context, a minuet of reciprocal gestures is currently taking place between the United States and Iran....U.S. policy, especially when tied to legislation, changes slowly, like the turning of an ocean liner. But absent some new act of terrorism or aggressive conduct from Iran, the path to a gradual normalization is now engaged

* * *

Faced with continuing multi-source turbulence in the Middle East, I believe that dif-
ferences between Europe and the United States have lessened as consultation has increased and appreciation grown for the broad areas of common interest and common values between the two. The positive contributions of the European Union special envoy to the peace process and France’s role in helping prevent sudden escalation in South Lebanon have lessened Europe’s feeling of exclusion from Arab-Israeli negotiations. In like fashion, increasing U.S. interest in establishing its own critical dialogue with Iran has softened its criticism of Europe’s critical dialogue even though differences remain about the usefulness of economic pressure in securing policy modifications in Tehran. How to handle the “Total deal is now more of an internal American problem than a U.S.-French one. For Japan, however, the challenge of balancing its vital long-term energy interests and its close cooperation with the United States on Middle East issues remains acute. Saddam Hussein is regarded as a villain in all Tri-Ratral Commission capitals. We agree that UN resolutions on Iraq must be respected, and we all recognize the dangers of his weapons-of-mass-destruction programs. The need to mobilize and be prepared to use force as part of our overall diplomatic strategy is more strongly supported in Washington and London than in Paris, Tokyo and Moscow, but a foundation of common interest exists. To sum up, a joint approach to the challenges facing us in the Middle East is superficially attractive, simplistic and unrealistic. Let Japan, Europe and the United States benefit from their diversity, keeping it within the broader framework of their common interest, and discipline themselves to the desirability of greater consultation, complementarity and cooperation in their dealings with this vital region.

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R E I N H A R D S C H L A G I N T W E I T

Positive Approaches to Iran and Iraq

I WOULD LIKE to shed light on developments in Iran and Iraq, where European and American opinions still tend to differ. Both countries are important Middle Eastern powers. Both strive to be regional, even Third World leaders. It is my thesis that Europe and the United States—-I do not know enough to write about Japan—could help in turning these countries into more responsible modern societies. To antagonize them, as we largely do now, is counter-productive.

Yet Iran and Iraq are fundamentally different, and should be treated differently. Iran, with its Islamic revolution, has created a new identity for itself; it corresponds with a region-wide trend to replace failed ideologies like socialism and nationalism with politicized Islam. It now sets out to correct excesses and artificialities of religious rule in response to demands of a new, post-revolutionary middle class. As part of this process, Iran tentatively starts opening up to the West, even to the United States, offering possibilities of cooperation and exchange. Nevertheless, Iran will in the foreseeable future maintain Islam as the basis of its identity, as well as Third World opposition to Western political and cultural dominance.

If the West could neglect Iran’s anti-imperialist rhetoric and build up economic, cultural, and political ties, it would reply to a great interest in the emerging bourgeoisie, and encourage the gradual opening up of Iran’s foreign policy. Iran’s submission to NPT controls and its signing of the Chemical Weapons’ Convention can be taken as evidence that it is able and willing to move in that direction. A positive Western policy towards Iran could

…IRAN TENTATIVELY STARTS OPENING UP TO THE WEST, EVEN TO THE UNITED STATES...
also favorably influence the security situation in the region.

Iraq, on the other side, exemplifies a cruel Third World dictatorship. Saddam Hussein's aggressive policy steered Iraq into isolation and enmity with the civilized world. This conflict earned Iraq the sympathy of underprivileged, disadvantaged populations in the Middle East; although in reality non-religious and secular, it attracts the acclaim of anti-Western Islamic fundamentalists in the region.

Both Iraq's autocratic rule and the international embargo have prevented any evolution of its people towards a more modern, participatory society. The middle class is perishing together with parts of the non-traditional economy. It is questionable to what extent Iraq's population supported Saddam Hussein's attacks against Iran and Kuwait. But seven years of UN sanctions have bred a feeling of injustice and revisionism shared now by large segments of the society. Continued isolation and foreign control will exacerbate this dangerous popular mood; their relaxation, however, could lead to new threats towards neighbors or towards Israel.

It is nearly impossible to find answers to this dilemma. There is no valuable remedy in sight but to continue containing and weakening Iraq's aggressive apparatus. It should be carefully examined, however, if those measures could not be limited to the military field, and supplemented by a more forthcoming economic, cultural, and social policy. A graduated positive approach could encourage the development of a middle class, including, in the longer run, moderate, if not oppositional, trends in Iraq's population.

...SEVEN YEARS OF UN SANCTIONS HAVE BRED A FEELING OF INJUSTICE AND REVISIONISM SHARED NOW BY LARGE SEGMENTS OF THE SOCIETY.

YOSHIKI NOGAMI

Keep the Peace Process from Dying

A FAMOUS ISRAELI author, Amos Oz, once told me that he prefers Anton Chekhov to William Shakespeare. In Shakespeare's plays all the protagonists, claiming they are morally right and their opponents morally wrong, die on the stage in the end. In Chekhov's plays nothing dramatic happens. People wine and dine and are distrustful of each other, but they still live. That's why he prefers Chekhov to Shakespeare. Unfortunately, it will be years before the people in the region acquire a taste for Chekhov.

Until such time, we in the Trilateral areas need to build a mechanism so that the peace process does not die. This is my main point. Unfortunately, the Oslo Accord—which looked absolutely fantastic when we first saw the outcome—does not have such a mechanism. When players change, when the mood changes, as long as there is no life-supporting mechanism, the whole process will be affected. And this is what we are seeing now....

The Madrid/Moscow architecture did provide for such a mechanism in the form of concentric circles, with multilateral negotiations in the outside circles and bilateral negotiations in the center. The lesson to be drawn from the experiences of the past two years is that we cannot yet leave the process of confidence-building to the two direct parties. The concentric circles need to be rebuilt—at least to keep the process alive and prevent further degeneration of the situation. Here are roles for the Trilateral governments plus, possibly, Russia. The United States will take the leadership role in keeping the process from dying, but there is much that Japan and the European Union can do to strengthen the process of con-

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fidence-building. We have to have a series of layers of confidence-building measures surrounding the core political dialogue between the two direct parties....

Efforts on the part of Japan and the EU to sustain economic assistance to the Palestinians are crucial. At the same time, more critical dialogue between the European Union, Japan and the Palestinian Authority on more effective programming and administration of aid is sorely needed. Frankly, EU assistance to Palestine is too widely scattered, while Japan needs to increase its direct assistance instead of distributing it through the multilateral institutions. Economic assistance to the Palestinians is also a vital instrument for confidence-building between the Palestinians and Japan. While the European Union should worry less about its visibility, Japan should try to be more visible. Furthermore, aid coordination between EU and Japan, the largest and second largest donor respectively, is apparently non-existent. This must be rectified....

What we learned from the experiences of the past two years is that the development of the process from the end of the Gulf War up to Oslo was in fact too good to be true, and that the peace process will require a long period of endurance and nurturing. What is vital at this stage is to send out a loud and clear signal—to the people in the Palestinian streets and to ordinary Israelis who tend to be somewhat complacent with the status quo—that we are deeply concerned with the current state of the peace process. President Clinton should perhaps visit the region.

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DOMINIQUE MOISI

Europe in the Middle East

It is not because America today seems to have less—or less efficient—clout in the Middle East that Europe’s cards are automatically strengthened....Europe’s means of action have not increased as a result of Washington’s lack of breadth and imagination....The evolution in the region itself is calling for a greater involvement of Europe....

Europe cannot afford the luxury either to rely solely on the Americans or to specialize in criticizing them from a position of strategic backbenchers. We can neither ignore our own limitations—which are due as much to objective reality as to subjective factors—nor simply look passively at the region....I am therefore advocating a new combination of modesty and ambition in the definition of Europe’s role in the region....

Europeans are not in the front row in strategic responsibility; but they are in the front row in geography, in terms of vulnerability. If the Europeans do not concern themselves with the Middle East, Middle East violence can very well spill over to Europe—not to mention our dependency on oil. If the Middle East is domestic politics for America, it is historic responsibilities for Europe. Morally, Europe is responsible for the Middle East problems on two distinct counts: colonialism and anti-Semitism. The former gave rise to Arab nationalism, while the latter, culminating in the Holocaust, opened the way to the creation of the state of Israel. Being responsible for the problem, Europe should be at least part of the solution.

Europe has specific cards to offer beyond sheer economic clout—which is impressive. The European Union is, in this regard, the most important actor in the region. More than two-thirds of Israel’s trade is made with the Union. Without the Union’s financial aid, the Palestinian Authority would have ceased to exist. Europe may understand better

IF THE MIDDLE EAST IS DOMESTIC POLITICS FOR AMERICA, IT IS HISTORIC RESPONSIBILITIES FOR EUROPE.
than the Americans the importance and difficulty of creating a proper dialogue with the Muslim world. In three of the leading European countries—France, Great Britain and Germany—Islam is numerically the second religion by far. Given its own nationalist and ethnic demons, Europe can contribute its understanding of tragedy and its model of reconciliation with itself—symbolized by the Franco-German couple. Also, because they are not the main geo-political actors, the Europeans can be more open—and call a spade a spade. But they cannot do it by neglecting their own image, which is, in itself, part of current reality. For the Arab side, the Europeans are a useful counterweight to the Americans and are mainly perceived as potentially useful in their ability to marginally apply pressures on Washington. Europe should not neglect the fact that in Israel its image is still characterized by a combination of the following words: irresponsibility, partiality, greed, and, in the end, impotence (“Europe, how many divisions does it have?”)...

By realizing that their policy can only be complementary to that of the United States, Europeans have learned a lot in the last twenty years. They know that their only card is to be pro-peace, and not to balance a too-pro-Israeli U.S. position with a too-pro-Arab European one....

In concrete terms, what can Europe do?...To concentrate on concrete actions aimed at making the lives of the Palestinians less difficult is a must. To contribute to a peaceful solution in Southern Lebanon, where even the Israelis are asking us to play a role, is also welcome. But that is not enough. From the height of its relative strategic impotence, and from the height of its real economic and financial clout, Europeans should state repeatedly what they see right and what they see wrong. They have a moral responsibility—much more, from that point of view, than the Americans. It will be a difficult and unrewarding task which will presuppose on the part of the United States some understanding and openness.

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...Their only card is to be pro-peace, and not to balance a too-pro-Israeli U.S. position with a too-pro-Arab European one....

SEC T I O N 3
MEETING THE LEADERSHIP CHALLENGES OF THE 21st CENTURY

Y O I C H I  F U N A B A S H I

Japan: Beyond Leadership Crisis

Can Japan Lead?

Many members have raised the question: Why has Japan not played a leading role in the recent Asian economic crisis? In more general terms, what is the nature of Japan’s leadership crisis? I will try to answer those questions in my presentation.

Japan’s economy is four times as big as China’s. Japan overtook the United States as the largest provider of aid to the region in the 1970s and has remained the largest donor (its disbursement of grants and concessionary loans to Asia in 1995 was 15 billion dollars). It is the world’s largest creditor nation. Japan has committed the largest part of the IMF’s bilateral bailout packages to the region in the recent crisis. Unfortunately, its economy has yet to either rebound or absorb more Asian exports. Japan does not help Asia when Asia is in crisis—this is the first and most important part of the perception of Japan’s failure to lead.

This crisis is very different from the one Japan faced in the Gulf War, one of the most serious crises Japan faced in the post-war era. (The Korean War in 1950 and oil crisis in 1973 were others.) At that time, the debate revolved around collective defense, in which Japan was inhibited from engaging under the Constitution. The issue was how to contribute to a war effort in a peaceful manner, and Japan could not make up its mind what to do.

This time the issue is the economy and the scene is in Asia. It is familiar ground. Yet, Japan
has not engaged dynamically. Japan let the United States lead the way on the Korean bailout even though Japan is more heavily involved in finance and the economy in Korea. Korea long has modeled its economic development after Japan. This could be the beginning of a radical departure from that pattern, and a turning to the American model.

In the meantime, China has demonstrated that it is Asia’s country of last resort by holding the value of the Renminbi, China’s currency. Li Ran-qing, China’s vice premier recently said that China will not devalue its currency because “China has a responsibility to do so for the sake of Asian stability.”

China recently announced several hundred billion dollars of pump-priming measures to boost its economy. In contrast, Japanese political leaders seem to have only talked up the markets. U.S. Trade Representative Charlene Barshesky said China “understands the importance of stimulating domestic demand better than Japan.”

China looks beyond its narrow national interests while Japan is preoccupied with its own political problems. China is now an Asian leader, while Japan is a second fiddler—this is the second part of the perception of Japan’s failure to lead.

The new perception, if not new reality yet, must be hard for Japan to face. Japan has been the predominant Asian power and has never been challenged since late 19th Century. It had already become one of the five leading powers by the time of the Versailles Treaty after World War I. It aligned and solidified its privileged status in an alliance with the United States after it was devastated in World War II, while China discarded its more natural position as America’s No. 1 partner in the region and challenged the new order. New challenges from China, in the long run, could determine Japan’s course. The U.S. response to them will be decisive.

**Immobility of the Political System**

Leadership-shy Japan is nothing new. Japan has not felt comfortable with a leadership role in the post-war era. It has found a follower-ship role easier. Even when Japan took the lead, such as in the inception of APEC in the late 1980s, it was careful not to be seen in the vanguard and was content with Australia getting the credit for being the father of APEC. One Australian scholar termed this Japanese way as “leadership from behind.”

Japanese themselves often tend to believe that this may have something to do with the genes in the body politic of a society noted for punishing the person who stands out and suppressing differences. A well-known Japanese proverb in foreign countries is: “a nail which sticks above must be hammered down.” Former Prime Minister Yasuhiro Nakasone’s flair for “differentiation” and showmanship has never been popular in Japan. Nonetheless, it is not a gene but an environment which hinders Japan from leading.

Perhaps Japan does know what to do but not how to do it. The formula for an economic stimulus package has been in the cards for some time. Yet, the political leadership has not managed to sell it to the markets well. The procedure-oriented relationship between the government and markets has long abhorred “surprise” from either side. Japanese mandarins are geniuses at anticyclimaxing the climax. They also have a poor sense of timing. The longer Japan has procrastinated to take decisive action, the more costly it is.

Japan also sensed keenly that the Asian economic crisis would bring contagion very early through the whole region. The Ministry of Finance came up with the idea of an Asian Monetary Fund in the early stage when it first faced the Thai crisis. This idea was effectively blocked by the U.S. Treasury. Japan’s move was met with suspicion as a disguised attempt to form an Asian bloc or yen bloc. Insufficient macroeconomic policy coordination and poor adjustment of their respective Asian policies between Tokyo and Washington in the past several years, in no small part, caused the discrepancy.
Prime Minister Hashimoto's recent visit to Indonesia clearly was designed to demonstrate that Japan is still a player. It is reported that Hashimoto tried to cajole President Suharto to accept IMF-prescribed reforms. Although this visit was welcomed particularly by reform-minded Indonesians, it was seen as tactical rather than strategic, reactive rather than proactive in Washington, D.C., and Hong Kong. Hence the much heard criticism of Japanese decision-making: too little, too late.

The immobility of Japan's political system, to a great extent, hinders Japan from taking bold action in a timely fashion. The long-time dominance of the bureaucracy and its compartmentalized structure of feudal fiefdoms, ritualistic and time-consuming consensual decision-making processes, and bottom-up rather than top-down initiative are constraints on decisive action and strong political leadership. The coalition government which the LDP has formed in the past four years has exacerbated the situation by further complicating and compromising the process.

**Populist Politics**

More fundamentally, policy priorities have drastically changed and the politicians simply follow the wind rather than lead or transform. People do not give high priority or attention to traditional foreign policy any longer. Instead, the public's main concerns are now job security, medical bills, pensions and crimes in schools. They are more inward-looking.

And they are more intolerant. They are prone to indulge in a blame game—who is to be blamed for this economic mess? The bureaucrats, particularly Ministry of Finance officials, are the primary targets. Prime Minister Hashimoto chose a former prosecutor as the Minister's top deputy after MOF officials were arrested for bribery charges last month. The whole elite class in Japan's financial establishment has been indiscriminately attacked. A season of populist politics has arrived in Japan.

The politicians let the bureaucrat-bashing go on unfettered. In fact, they encourage it. After all, it is their mismanagement of the economy—the bubble and its bursting—which caused Japan's downward spiral and lackluster image in the world. They have found it expedient to shift the blame from themselves to the bureaucrats. Moreover, they have to inject huge amounts of public money into the banking industry to bail out the debilitated banks. Bureaucrat-bashing is a political prerequisite for the public nod to the bailout plan. To some extent, MOF and BOJ have been made scapegoats.

These populist politics have not convinced the markets that the politicians are serious about the economy.

The root cause of these populist politics in Japan is that people fear adversity and uncertainty. They fear the erosion of Japan's economic prowess, dissipating economic dynamism, missing the bus of the third industrial revolution (such as telecommunications, information and financial services), challenges from China, and, perhaps most critical among all, the effects of being the most rapidly aging society in human history.

Japan is still a country of high savers. Personal savings in Japan total eight trillion dollars. Japanese save almost twice as much as Americans. Yet, the Japanese economy has not rebounded because people do not spend enough. Some economists predict that half of the forthcoming personal income tax reduction will go straight into savings. When personal consumption is most needed, Japanese still save because they fear the future.

Japan's psychological contraction is dangerous not only for its dampening effects on the economy but also for its destabilizing impact on the world scene. The widening gap between the Japanese people's diminishing view of themselves (hence, more inward-looking focus) and expectations on the part of other countries from the still-number-two economy in the world is not conducive to the world economy's progress and regional stability.
Political Reform and Economic Reform
Japan’s economy will not revitalize fully without economic reform—deregulation and liberalization. The system is too entrenched in the close-knit network which stifles new entrepreneurship and new opportunities. However, economic reform cannot take place effectively without political reform. This sounds like something we might say about China, but it is manifestly true of Japan: Without economic reform, no political reform; but without political reform, no economic reform.

It is highly unlikely that the political system will change much unless, for example, the heavily subsidized agricultural and fisheries industries are drastically rationalized. It is equally unlikely that economic reform will thoroughly progress unless, for example, the prohibitively costly barriers to new aspirants are removed and new blood infused into the political and electoral system.

People do not seem to believe in the politicians’ will and ability to carry out economic reforms. They suspect that politicians are beholden to the vested interests which resist reform.

Prime Minister Hashimoto tried to address these long-overdue issues last year. In principle, he aimed to establish accountability and transparency of governance and smaller government. So far, this reform effort has not produced much. It failed in downsizing the government and is criticized for just shuffling and reshuffling government agencies.

One of the reasons why Hashimoto’s reform has not succeeded is its lack of ideological thrust. It is a striking contrast to the Nakasone era. That was the era of the neo-conservative movements of the 1980s. Anti-labor and anti-communist Cold War politics still meant a lot. Prime Minister Nakasone could skillfully mobilize nationalistic sentiments and symbols—a high profile in G-7 summits for example—to get Japan committed to an internationalist agenda and policy. Nakasone’s reform was a combination of political dynamics, of internationalism and nationalism.

Prime Minister Hashimoto is not so lucky. He cannot resort to the same rhetoric and symbols. Anti-communist ideology is passe. Glorification of markets is politically risky in Japan as “Anglo-Saxon” globalization and global standards are seen as a new threat—not only to Japan’s economy but also to the value system in Japan and Asia.

The Hashimoto government is a coalition with the former socialists and its political tone has to be “kinder and gentler.” Japan, with its stagnant and precarious economy, has to take the weaker and more vulnerable segments of society more seriously. It has to pay attention to their needs and sentiments. The resistance to dynamic economic reform becomes stronger and stronger as Japan’s economy becomes weaker and weaker.

People are increasingly frustrated with the weak leadership but at the same time they are more protective and defensive and even seem to fear strong leadership for change. Complacency and fear are at the core of the Japan problem. People are nervous and losing confidence in themselves. Still they are better off by world standards and do not want to lose the fruits they have acquired.

It is critical for Japan’s political leaders to show the way, inspire the public and restore confidence. People want to hear sincere words, from leaders they can trust. Something like: “We have nothing to fear but fear itself.”

Geography and History
Japan’s leadership crisis is also a product of the drastic change in the international environment in the past decade. Its leadership structure was gradually shaped and deeply linked with the Cold War structure. The U.S.-Japan alliance was cemented by the Korean War; Japan’s leading position in Asia came as a result of China’s constant turmoil, instability and poverty; domestic political stability was buttressed by the LDP’s de facto one-party rule and cooperative and often collusive relationships within the “iron triangle” among the political class, business elite and mandarin bureaucracy.

With the wisdom of hindsight now, its sys-
tem perhaps worked too well for Japan. Japan is paying the price for its past success as success now demands change. It is always hard to change the formula and habits of success.

It is particularly difficult when there is lack of Gaikatsu (outside pressure) on Japan to change. The famous Gaikatsu formula is losing its magic. The United States, the premier source of Gaikatsu in the past, is now more tempted to spend its time and energy on opening up booming China’s markets instead of on time-consuming and constantly frustrating efforts with Japan—or to delegate the role to the IMF (rather than to USTR) with its conditionality leverage.

Japan’s slowness of coming to grips with the rapidly changing post-Cold War world has resulted in Japan missing golden opportunities in foreign policy: (1) It could have made a deal with Gorbachev on the Northern Territories in April 1990 when Japan’s economic power was at its zenith. (2) It could have effectively tackled the Gulf War if Japan had defined its new and internationally compatible power—i.e., global civilian power—more articulately and exerted it effectively. (3) It could have cemented its relationships with its neighbors, China and Korea, much more firmly, particularly after the emperor’s historic trip to China in 1992, if Japan would have pursued more vigorously a policy to address the history issues. (4) It could have taken a lead to cope with the Asian economic crisis if Japan would have mobilized APEC. Or the crisis could possibly have been avoided if Japan would have investigated thoroughly, then disclosed and shared with fellow Asian countries its analysis of the root causes of its bubble and burst, which started several years earlier.

Japan now finds more difficulty in expressing its power. The breakdown of the concept of the West and fulfillment of the mission of the G-7 trilateralism of the Cold War era has deprived Japan of the major international forum for its power expression. The entry of Russia into the G-7 and Japan’s initial resistance to it, the rise of regionalism and Japan’s sense of alienation from the EU and NAFTA, the bubble and burst roller-coaster seen by the public to be caused by G-7 pro-dollar policy coordination, and the “cash dispenser” image of Japan and resentment at having “taxation without representation” imposed on it in G-7 burden-sharing diplomacy in the Gulf War—all these have contributed to weakening public support in Japan for the G-7.

Japan became more interested in and instrumental in pushing for regional institutionalization and integration in Asia Pacific. However, Japan has been forced to realize its constraints. China is resistant to allowing Japan to play a major political role. Korea is reluctant to embrace Japan’s leadership. In both cases, the legacy of history still is a major impediment. Japan’s hesitation and clumsiness to commit itself during the Gulf War crisis was, in no small part, due to deep suspicions and opposition from China and Korea, concerned about opening the way for a Japanese military role in the region. Japan’s insufficient and ad hoc efforts to come to terms with the past during the Cold War era have begun to tax Japan.

Japan’s timid responses to the Korean financial crisis, in a way, reflected the psychological barrier about its former colony. Japan simply did not seem to know what to do with Korea. It feared being seen as either a “savior” or a “deserter” of Korea. For Japan, the least agonizing way to help was to follow the U.S. lead.

With the decline of the G-7 and difficulties of institutionalizing the regional framework, with an apparently increasingly remote chance of entry into the UN Security Council’s permanent membership, with China’s rising power and intense sense of rivalry with Japan, and with Japan’s economic stagnation at home, Japan will find its role, not to mention its power, harder to focus and define.

The challenges to Japan are enormous. And it requires political leadership to meet them. Japan has provided much ODA, sent many “economic development corps” and invited hundreds of thousands of foreign scholars and guests in various exchange programs in the
last 30 years. However, it still is not sure whether all this helps Japan or how, if it does. Their contribution is considerable. But something is missing from the scene. One thing is the lack of strategic vision and political will. Another is a lack of involvement of people and society. We still have a highly statist approach.

Sharing
One thing Japan and Japan’s political leaders should keep in mind in taking new steps towards rebuilding the new Japan is to learn the art and wisdom of sharing. Certainly, it is a much more difficult and more subtle endeavor than taking. Yet, Japan has benefited enormously from the sharing from the international community after the destruction of the World War II.

Just take the example of Prime Minister Shigeru Yoshida’s state visit to the United States in 1954. When he made that trip as the first Japanese political leader after Japan’s independence from the Occupation, he was first greeted with swelling good will by New Yorkers. 1200 guests showed up for a black-tie dinner at the Waldorf Astoria ballroom to celebrate the new Japan. The magnificent dinner was hosted by John D. Rockefeller III, then the Chairman of the Japan Society in New York. One of the Japanese government delegates felt overwhelmed. He later wrote a moving account of the scene and expressed his wholehearted gratitude for the spirit of giving of the Rockefeller family and American friends in his memoirs.

That young delegate, Kiichi Miyazawa, then a Ministry of Finance official, had been deeply involved in mapping out a post-Occupation new course for Japan pushing economic and political reforms further, in spite of the strong resistance from the old forces just coming out of the closet at the end of the Occupation. The reforms were originally introduced by the GHQ but were soon embraced, fostered and developed by the Japanese themselves. Cold war necessity notwithstanding, it is this foundation of liberal internationalist strategy on which Japan developed its economy and democracy and truly formed its new modus vivendi with the rest of the world. Twenty years after this unforgettable acceptance dinner, Miyazawa was to be one of the founders of the Trilateral Commission, founded by David Rockefeller, John D’s younger brother.

Japan’s trilateral relationships were the key to further acceptance into the world community. As Japanese Chairman Tony Kobayashi said yesterday, Japan has benefited more than any region from the trilateral exercise. One thing Japan should learn from its experience of the trilateral dialogue is the strategic importance to see ahead and act and share.

Japan must prepare itself to face a new power balance and manage it preemptively by trying to incorporate the new rising forces into the system. Japan can and should play an important role in helping neighboring rising countries, particularly China and Indonesia, firmly integrate into the international community. This role will be more crucial as the Asian drama will likely unfold with many surprises in the future. Japan should see sharing as not just an altruistic act but also the finest form of engaging and living together.

Fortunately, there is a reservoir of good will, of proactive willingness to commit, and of liberal internationalist orientations in the Japanese public, particularly among the younger generation. The public’s strong support of ODA, UN peacekeeping operations, refugee relief, and a larger non-military and civilian role for Japan in the international community, and emerging NGO and NPO forces in policy-making, can warrant this cautious optimism. The most crucial task for Japan’s political leadership is to harness these forces and resources and direct them into rebuilding Japan for the 21st Century.

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Europe's Main Task: Consolidate a Liberal Order Across an Ever-Larger European Union

I regard myself as a devoted European but I come from a cold and rather unsentimental part of our continent. So I always react rather reservedly when I am confronted with high-flown and bombastic expressions of what Europe is all about or what kind of role Europe should play in the world. Too often the European scene is filled with words that cannot be taken at face value. One example—that I do my best to repress, but with very little luck—was when the troika of European Foreign Ministers set out for Belgrade in 1991 to deal with the problems in Bosnia, in the days before Dayton. “This is the hour of Europe,” the lead Foreign Minister declared proudly. As we are all aware and knew in our hearts at that time, it was indeed not the hour of Europe.

Being unrealistic when we talk about a Common European Foreign and Security Policy is certainly not the right way to meet the leadership challenges of our time. What we should aim for is a more common foreign and security policy, but even that has proven to be very difficult indeed. We should be realistic about this, instead of continuing to paint a too rosy picture of the facts of life in the Europe of nation-states that we will continue to have in our lifetimes. And we should define our global role accordingly.

Setting Priorities Right: Overcoming Division, Buttressing Peace and Liberty

Political leadership is about setting your priorities right and also about not allowing the best to become the enemy of the good. Europe's main challenge is this: we have to find ways and means to form the new structures that will make it possible for us to overcome 40 years of division in Europe. I firmly believe that this can only be done by exploiting those structures that have effectively served and safeguarded peace and liberty in Western Europe—NATO and the European Union. It is necessary to expand these structures, to show that they include the new European democracies that have come into being after the breakdown of the Soviet Union. I believe it's extremely important that Europe undertakes its full part of responsibilities for fulfilling this task.

This is a precondition for continuation of the close links between Europe and the United States. Let's face the fact that we Europeans are not able to solve these problems without the United States. And we should also be aware that the United States needs relief because of its global responsibilities, and that the Americans are not going to accept the situation where they get the feeling that the Europeans are going for a free ride. Consequently, we do have to follow a parallel route on the two important tasks that are facing us: the enlargement of NATO, which is a shared task, and the enlargement of the European Union, which is a European task. The enlargement of NATO is decisive with regard to establishing a new European security structure, and I believe it will be a lot easier to collect the necessary political backing among U.S. political leaders if Europe at the same time displays a willingness as well as an ability to solve our part of the joint task. This is where we must set our priorities right.

On top of the European agenda of the years to come is the establishment and the consolidation of a liberal order across an ever-larger European Union.

Only this weekend we had an example of...
wrong priorities in York—where the ECOFIN ministers met to discuss the EMU and where the German Minister of Finance, according to the news agencies, threatened to block the enlargement process if solutions were not found to questions relating to economic burden-sharing and the right way for the EMU to function, etc. This confirms my firm belief that Finance Ministers can be held on a very short leash when it comes to foreign policy issues. They are bookkeepers and their roles should be kept in their books.

The EMU is of course going to take a lot of our strength in the years to come, but the EMU must not be allowed to divert effort from the enlargement process. I am a strong believer in an EMU for political reasons—for political reasons only—and I admire the present German leadership for having the strength and showing the kind of understanding of priorities to go for this for political reasons. But we are setting our priorities wrong if the EMU is allowed to block the process of creating a whole Europe. I was reminded of that when, only a few days ago, I got the latest issue of Foreign Affairs for which Timothy Garton Ash has written a remarkable article. Let me quote him about the situation in Europe: “We were like people who for 40 years had lived in a large, ramshackle house divided down the middle by a concrete wall. In the western half we had rebuilt, mended the roof, knocked several rooms together, redecorated, and installed new plumbing and electric wiring—while the eastern half fell into a state of dangerous decay. Then the wall came down. What did we do? We decided that what the whole house needed most urgently was a superb new computer-controlled system of air conditioning in the western half. While we prepared to install it, the eastern half of the house began to fall apart and catch fire. We were playing the fiddle in Maastricht while Sarajevo was burning.”

Timothy Garton Ash put his finger on a very important point. Our Europe of the 90s, our Europe of the 21st Century, is a new Europe; but with very, very deep roots in the old Europe. We have a map of a new Europe; we have a lot of new borders; a lot of new names have appeared on that map. This process continues, and this is the real challenge we are facing in Europe today. How can a more fragmented Europe avoid instability on a continent that recently experienced war again after a period of relative stability during the last four decades? To meet that challenge, European unity is a must. We need strong overall political frameworks to give room for this growing number of European nation-states, without sacrificing the peace that has characterized our part of Europe since World War II. I think this is obvious to all Europeans; I think it is equally obvious that the structures forming the European Union are the only answer if we seek practical solutions to our problems.

So European integration is the answer to overcoming the 40 years of division in Europe. And integration should lead to peace and liberty, because that was always the goal. Economic integration and the pooling of resources—that was always the means and not the goal. This was clearly stated in the preamble of the Treaty of Rome: “Pooling their resources to preserve and strengthen peace and liberty.” It is very important to keep this in mind all the time, that European integration is first and foremost a political endeavor. It is so today as it was more than 40 years ago when the Treaty of Rome was signed. Therefore, it is in full conformity with the original vision of what has become a so-called European Union that this is now going to be enlarged to include the new democracies of Eastern and Central Europe.

Institutional Problems, Economic Interests
To make this vision possible we have to deal with a number of practical and political problems and, as always, the devil lies in the details.

We have today a European Union of 15 countries with basic structures more or less the same as when there were only six members. This sometimes makes decision-taking very difficult—not to mention all the practical problems you have to face when the whole
thing has to be conducted in eleven different national languages and two alphabets, just to make the confusion complete. Other practical problems include the number of Commissioners and the rotation of the Presidency. Should Germany, along with Denmark or Luxembourg, be satisfied with having to wait 13 years between Presidencies in a Union of 26? These are all, of course, institutional problems; and we have a tendency to put them aside saying, "Well, these are just institutional problems"—but they contain a lot of political dynamite.

This is also the case when you approach questions where economic interests are involved. To start with the hardest case, the Common Agricultural Policy of the EU needs to be reformed as a precondition for enlargement with countries having exceptionally large agricultural sectors like Poland and Hungary. Fortunately, this policy also needs extensive reforms due to demands from the world trading system. But it is inevitable that this leads to some resentment towards the enlargement process.

**Include the Baltic States Now**

Now negotiations are starting with five Eastern and Central European countries—only five, unfortunately. It will be most unfortunate if a situation arises where some countries feel that they are being rejected. Nobody had expected, of course, that all ten Eastern and Central European countries could join simultaneously. But it is important for them all to know that they are part of a process.

A very special case in this context is that of the three small Baltic states—Estonia, Latvia and Lithuania—part of the very sensitive Baltic region. These three countries are special because, among all the countries applying for membership in both NATO and the European Union, they are the only ones who broke out of the former Soviet Union, into which they were forced in the early days of World War II. It took them half a century to regain their independence, and they are vulnerable because of their geography and because of their history.

They were not among the first former Warsaw Pact members to be invited into NATO. I, for one, believe they should have been—but at least at the 1997 Madrid NATO summit it was acknowledged by the heads of states and governments that these three small states should be regarded as aspiring members.

There seems to be no explanation why the European Union could not bring in immediately these three states, with five-and-a-half million inhabitants. Why couldn’t it be done immediately, thereby drawing some necessary lines—because our problem is to avoid the situation where Moscow might regard the Baltic countries as in its sphere of influence. The temptation lies there, if false impressions are allowed to root in Moscow regarding the rights of these three small countries to act as free and independent states. Please observe what is happening there—problems can very often arise on the European continent in the small countries.

* * *

To sum up, we have to deal with the problem of maintaining the support of our populations in the expansion of the European structures. We are still faced with the feeling that the European Union has grown into an excessive bureaucracy, and only too often see how national governments use the EU as an excuse for establishing new bureaucratic rules. We still have unfilled problems regarding decentralization, participation, openness, information, democracy—these are key concepts in the further development of the European Union.

My conclusion is that our main task, looking into the next decades, is to consolidate what I call a liberal order across an ever-larger European Union. We have to be realistic when we deal with the rather grandiose notions of a common foreign and security policy (The acronym CFSP might be exchanged for MMCFSP, Much More Common Foreign and Security Policy—I would be satisfied with that.) We also have to be careful that deeper economic integration does not undermine the
liberal order it is intended to support. In other words, we should always remember to distinguish between means and goals; between tool and aim. And above all, we should not believe that history is dead—because then it might resurrect in all its horrors. This is expressed in a small poem by one of our beloved Danish poets and philosophers, Pétur Heim, who died a couple of years ago: “We think of our age as the age of all ages—when man has grown modern at last. But what other page among history’s pages was so overburdened with past?”

Uffe Ellemann-Jensen, a Member of the Danish Parliament, was Minister for Foreign Affairs (1982-93) and National Chairman of the Liberal Party (1984-98).

RICHARD HOLBROOKE

More Cumbersome Institutions and Processes are Leaving Problems Unsolved

Reflecting on the theme of this morning’s session, I would like to talk about leadership and institutions and the delicate inter-relationship between them. People need institutions and institutions need leaders. A delicate balance exists between people and structures, between process and outcome. Without institutions, strong leaders can do great harm. But without strong leaders, on the other hand, institutions can prevent action and turn into stultifying, constipated bureaucracies—and the search for solutions to problems can wither.

We often lament—it’s a recurring theme at conferences like this as long as I can remem-

ber—the lack of strong leadership in the modern world, whether for traditional problems like dealing with Bosnia or Kosovo, or new problems like global warming and the challenges of drugs and AIDS. There is some truth to this lament, but I think we should not overdo the self-flagellation. People respond to challenges; there was nothing inherently heroic about the men and women—primarily men—who directed the leadership of the Western world after World War II, but today they look like giants because they responded to the challenge. The challenges today are more diverse.

Rather than focus on the need for strong leaders, which is a cliché, I want to talk a little about institutions. I’d like to do that across the Trilateral world—for the United States, Japan and Europe—with apologies to my Canadian friends. In all the Trilateral countries, institutions have become more bureaucratic in recent years, just as the issues they confront have required more imagination.

United States
First let me turn to the United States. Our system today is far less flexible, far more cumbersome, and far less likely to produce an action plan and the will to carry it out than it was when we confronted the crises of the Depression, World War II and the Cold War, which—if you think about it—all were contained in a very brief period, from 1933 to the late 1940s. Today in Washington there is an air of hostility between people, a stalemate, a sense of the limits of power. Meetings in Washington in the Executive Branch usually begin with why issues cannot be addressed; what the limits are; what will happen if the press finds out about the deliberations; and what the Congress will do. A good example is the United States’ failure to pay its dues at the UN. From 1991 to 1995, for example, U.S. commitments to peacekeeping in the former Yugoslavia were inadequate. Only at the last minute, facing the abyss in the summer of 1995, did the Administration launch the diplomatic and military efforts that led to Dayton.

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There are a whole host of more recent examples. The press, meanwhile, has a venomous tone which you’re all familiar with.

So Washington is usually in stalemate. This is not simply a matter of divided government. To be sure, the Republicans control both Houses of Congress while the Democrats control the Executive Branch, but that was equally true in 1947—when some of the most creative policies our nation ever forged were created.

Japan
My friend Yoichi Funabashi has made a wonderful statement. Japan is in deep trouble, but I will not go any further than Mr. Funabashi already has. He seemed to suggest that he wants Gaiatsu to return, but that’s not the way for Japan to proceed. Gaiatsu may produce some progress, but it will also produce much more resentment. We all want the Japanese to do more on their own.

European Union
The European Union is obviously quite different from the United States and Japan, which are, whatever their other differences, individual countries. I want to comment based on my experiences with the European Union over the last five years.

We are, of course, a long way from the dreams of Jean Monnet, George Ball, Robert Schuman, and the other great visionaries who, in the late ‘40s and early ‘50s, began the process which has brought us to where we are today. The bureaucrats have replaced the dreamers, and in some ways their actions are exactly antithetical to the original goals of the founding fathers.

The struggles in today’s European Union over power and prerogatives are disturbing. The search for a Common Security and Foreign Policy is virtually hopeless. A few days ago in Berlin the German Foreign Minister, turning to Henry Kissinger, said, “You’ve asked for twenty years what Europe’s phone number is. We aren’t going to ever have a single phone number.” Uffe Ellemann-Jensen just said that he would like a little more common security and defense policy. From my vantage point, I’d like to see some common security and defense policy which isn’t simply a watered-down and meaningless statement.

The challenge will be with us again tomorrow in Bonn when Secretary Albright chairs a contact group meeting on Kosovo—which will include, of course, the Russians in addition to Italy, France, Germany and the United Kingdom. I can guarantee you that meeting in Bonn is not going to produce a policy to deal with Kosovo. It will be a classic tug-of-war. The Russians want to delay any action because they’re fronting for Milosevic. The French and the Italians are going to work for half measures. The Germans will support the United States, which will call for very vigorous action. The British will lean towards the United States. The communiqué will get a lot of attention, but I tell you in advance it’s going to mean nothing. It is not going to produce the kind of pressure on Milosevic that will avoid the next conflagration.

I want to recount a brief incident which is a metaphor for the dilemma Europe is in. On the first day of the Dayton negotiations, we had meetings of the contact group. There were three co-chairmen in Dayton—a Russian Co-Chairman (the Deputy Foreign Minister, Igor Ivanov), a European Union Co-Chairman (Carl Bildt, former Prime Minister of Sweden), and myself as the U.S. Co-Chairman. The British, French and Germans also each had their own representatives there—political directors from the foreign ministries. As soon as our first contact group meeting on procedure was over, the British and the French representatives pulled me aside—individually—and said, “Carl Bildt doesn’t talk for our countries.” (The Germans didn’t say a word.) I said “Well, why are you here? Why is he here? Who does he speak for? Does he speak for the EU members who are not in Dayton—the Danes, the Spanish, the Italians? He’s the Co-Chairman of the conference.” They said, “Well, he can’t speak for us.” Bildt and I both recount this
story in the books he's written and I'm finishing, so it's not a secret—Bildt himself tells this story to illustrate the constraints on his own role. You cannot have a situation like that and expect Europe to have influence.

Now, to be fair, the British and the French had their own national sovereignty and points of view. But at some point, they've got to figure out how to approach a problem of those dimensions and stop focusing on process. It was all process, I assure you. And it was very sad.

Now we have a similar problem. I am currently the President's Special Representative for Cyprus. The EU has its own representative and about half the European Union countries have their own Cyprus negotiators—who constantly fly off to Cyprus, whenever they feel that domestic pressures or external factors require it, to talk to Clerides and Denktash and confuse the situation. Nobody will invest any power or authority in anyone else. The Finns have a Cyprus negotiator. The Swedes have a Cyprus negotiator. The Irish have Cyprus negotiator.

On top of all that, what is the EU? Before Dayton Hans van der Broek came to me and said, "We have to be at Dayton." I said, "You are—Carl Bildt." He said, "No. He's the EU's representative. We're the Commission." The six-month rotating Presidency of the European Union is a very odd structure. By lottery it turns up a President. At the height of the European crisis over Bosnia, the lottery turned up Luxembourg and the Luxembourg Foreign Minister made his famous statement, "The hour of Europe has dawned." At the end of last year the European Union turned up Luxembourg again—to deal with the Turkish problem at the Luxembourg Summit. Now I have no criticism of the Luxembourg leadership—they're extremely intelligent people and they run their country very well. But to come into the EU Presidency for six months and confront a crisis like Kosovo or Turkey—this has now happened regularly—and then to give up the Presidency after six months and pass it on to somebody else is a very difficult procedure. And each country, of course, wants its Presidency to have a different emphasis. The Finns have already announced that their emphasis in the last six months of 1999 is going to be dealings with Russia. That's an excellent idea. But they'll have six months; they'll have a declaration on Russia, and nothing will happen. When the Spanish turn comes, they'll talk about something else. And so on and so forth.

I am not here to lay blame but to encourage you. I constantly hear that the United States doesn't really want a strong EU, that the United States doesn't really want the EU to work. That is not true. The United States—for reasons you all understand—is ready to assume some of the responsibilities and obligations of leadership, but not enough, in my view. The Congress is always timorous and reluctant, and our leadership is always going to be constrained by financial and political factors. We need and want strong partners.

* * *

So I would urge that when we leave Berlin today, we try to think about how to improve our institutions. I believe that the raw material of leadership is quite as good as it's ever been. But our institutions have become endlessly more cumbersome. We ought to focus more on that as the Trilateral Commission enters its second quarter-century.

Richard Holbrooke, now Vice Chairman of Crédit Suisse First Boston in New York, was U.S. Assistant Secretary of State for East Asian and Pacific Affairs in the Carter Administration (1977-81) and Ambassador to Germany and Assistant Secretary of State for European and Canadian Affairs in the first Clinton Administration (1993-97).
DAVID ROCKEFELLER

1998 is the 25th anniversary year of the Trilateral Commission. David Rockefeller, Founder and Honorary Chairman, spoke briefly at the outset of this forward-looking session on "Meeting the Leadership Challenges of the 21st Century" and received a standing ovation. Mr. Rockefeller began by sharing a letter he had just received from Max Kohnstamm, European Chairman in the Trilateral Commission's first few years, which recalled the key roles that several other individuals have also played along the way—Tadashi Yamamoto, Zbigniew Brzezinski, Georges Berthoin, George Franklin and Gerard Smith. Mr. Rockefeller then continued with his own remarks:

This is a nostalgic occasion for me. When Trilateral was launched in 1973, I never dreamed that it would be able to accomplish all that it has. It also never occurred to me that we would be here in a united Berlin on the occasion of our 25th Anniversary. But, happily, we are here and I want to thank every one of you for your wonderful support of the Trilateral Commission over the years. Our three Co-Chairmen have asked us to mark this Anniversary with more than a sentimental review of our past accomplishments. They have called for a bold assessment of the role that the Trilateral areas might play in the future. Our three speakers this morning will outline some of the many challenges that they see still confronting the Trilateral nations, and I look forward to their presentations.

For my own comments I would like to concentrate on leadership, as it relates to the Trilateral Commission. This is a theme I have been thinking about a great deal as I have been working on my memoirs and trying to understand the motivations and achievements of some of the remarkable people I have had the privilege of meeting over a long life. In many respects, I think the idea of leadership goes to the heart of Trilateral's purpose and the contributions it has made. We join together to meet fellow opinion-leaders of the Trilateral nations, to learn from one another, and to form judgments on the state of the world. But in an undefined and intangible way, I think Trilateral also helps prepare us to play a greater role as leaders in the world community. The world community is changing profoundly in its make-up and in the challenges that we face. These new global issues can benefit from the leaders developed at these Trilateral meetings.

Leadership, whether among nations or individuals, has many attributes. I will mention four—all rather obvious, I must confess, but often forgotten or neglected.

First, leadership has to be future-oriented, while at the same time drawing on the best traditions of the past. The Trilateral Commission was launched because Japan had become a powerful player in global economic markets, but lacked a forum in which to engage the leaders of Western Europe and North America. I believe Trilateral has gone some distance in correcting that gap. Now once again Trilateral is faced with the challenge of
identifying those nations which have come to play a greater role among the industrialized democracies. I strongly support the decision of Trilateral's executive committee to include individuals from other areas in this triennium. While it would be counter-productive for us to become a mini-UN, we clearly need to broaden our base. We should reach out to leaders in emerging countries who are determined.

Second, effective leadership demands both knowledge and an awareness of the public interest. This also seems to me to capture the essence of what we have tried to achieve through Trilateral. We take part in these meetings to deepen our understanding of the global economic and political system. The nations that we represent need the thoughtful and objective advice that qualified individuals from the private sector can provide. This is so because a vibrant civil society—which checks, monitors, and strengthens government—is a key element of a robust democracy. A healthy and creative private sector is the source of so many of the advances that benefit humanity.

My third point is closely related to the second. Good leadership cannot operate in a vacuum. It must be accepted by a large percentage of the citizens of any nation. Only then can it give impetus and direction to movements and ideas. This requires listening attentively to others and engaging them in constructive dialogue. That dialogue—or “triad” in our case—is part of the learning process which Trilateral nurtures. I like to think that our plenary gatherings have benefited those who have participated in them. It may not be entirely a coincidence that a number of our members have gone on to occupy the highest government positions in their respective countries.

Fourth, leadership requires the dedication of time and resources. “Important things happen” in the world as a result of positive individual leadership. The world is filled with unprecedented opportunities, but those opportunities will not be realized without the dedicated and informed involvement of opinion-makers drawn from the public and private sectors of all the countries represented in this room. We should not exaggerate our importance, but neither should we underestimate our potential. Over the years, the Trilateral Commission has enabled some of the brightest and most capable citizens of the leading industrial nations to get to know one another, to better understand the complex problems our nations face, and to share in formulating a vision of how the world can become a more prosperous, safer, and more humane place to live.

* * *

I believe the Trilateral process has worked well in the past and I am convinced it will continue to do so in the future. In closing, I would like to suggest that it has not only worked well; it has also been fun! I feel very privileged to have played a small part in the process.
Section 4
Europe's Challenges

Eberhard Diepgen, Governing Mayor of Berlin, received Tri lateral meeting participants at the Berlin City Hall (Rotes Rathaus) on the evening of March 22. Aleksander Kwasniewski, President of Poland, spoke at the City Hall that evening. His remarks are presented at the end of this section, after the presentations which opened the March 21 session on “Europe's Challenges.”

Lamberto Dini

EMU and Europe's Political and Economic Advance

Virtually everything has by now been said about the single currency during months and years of almost excessively heated debate in our countries, and between our governments. I would like to address not only the opportunities it offers and the advantages it brings, but also the hidden challenges, challenges whose repercussions will be felt long after the January '99 deadline.

The Birth of the Euro
Throughout the whole process leading to the single currency there has been no shortage of sceptics and detractors. There may have been some cause for doubt about keeping to the timetable, but the prophets of doom and the opponents of the whole project have been proven wrong. Nothing they have done has tarnished the innovative—not to say revolutionary—significance of the decision to go through with it. It will prove to be the greatest currency revolution since Bretton Woods.

And it will be a European revolution. It will also mark a stride forward in the best tradition of the integration process, as the fruit of a loftier view of political planning. The founding fathers also took their cue from a concrete market issue. In this sense, the Monetary Union is a project with a long history to its credit. It is the response to a real immediate need: the need to consolidate the Single Market, to be able to respond to the ruthless rationale of the global economy.

Furthermore, the currency possesses a symbolic power that no other physical sign of integration has ever had before. It makes European citizenship a tangibly powerful reality. Having the common currency will make integration a daily, undeniable and visible reality.

The Geography of the Single Currency
The single currency has radically changed the economic culture of the member states. It is now a generally accepted fact in all our countries that growth cannot be achieved without a healthy financial environment. This prevailing culture has fuelled an effort at convergence involving every country. Each of them is determined not to squander all the sacrifices that have been made, and realizes that there are no miracle cures to the complex problems of the contemporary economy. We do not therefore feel at this stage that anyone can begin expressing doubts about the path ahead or the number of participants, even though sometimes the search for ever new evidence of eligibility seems almost to stem from a desire to shed responsibilities. And right up to the last moment there will continue to be an anonymous guerrilla war waged against the inclusion of certain countries in the first wave of the Single Currency.

Italy's Participation
I do not intend to repeat the figures on the Italian economy. Neither do I wish to recall the extraordinary efforts that have been made to comply with the Maastricht criteria. All this is the result not only of Italy's pro-European...
spirit, that huge reservoir of goodwill without which we would never have managed to reverse the forecasts that Italy would be excluded.

In Italy, as in the other countries, the prospect of joining the Euro has changed the prevailing culture. It is this change of awareness, this Copernican revolution in everything but name, that underpins the sustainability of our compliance with the Maastricht criteria. Enlightened government policy has not in itself been sufficient. Yet the Euro is certainly no secret revolution, taking place without being exposed to the judgement of the people. It expresses convictions that today are firmly entrenched in every area of Italian life. These convictions have led to a radical overhaul of finances and major reforms in the pension system and in public expenditure. There has been a change of heart and a change in behavior, enabling Italy to exploit the benefits and advantages of the Single Currency. These benefits have been internalized by the Italians. However, all this now needs to produce further changes in policy and in the economy, going much further than mere convergence. I believe that Italy and Europe will be able to take those changes in their stride. But they still lie in the future.

The Vitality of the Euro
Distinguished voices are being raised, not only in Europe but also on the other side of the Atlantic, denouncing the macroeconomic costs of the single currency. They claim that even if the Euro does come into being, it will not last for long. It will, they say, straitjacket too-wide-differing countries into compliance with over-rigid rules. Their main allegation is that the single currency is genetically deflationary, making it, according to its most virulent critics, liable to create an anorexic Union. These arguments are based on the fact that the European economy has grown very slowly during the period of convergence, which has led to a further rise in unemployment in many countries. However, I believe that the high unemployment rate in some European coun-

tries is due to different reasons altogether, largely of a structural nature. Here again it would be a mistake to ignore the fact that the Euro is not only a great opportunity, but also an open challenge, a challenge that we must take up and one on which the vitality of the Euro itself depends. It would therefore be utterly reckless, after having found that this incredible wager has been won, to imagine that everything will then come about automatically. On the contrary, it will be necessary to add new instruments to those used in the recent past. The success of this extraordinary experiment will depend on the response we make. We must begin, even now, ensuring that after January 1, 1999, we are not overcome by a sense of relief. The Euro will put the consistency and sustainability of government policies, corporate behavior and the conduct of private citizens severely to the test. In particular, it will require the following:

- a re-balancing of economic instruments against monetary instruments;
- retaining a solidarity and cohesion mechanism within the Union,
- the completion of the institutional architecture; and
- strengthening the external projection of the Union.

It is on these objectives that the duration and the soundness of this revolutionary innovation depends, to a certain extent. The originality of the single currency lies in the fact that it forms part of the more general integration process, which is governed by institutions, rules and deadlines. This is why the currency will impose far-reaching changes that are potentially able to cement the other dimensions of the integration process cohesively together. But I am not sure that every government is always fully aware of this fact.

One may reasonably expect an impetus towards closer coordination not only of budgetary policy, but also social and fiscal policy. It would also be irresponsible to neglect the
employment issue. This is precisely the area in which the social acceptability of economic and monetary union will be put to the test. All this is generally summed up in the concept of government of the economy. It has a two-fold dimension: (a) one refers to specific policies (fiscal, budgetary, economic, employment) and (b) the other to the institutions.

The most immediate target, enshrined in the Amsterdam Treaty is to improve coordination of economic policy. This is necessary to conclude a different kind of social covenant with our people, to incorporate the unsustainable mass of those at present excluded, and to facilitate the new spirit of enterprise on the part of individuals. This will not only depend on the commitment of governments, but also on the business community and the general public. Companies directly exposed to competition—and that means the vast majority of them—must give up any illusion that they might eventually be bailed out of their inefficiencies by currency devaluations, give way to wage concessions that exceed productivity, or linger on in obsolete production sectors. Social security and health care must remain subject to strict financial constraint. Government departments and agencies must achieve levels of efficiency and innovative capacity far higher than today's. Government has to withdraw from the economy and leave room for risk and private enterprise.

The single currency is intrinsically social in character. It imposes sound and stable macro-economic conditions in the absence of which no sustainable and vigorous growth can be achieved. It remains the responsibility of national governments to decide on how to distribute the fruits of that growth. This demands a convergence effort which does not clash with the demands of social cohesion and solidarity. But it also means that the instruments for practicing solidarity at the Union level, by which I am mainly referring to the European structural funds, must retain their unimpaired capacity to redress imbalances, imbalances between economies whose diversities will be shown up even more evidently by the Single Currency. Lastly, the low degree of labor mobility and the absence of any central redistribution mechanism comparable to those that exist in federal-type unions will make it necessary, as I have already said, to gradually abolish the labor market's rigidities.

The Institutional Evolution of the Union
The Euro is the hard core of European governance. It is a political fact, par excellence. It consolidates one of the areas from which the future of the Union will be guided, and is therefore blazing the trail towards closer political integration too. The Euro is anticipating the concept of flexibility enshrined in the Amsterdam Treaty. It is around the Euro that, for the very first time, a new generation of institutions are taking shape, with the responsibility of managing not unity and equality, but disparities and inequality.

The Euro nevertheless makes it necessary even now to back up monetary rigor with institutions, even in embryonic form, that are able to bring about closer economic policy coordination. This means managing policies according to the concept that I have summarized in the term "government of the economy," government which in some way helps to correct what one might otherwise call the loneliness of the central banker. The currency is a key institution around which market-oriented societies hinge. But the creation of the currency is not an act of economic virtue: it is a political process. This is the way we have always understood it in Italy at least. In the longer term, the currency cannot remain politically headless. I am not sure that all of us realize that the Euro must be the springboard for a new phase of growth of Europe's institutions. The dilemma has been expressed, often misguided, in the federation-versus-confederation debate. The Euro is the Union's first truly federal structure. It is paving the way to enable the whole process of European construction to move forward in the same direction, to give the Union a different capability to act, and an
identity that is still partly to be thought through and decided upon.

Relations between the Union and the Rest of the World
The Euro will make it possible to transfer the power of the Union outwards, and to afford greater protection against the pitfalls of the global economy. The Euro will heighten our awareness of Europe’s geopolitical function. But it will bring out with even greater evidence the limitations of the present structures that prevent the Union from strengthening peace and the rule of law. For the Euro is a peaceful revolution in international economic arrangements, which is precisely why it sometimes gives rise to mistrust. For example, after a period of benign neglect, doubts and fears sometimes emerge, not from the government but in certain sections of the press in the United States. These are doubts and fears which must be dispelled by facts, by specific actions, expressing the vocation of the Euro to create stability. In other words, the new currency must not only be something which strengthens Europe’s identity and affirms the presence of the Union on the wider world stage. It must also be an element that brings balance and stability to the international monetary system, alongside but not in opposition to the dollar. It will be necessary to make the external projection of the Euro an instrument for re-affirming the centrality of the relationship between Europe, on the one hand, and the United States and Japan on the other. Once the period of adapting to a wholly unprecedented situation is passed, the tripartite bonds may emerge strengthened and re-balanced as a result of the introduction of the Euro, and in more general terms, by the deepening and broadening of the European integration process. Europe does not have an isolationist tradition. Just as the single market has not turned out to be the much feared “fortress Europe,” the single currency will not be an instrument for destabilizing currency competition on a worldwide scale. If anything, it will act as a shield to ward off financial mar-

ket turmoil. This marks a major step forward, particularly in view of the many unknowns which will have to be faced in the coming years.

...TRIPARTITE BONDS MAY Emerge STRENGTHENED AND RE-BALANCED AS A RESULT OF THE INTRODUCTION OF THE EURO...

In conclusion, the Euro will help to overcome the fears of the present time, and restore our confidence in our own future: confidence in our capacity to return to greater competitiveness without reneging on the social economy and the market economy; confidence in the deepening and broadening of the European integration process; confidence in the future of the Euro as an international reserve currency alongside, and not against, the dollar and the yen. It will also help to satisfy the need for security, jobs and external authority all of which are aspects of European citizenship. But the greatest challenges still lie ahead. And we must be properly prepared to take them on.

Lamberto Dini is Italy’s Minister of Foreign Affairs. He served earlier as Prime Minister, Minister of the Treasury, and Director-General of the Bank of Italy.

TORU KUSUKAWA

What Will Happen with the Euro?

I STILL REMEMBER in 1958—I was stationed in Germany at that time—when President de Gaulle announced the return to convertibility of the European currencies. Now we see that the Euro, the united currency, is really becoming a reality. I must congratulate all the members of the European Community for the endeavors they have made so far. Having said that, I will concentrate on some questions about what will happen with the Euro.
Deflationary Impact? Our concern is, first of all, whether there might be a deflationary impact on each of the countries. The Maastricht criteria and the subsequent "stability pact" seem to say that fiscal constraint is always to be maintained. We have to watch very carefully what happens.

How Will It Work? The Euro for Japanese is quite an intellectual challenge. We have a lot of intellectual interest in how it will be done and how it will be run. What about the interest rates in the future of each member country? I presume there may be rating differences among the member countries, so that one country's debt may have a yield of five percent and another four percent or something like that. That might be a possibility for technically solving this sort of thing.

What will happen with labor or social security policies? They might properly belong to the sovereignty of each member country. But harmonization may be necessary if you only have one currency.

A Second Reserve Currency? With the size of the European economy, having one currency probably means the emergence of another international key currency. Are we going to have two reserve currencies, so that, for instance, the Middle East or some countries around there may tend to put their reserves in Euros? If that happens, what will be the position of the U.S. dollar? We in Japan might split our reserves into two.

How about the Japanese yen? Because of the currency turmoil in East Asia, we might have to do something about the yen becoming a bit more international. We might even have two-and-a-half key currencies in the world.

Big Fluctuations between Key Currencies? What will be the relation between the dollar, Euro and yen? We have seen very big fluctuations between the Japanese yen and U.S. dollar in the past four or five years. Volatility is so big; one time the dollar went down 50 percent and another time it went up 50 percent in the span of two years. One of the reasons why we have currency turmoil in East Asia is this fluctuation between the Japanese yen and the U.S. dollar.

Would that be so between the Euro and the dollar? Are we going to have a very stable sort of relationship or rather choppy turmoil between the two currencies? We have to be careful, because this will greatly affect the currency situation in the world at large.

A Continental Market to Rival London? Whenever we from outside of Europe come to Europe for new issues or something like that, we usually come to London. We don't come to Frankfurt, because that market is limited. We don't really get what we want. With the creation of the Euro, are we going to have markets on the Continent equivalent to the services available in London? London is outside of the Euro. What will happen between the two?

Lessons for Asian Currencies? I have mentioned the East Asian currency turmoil. The link or the pegging of these Asian currencies to the U.S. dollar has made life rather difficult up to now. We really need some sort of arrangement to make harmonized relations among the East Asian currencies. For that purpose I am sure we can learn quite a lot from the experience and the insights that Europeans have accumulated.

Toru Kusuhara is Chairman of the Board of Counselors of the Fuji Research Institute Corporation.
JAVIER SOLANA

A New Era in Europe: Challenges and Opportunities

I would like to discuss five points—first a general point about the stability in Europe today, then four issues that need continuing attention.

Unprecedented Cooperative Momentum
The changes that have taken place in Europe in the last decade are enormous. Probably in previous centuries such fundamental change would have led to major upheaval and maybe to conflict. That has not happened. Although ups and downs have taken place, most nations, old and new, have displayed a remarkable sense of direction and a remarkable sense of common purpose. I would argue that never in this continent's history has there been a stronger cooperative momentum. Given this momentum, I think we should start describing this time in different terms. We still call the era we are living in the post-Cold War era. I think we have to start looking at this period without any reference to the Cold War. It is a new era that will be defined by three elements to my mind: first, a cooperative security architecture that includes a more self-confident, inclusive Europe; second, a healthy trans-Atlantic link; and third, a Russia firmly geared to reform and cooperation.

Speaking with One Voice in the Balkans
Sometimes we tend to think about beautiful architecture and forget the reality of the day. Today we have a very serious problem, which is the situation in the Balkans. I would like to say to you that at this point the situation in Bosnia-Herzegovina is getting better, with the effort of the SFOR and IFOR. More than 30 countries, led by NATO, have deployed on the ground, trying to bring peace.

We were able to stop the war, but that is not enough. To bring peace is to bring reconstruction of the country and, the most difficult part, to bring the reconciliation of the people. We have a lot to do in reconstructing the country, and that cannot be done only by NATO—reconstruction also of the morale of the people, the conscience of the people, the tolerance among the people. This is our challenge. We are making progress but we still have a long way to go. The example these days of Kosovo confirms that there still is a lot to be done.

Let me stress two basic aspects concerning Bosnia and the Balkans: First, in its most important operation ever, NATO acted in an operation for peace; and second, after a certain period of time, too long to my mind, the international community started to talk with one voice, and is speaking with one voice. We have learned a lot from 1991 until 1998. Today, when the crisis of Kosovo started anew, the international community spoke from the very beginning with one voice. Let us hope that the international community will continue to speak with one voice. (I want to thank our friends from Japan, who have been helping us very much on the reconstruction of Bosnia-Herzegovina.)

Let me finish this point on the Balkans with an anecdote. I was in Ljubljana about two months ago. Ljubljana is the capital of Slovenia, a very small country that belonged to the ex-Yugoslavia, about the size of Israel, with about two million people, a beautiful country. I was in the town hall. Somebody approached me. “I am 87 years old,” he said, and asked me to accompany him to a window. He opened the curtain and told me, “Do you see that river?” “Yes, I see that river.” “This is the river that crosses Ljubljana. It goes to the Sava River, which goes later on to the Danube. This river is in the heart of Europe. You see that house?” “Yes, I see that house.” “In that house I have lived 87 years of
my life, and at the same time I have lived in seven different countries.” This is Europe. These are the Balkans. This is what we have to face.

**NATO and EU Should be Open Institutions**

My second point is that the basic institutions, NATO and the European Union, have to be open institutions. We cannot speak of a Europe which is open with institutions which are closed. Opening NATO and opening the European Union is not just a challenge from the point of view of the economy, or from the point of view of politics. It goes also to the heart, or the moral component of the citizens of Europe. We have to keep the door of these two basic institutions open.

I know this is going to cause problems. I know it will cause economic problems for many countries of the old Europe. And I know it will be difficult for some other countries to understand. But I would like to argue that whatever the cost, we need to have a vision of Europe. And that vision encompasses and entails the opening of the two institutions.

This opening of NATO and the European Union is not being done in a vacuum; it is being done against the background of a very profound relationship between these countries and current NATO and European Union members. Within NATO, we have created the Euro-Atlantic Partnership Council that relates those countries with NATO. Every month at the headquarters of NATO we get together, 44 countries. The European Union has created Association Agreements that mean that those countries, in the period until they are full members, will be kept in close touch.

We cannot accept the concept of new dividing lines. No country now is totally out. Maybe some countries are not happy with the position they have today. But they know we have opened the process; and that process is set to continue.

Let me finish this point with another anecdote. I was having dinner with the President of Poland—he will be with us tomorrow—in the very same room in which the Warsaw Pact was signed, the very same room. He said to me, “Do you know why we want be part of the European Union and NATO? For the very same reason that the countries that belong to the European Union and NATO do not want to leave the European Union and NATO.” I think that answer explains very well the profound sentiment that these countries do have to belong to the basic institutions of Europe.

**Long-Term Relationship with Russia**

Thirdly, we need to have a long-term relationship with Russia. It is impossible to construct a new architecture of security in Europe without taking into consideration Russia—let alone against Russia.

As you know, I have been working very hard in the last years to strike a good bilateral agreement between NATO and the Russian Federation. We achieved that, we signed the Founding Act on 27 May, 1997, in Paris. There were people who thought it was contradictory to open NATO and at the same time to try to get a good relationship with Russia. That has been proven wrong. We have been able to do both things, to open NATO and at the same time to construct solid bilateral relations with Russia.

I would not like to give you the impression of a naive politician who thinks that everything is solved in bilateral relations between NATO and Russia. That is not true. We have ups and we have downs. But I can tell you that in the seven months that we have been working together, only seven months, in the Permanent Joint Council, we have done quite a lot. I think we have started to construct confidence, trust between the old adversaries.

I was in Bosnia not long ago, visiting the Russian troops which are there. The Russian troops stand shoulder-to-shoulder with American troops, with German troops, with 33 countries that have troops deployed on the ground. So we are gaining practical experience of how to cooperate for the same aims, for the same goals.
A New Balance between Europe and North America

My last point is the opportunity we have, touching with the tips of our fingers the 21st century, to give an impulse to the trans-Atlantic link. Lamberto Dini has talked about the meaning of the monetary union. We have a fantastic opportunity with a Europe that is getting closer and closer, and more and more integrated, to strike a new balance in the relationship between the European Union and North America. We should not worry about "too much America"—rather there is "too little Europe."

This is the moment, not only in NATO but also in the European Union, to strike a new bargain between the United States and Europe, to take this opportunity and make the most of it. 1999 is going to be a splendid year for that. We will have a summit of the Alliance in Washington; the OSCE will have a summit; the Treaty on Conventional Arms will probably be adapted. From the point of view of security we have a splendid moment to really take a bold step forward, fly a little bit high and try to face the 21st century in better shape than we are now.

* * *

My grandfather thought, at the beginning of the 20th century, that this would be the century of opportunity, of freedom. It was not. It was the century on our continent of wars. Let us hope that the 21st century, for my son and my grandson, will be the century of peace, stability, freedom and prosperity.

Javier Solana, former Spanish Minister of Foreign Affairs, is Secretary-General of NATO.

HENRY KISSINGER

The United States and Europe: What Are We Trying to Do?

I was asked to talk about what the United States expects from Europe, but I am not going to talk about that precisely, because I wouldn't know what the United States expects from Europe right now.

No Settled View, Not Even a Real Debate

The American debate on foreign policy at this moment is the worst that I have ever seen. I cannot understand, for example, how it is possible that professional diplomats who served as ambassadors in Russia and people who were organizers of the Cold War structure of alliances can now go to the American Senate and urge it not to ratify NATO expansion when it has already been signed. I can understand the argument three years ago, when it was still open. But for many of the old establishment figures to disavow a major policy of the United States that all its allies have agreed to, under our urging, is a rather shocking description of what goes on in America today. What worries me most about America today is that our debate is getting polarized between quasi-isolationists on the left and hegemonialists on the right—between people who want to withdraw from international affairs and people who think we can impose everything by unilateral action, that every other country is a bloody nuisance since we can have our way anyhow. And the two tend to converge very often on practical policies.

So we in the United States not only don't have a settled view of what we expect of Europe, we don't even have a real debate from which a settled view can emerge. Our politics has reached the stage where if you attack the
Administration for anything, they will tell you they are already doing what you are asking for, so there is never any clear-cut argument.

The orthodox view was expressed by an American participant this morning in his question to Chancellor Kohl: the better Europe is the better we like it, because a strong Europe will be able to help us carry our burdens. That was a view appropriate to the '60s when there was a great community of purposes, but I do not think it is axiomatic under present conditions that a strong Europe will necessarily carry our burdens—or that carrying our burdens is a motive for Europeans to organize themselves. They may want to organize themselves not to carry our burdens. When one looks at Iraq, Iran, and many other issues around the world, it is not self-evident to me that the European perception is always identical with the American perception.

Now I am a great believer in an Atlantic Community. Our ability to master the problems of fundamentalism, the impact of globalization, the long-term implications of the rise of China or Asia, does require a common Atlantic position plus Japan. But we have to know what it is we are trying to do.

NATO Membership, NATO Coherence
I am a great advocate of NATO expansion, up to a certain point, because I believed it was essential for the countries that had been consigned to the Soviet bloc, by the accident of military deployment at the end of the war, to be given an opportunity to return to their historic positions, to find their way in the structure of Europe and the Atlantic. But I am very uneasy with the argument that NATO is some sort of open-ended club that anybody can join if he meets certain democratic and commercial criteria. And I am very uneasy about the argument that we must not create new lines. It is the essence of an alliance that it creates a line. Somewhere (we should argue about where) there has to be a definition of what it is you are trying to organize. Otherwise we are in a mishmash that has no stopping point and no definition. Nor should we try to fob off of countries like Russia by saying, "You are eligible for NATO." The Russians can see through that.

We ought to distinguish between defense organizations, political organizations and economic organizations. There can be different groupings for each. What I expect from Europe, and what I expect from the United States, is that we begin defining what the hell we are trying to do and who belongs to what, and then be honest enough to say, "This is what we think; if somebody has another view, let's hear it and let's get it settled."

I fear that NATO is getting over-extended. There are so many groupings—NATO Council, Permanent Council, Cooperative Council, Euro-Atlantic Council, 42, 16, 19—all serviced by the same Secretary-General with the same staff. How is it possible to have coherence in such an organization? I am a great believer in having Russia participate in political decisions; I am strongly opposed to having Russia in the NATO Council. And I don't think this is something we can just fudge, because that will lead to an endless theological debate: Which issue goes into the NATO Council; which goes into the Permanent Council; when does the NATO Council vote; what cannot go into the Permanent Council? It is much easier to say there are certain political issues in which certain nations participate and there are defense issues in which they don't participate; and then create the appropriate institution for each purpose, with the appropriate secretary-general for each organization. I hope and pray that we keep those institutions separate and not pretend that they are serving the same purpose.

Other Issues Needing Thought and Real Debate
We need not just to run organizations but to deal with a whole series of problems.

In the Middle East, for instance, what Europe should ask of us and what we should ask of Europe is some definition of what we are trying to do. On Iraq the question is not: Do we bomb or do we have sanctions? The
questions are: What is the endgame? What is the purpose we are trying to achieve there? And how are we going to accomplish it? On the Israel-Palestinian question, again, the real debate, instead of grandstand plays by various groups, should ask: What are we trying to do? What do we consider a just end-result of this process? We talk forever about more consultation. It isn’t a question of more consultation; it is a question of more thought which is then expressed in consultation.

In Southeast Asia, I believe the attempt to solve a currency problem with a huge program of economic reform has created a massive political problem that makes the economic problem insoluble. It means that every economic proposal is seen through the prism of an attempted political revolution by the outside world. Must every last economic institution of the West be transported to other countries? When a country is in trouble, is it really true that globalization requires that the first thing we tell the country is to devalue its currency and increase unemployment? Is there no positive message we can bring them, except that in three years you may be able to go to the market again? I don’t pretend to have the answer, but I believe we are seeing two things. One, we are making the problems less soluble. And secondly, even in those countries where it looks as if we are solving them, like Korea, we are creating a nationalist backlash that in the second round will create a problem between Asia and the United States. That is an issue Europe and America should discuss.

I agree completely that Russia has to be brought into this conversation. But is the way to do it to treat Russia like a psychiatric case or to treat it like a serious country with serious national objectives that get discussed. In my view, what we really want from Russia is for it to stay within its national borders. If we can settle that question, everything else will flow more easily.

We know we may see a meltdown in China at some point, or we may see the emergence of a Chinese superpower. This is another topic we ought to discuss from a conceptual point of view.

Tori Kusukawa has correctly identified the issues that will arise from the creation of the Euro. Europeans are afraid to discuss them now because they don’t want us to interfere, and some Americans are reluctant to discuss them because they don’t believe the Euro will be very serious. So there is no real dialogue on these issues.

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Sooner or later these issues have to be faced. What would I like to see is that we Americans ask ourselves, what do we really want? And that the Europeans deal with us after defining what they want. I can see what will happen, for example, in the Middle East later this year. Many Europeans seem to think they can euche us into lifting sanctions on Iraq and Iran without our noticing it. This will lead to a horrible explosion with the American political process if we do not achieve some degree of agreement on what we are trying to do.

Henry A. Kissinger, former U.S. Secretary of State and Assistant to the President for National Security Affairs, is Chairman of Kissinger Associates.

HAN SUNG-JOO

Challenges for Asia-Europe Relations

I will talk about challenges for Asia-Europe relations, which in shorthand form is now called ASEM—Asia-Europe Meeting. The second ASEM summit will be held in London shortly.
The Economic Health of Asian Countries
One challenge is, obviously, the economic health of the Asian countries. At the first ASEM meeting in 1996, there was still a degree of boom going on in Asia, although people began to realize much of that was a bubble. Europe properly recognized Asia as a market, as exporters, possibly competitors, and for its investment opportunities. Perhaps at that time Asian economic strength was the main reason for seeking closer relations with Asia for Europe. Two years later, it seems to me that Asian weakness is the main reason for Europe to seek closer relations, because Europe has so much stake in it—in terms of non-performing loans, reduced exports, and greater competition coming from Asia. I have seen some numbers on the Asian portion of loans made by the banks indicating that Japanese banks extended 70 percent of their international loans to Asian countries, while European banks issued 30 percent to Asian countries, and American banks 25 percent. Maybe the numbers are not very accurate, but I think they tell the general story. Europe is ahead of America on this scale, and to that extent has a great deal at stake in what is happening in Asia.

The Role of America
The second challenge is the role of America. When ASEM was first contemplated, I think we cannot deny that both Europe and Asia thought this was one way to at least balance the dominating influence of the United States. Then, in the course of the last few years, I think both Asia and Europe found that you really cannot count out America. In fact, the importance of the role of the United States became larger, both in security and in economic areas. Europe tried to deal with Bosnia on its own and could not, and therefore the United States had to step in. We don't know what is going to happen in Kosovo, but I would not be surprised if at some point the United States is involved. In Asia, the United States has always been very closely involved in the security area, but now with the economic crisis, the IMF plays a critical role and the United States plays a decisive role in connection with the IMF. Wall Street also plays a critical role.

So, in both security and economic areas, the role of the United States has become much more important. If ASEM initially was meant to operate without the United States, ASEM should now recognize and decide that one of the purposes of ASEM will have to be to get the United States more involved. It has the task of accommodating, indeed seeking, greater U.S. involvement in both regions and in both security and economic areas.

Europe's Development
The third area of challenge is Europe's own development. What happens in Europe will have a very significant effect on Asia-Europe relations. Mr. Kusukawa talked about the implications of the Euro for Asia, which, in addition to the reserves issue, has implications for investment, for trade and also generally in Europe-Asia relations. Also what happens in Europe in the area of governance, in Europe's attitude toward human rights, Europe's attitude toward democracy, all these will have significant impact on Europe-Asia relations.

As for Europe's interest in Asian security, one may ask the question: What can Europe do for Asian security? I think this is another element in forming the ASEM process. One example cited very often is European involvement, the EU's involvement in KEDO, the Korean Peninsula Energy Development Organization. I think Europe's motivation for participation was not only economic and diplomatic, but also symbolic, to show that Europe is participating in a very serious security issue in Asia.

Value Changes
The fourth area of challenge is what I would call value changes, or our attitudes toward changing values. Until very recently—as late as perhaps half a year ago—many Asians touted Asian values as the driving force of the Asian economy... Continued on page 35
A Confident and Outward-Looking Europe

The notorious Wall located not far from here used to symbolize the division of our continent. Today, the enormous change which this city is undergoing projects the image of a new Europe. It is a Europe which is reuniting and modernizing at the same time. It is a Germany which is building a new self-identity. While doing so, it is coming closer together with Poland. Not only politically, economically and culturally, but to some extent even geographically. With the capital of Germany 80 kilometers away from the Polish border, we are practically house-mates. It is surely more than the same geographic latitude that makes Warsaw another huge construction site nowadays. In Poland, we are no strangers to the various currents of change—whether it is in architecture, city planning, or for that matter in politics and social life.

EU Enlargement, A Pact of Mutual Confidence

We meet here in Berlin at the point when the candidate countries from Central Europe are finalizing their preparations for accession negotiations with the European Union. As a result, we will soon be making another decisive step towards a larger, more cohesive and prosperous Europe. For Poland, our integration effort is a work in progress. We have a clear view of what needs to be done before Poland joins the European Union at the beginning of the next century. The EU itself has an awareness of the changes and adaptations it has to introduce. We should now protect enlargement against any pitfalls it may encounter. In particular, the possible costs of enlargement should not be overestimated for political reasons while the benefits are being downplayed. What has to prevail is an understanding that enlargement of the European Union is an answer to many challenges that Europe faces and not a problem in itself. In this context, the adjustments the candidate countries are making will contribute to a stronger and more competitive Europe: a Europe with a cleaner environment, a Europe which is more efficient in fighting crime and ensuring our citizens’ security, and a Europe with a much bigger single market. The current fifteen should be left in no doubt—enlargement is in their fundamental interest.

In Poland, we look at the European Union as a pact of mutual confidence. All that Europe achieves is based on our trust towards each other and the feeling of shared solidarity. We expect that this solidarity will be extended to the new members. What is more, genuine solidarity tolerates no exemptions. Neither it exists or it does not. There is no room for special treatment. On one side, the confidence pact requires that Poland and other applicants accept the EU rules of the game in their entirety. The remaining time must be used effectively, so that the candidates prepare themselves to function and to succeed within the enlarged European Union. We should all be aware what demands are placed upon us by the need to uphold a confidence community. The
Union side ought to remember that the stronger the new members are at the point of accession, the better served is the Union’s interest. Poland and others must do their bit of homework. During the negotiations we will be sitting at opposite sides of the table but we will have a joint objective: making the best deal for the future Europe.

European integration is not a process without controversies. There are some who feel disenchanted or that more could have been done. It is useful to retain a critical eye because every project of such magnitude requires close attention. We ought to be challenged to think more deeply. We have to identify more with Europe; we need a stronger will to realize our designs through integration.

**Monetary Union and the Larger Europe**

The process of European integration is an enormously dynamic one. It allows for little breathing space as it moves towards ever more ambitious objectives. Projects such as the monetary union can only to a limited extent be a product of endogenous social and economic forces. They are undoubtedly driven more by a political will. That will can be summarized in a phrase Willy Brandt used in relation to a different, but not dissimilar situation: “What belongs together will grow together again.” We are not up to anything other than forging closer ties between countries with a common belonging. But we must tread carefully. There are enough challenges to test our resolve. It is above all necessary to be clear about our objectives. The next stage of the European project should not be just about a group of countries proving that a monetary union can work. This has been done before. Neither should it be about a handful of countries running further ahead of other members of the union.

The drive towards the “Euro” is running full steam ahead and rightly so. At the same time, we need to be aware that this is a historical junction in European integration. It is more than necessary to ask where the monetary union will lead Europe as a whole. By that I mean the larger Europe, comprising not only “Euro-land” but also EU members not joining and those who are not yet EU members. If the Euro is a divisive issue among members of societies which best qualify for its adoption, it may be partly because the message about its purposes has not yet filtered through.

There are two ways of looking at Europe’s current endeavor. In one, it is predominantly economic, with the Euro aimed at lower transaction costs and other such benefits. Should this be the case, the importance of the Euro is probably oversold. In the other, the objective is partly or primarily political. It could be aimed at consolidating Europe’s political identity. In this case, monetary union should not be an isolated area in which integration moves forward. It ought to be accompanied by giving more substance to the Common Foreign and Security Policy, and by advancing cooperation in the field of justice and home affairs. If you ask me where Poland stands vis-à-vis this project, the answer would be: yes, we want to take part. But let us be clear where we are heading. European integration has become too complex and too far-reaching to avoid answers to such questions.
International Stability Remains a Challenge

Given the virtual lack of interstate conflict, we could easily succumb to the illusion of relative harmony. It is only sporadically that we are reminded that disorder is a dormant threat in not-so-distant countries. But whenever we remove pressure for more human rights and a stronger rule of law, we risk allowing a return to instability. We ought to keep it in mind not only when the need for crisis-management arises but on a permanent basis. There seems to be a consensus over the need for Europe's Common Foreign and Security Policy. Yet, it has not yet been fully translated into reality. National interests are still placed ahead of European interests in areas where joint action would have accomplished better results.

In the management of risk in foreign affairs, Europe's interests and those of the United States, on the one hand, and Japan on the other are closely related. Trade disputes may seem to many to be proof of friction across the Atlantic and across the Pacific. The processes of restructuring which take place in our countries are not always compatible. We obviously have different social and economic models. However, being like-minded on issues of international stability will not be undermined by disagreements over health standards or banana import regimes. The absence of a single threat against which the Western world would unite does not mean that we should not work together. With the advent of the Euro, the relationship between the three leading power centers will have more impact on the world order than ever. It is up to us whether we find an optimal formula for it.

A Security Community in the Wider Europe

Poland has been actively seeking to build a security community in the wider Europe. We have argued for NATO expansion as a means of removing grey zones in the center of the continent. Poland has a strong stake in extending stability eastward and seeing the countries of Central and Eastern Europe form closer ties to the Atlantic community. We have spoken in favor of NATO enlargement being a process and not a one-time event. Its value would otherwise be greatly diminished.

This year, Poland is chairing the OSCE. We are seeking to demonstrate that we consider European security to be indivisible. It is my conviction that the current period in Europe's history will be judged with reference to two tasks. One of them will be the success of grand projects such as the monetary union. The other will be Europe's ability to ensure that stability is not only enjoyed at its center but applies to the entire continent.

The recent unrest in Kosovo confirms the continuing influence of hyper-nationalism in the former Yugoslavia. The violence that has led to so many casualties is unacceptable. Lack of Serbian-Albanian political dialogue can only lead to a further deterioration of the situation. Kosovo should not become a new Bosnia.
Trans-Eurasian Opportunities, Trans-Atlantic Partnership

One of the most fascinating questions in human history has been the one concerning boundaries. The frontiers of knowledge, the boundaries of civilizations have always attracted much interest. Some of the most inspiring ideas and works of art have been created at the point where different currents of human tradition mix.

While preoccupied with the challenging projects which it pursues internally, Europe must look outwards. Poland has focused a lot of its attention on the neighboring Ukraine and the slightly more distant countries of Central Asia. They are perhaps not known as investment magnets. However, the potential of the region as well as that of the Caucasus begins to offer rewarding commercial opportunities. There is a lot that European countries can contribute to ensuring that this potential is taken advantage of. The input can be particularly useful in areas of strategic importance—communication infrastructure and energy transportation. Poland has looked particularly closely at the role we can play in opening the Black Sea to commercial transport and exchange. It is vital that globalization not only amounts to faster and more extensive capital flows. It should also mean opening greater possibilities to the previously sidelined areas of the world. If one looks at Eurasia as a single entity, countries which lie on its fringes have recorded most impressive levels of growth. This will not necessarily be the case in the next century. We can jointly benefit from the vitality of some future new economic tigers.

At the same time, Europe remains the obvious partner of the United States. America has shown the world that to be a superpower means to participate, to care about and build the future. America will need to remain vigorously engaged in Europe. We hope that the old tendency towards decoupling Europe from the United States will not emerge again. What is more, the Atlantic partnership should be neither exclusive nor directed against others. It is not an alliance of Western interests and culture against the East. The partnership’s door should be left open to other countries. The idea of an alliance among the world’s three great democratic centers of power—Europe, the United States and Japan—may become attractive not only for Europeans.

* * *

We live in a period of change. It sometimes contributes to our confusion. It often generates fears and uncertainty. Yet it is also fascinating. It gives us an unprecedented opportunity to shape the course of our future. It opens enormous possibilities. It requires, however, an imaginative design and a responsible policy. Equipped with organizations such as the Trilateral Commission, we should be well-prepared to deliver on our ambitious expectations.

Aleksander Kwasniewski is President of the Republic of Poland.
and asserted a certain superiority for Asian values. But now people are beginning to say that Asian values or practices are responsible for the current economic crisis. I think the usefulness of Asian values—to the extent that we can identify Asian values—depends upon two things. One is the stage an economy is at. During the earlier stages of economic development, what we call Asian values are useful. The second element is the international context within which an economy operates. In a highly globalized economy, Asian values which were very useful in a less globalized context are becoming a liability.

If we talk about the Asian economy as something approaching crony capitalism (an expression that is very often used in Asia) and American capitalism as basically laissez-faire capitalism, where does Europe fit in this continuum? We have to think about harmonizing, synchronizing what we call Asian values with perhaps Western values or European values, to the extent we can identify them.

Some people regard the Asian economic crisis as the crisis of Asian values. We have to find out what to salvage, what to change, what to abandon and how to harmonize with outside values.

* * *

These are the challenges for Asia-Europe relations. In sum, we face the challenge of globalization. The world certainly has become more globalized, and there is a need for adjustment. There is a need for adjustment in our domestic governance and in our international governance. There is a need not only to restructure but also to adjust to each other and learn from each other. So there is a need for globalization in such areas as finance, social welfare, sustainable development, democracy and human rights.

Han Sung-Joo, former South Korean Minister for Foreign Affairs, is professor of political science and President of the Ilmin International Relations Institute at Korea University.

SEC TION 5
RUSSIA

Grigory Yavlinsky and Sergei Karaganov spoke informally at the outset of the Russia session on March 21, a session devoted primarily to discussion of developments in Russia with these two gentlemen. Their informal opening remarks are presented below.

GRIGORY YAVLINSKY

The Main Agenda in Russia

W HAT IS GOING ON IN Russia? What is the main agenda there?

Strong, Clear Liberalization of the Economy

I will start with the economy, because this is one of the most important aspects of Russian development of the last 5-7 years. The Russian economy is stagnating. We succeeded in keeping inflation low, but there is still no real economic growth. Real unemployment is high. Barter accounts for about 45 percent of turnover.

We have tasks that must be accomplished as soon as possible, and I think everything we need to do is on a liberal agenda for economic reform. I don't see any other possibilities except a strong, clear liberalization of the Russian economy in order to make it workable.

- First of all we have to create a reasonable tax system, which means reducing taxes and making the system simple and clear, with not many taxes. Russians are not really prepared to pay taxes, as you know. At present the government is able to collect only half of the taxes it expects. We have to move to a low, clear, relatively small number of taxes.
Secondly we have to use all our political and economic abilities to develop small and medium-sized businesses. One of the main problems of Russian economic development is the absence of widespread small and medium-sized businesses.

And third we need to provide real guarantees to Russian and foreign investors. This can be done in one year, and is an immediate goal for us.

But we also have long-term objectives. First is implementing real, workable property rights. Second is competition and de-monopolization; destroying old Soviet monopolies is the ultimate goal. Competition in the Russian economy is still unknown. Without real competition, and without real property rights, we will never reach what one can call a modern market economy.

Land privatization—private property in land—is one more strategic task for Russian economic development. Decentralization of power is another, making power more accessible for Russian regions and also for different business communities and groupings. Here I include the decentralization of the tax system and the federal budget.

Real Democratization and Creation of a Civil Society
But all this liberal agenda is possible if—and only if—Russia makes a political breakthrough. The major political tasks for Russia in the coming years are the separation of business from power, new rules of the game, and reducing pressure from criminal groups.

If you ask me where Russia is right now, I would say that Russia is at the crossroads. We are at the fork in the road. We have two paths before us. One is a long, difficult, painful road to democracy based on a market economy. The other one is much easier: simply doing nothing or doing what we are doing now—maintaining an oligarchic system based on monopolistic ownership and criminal behavior. This is the main choice for my country at the end of the 20th century.

To open the door to the 21st century, the ultimate goal for Russia in politics is real democratization and the creation of a civil society. The main problem of our economic reform was that we were not making political reforms simultaneously, we were not creating a civil society. We had a naive belief that privatization would do something by itself. But now we see that privatization without a legal system, without a judicial system, means criminal development, means corporatist development.

By losing opportunities to create a civil society, by doing nothing to effect real change from the grass roots of the society to the top, we are losing the confidence of the people. No macroeconomic stabilization, no privatization can help. We have to start immediately to create a real civil country, with civilian control of the military, with civil institutions throughout the country. This is the only way to keep the confidence of the people in reform. We have to make a new attempt to create a free press, a real judicial system, and the division of power, and to develop political party structures. This is the ultimate goal for Russia at the beginning of the next century. If we are not going to do this, if we do not concentrate all our efforts on this, we will have the system which I have already described—an oligarchic, corporatist, semi-criminal system. This system is not very different from the one we had before.

Grigory A. Yavlinsky is a member of the Russian State Duma and co-founder and Chairman of the Yabloko Party and its Duma faction.
SERGEI KARAGANOV

Domestic and Foreign Policy Progress

I am a great friend of Grigory Yavlinsky, and have been listening to him for many, many years. I must say that I have become an optimist, because I have passed at least 25 crossroads with him and I am still on a steady course. Nevertheless, his argument and analysis is pretty accurate.

Grounds for Optimism
I would add two items to his litany of problems the country is facing. (1) We are lagging behind in the information revolution. (2) We are witnessing de-population and, I would say, de-capitalization of Siberia, which could become, 10-15 years from now, a source of geo-economic and geo-strategic instability, instead of a promising source of economic growth for the whole of Russia and parts of Asia and Europe.

After saying that, I must say that I am a bit more on the optimistic side.

First of all, I see one very good thing in my own country. Russians have been famous for searching for the “Russian idea.” Our foreign friends have been pushing us in that direction. They were always asking, “What is the Russian idea?” More and more people in Russia are stopping this search. Instead of that they are starting to make money, build houses, etc. Maybe that is because we are changing at last and we are starting to do business.

Although crime was a growing problem, its growth has been stopped and is being reversed. For three years in a row, crime—including economic crime—has been lessening, though it still operates in the seats of power and still is a great problem.

There is some economic growth, though we would call it low quality economic growth—economic growth in the enterprises and in the branches of industry where it basically starts from scratch. There is a certain measure of economic stability.

Above all, laws, rather than presidential decrees, are more and more ruling the country. The judicial vacuum is rapidly closing. And that is largely because of the very effective (although highly and often criticized) work of our Duma, of our parliament.

We still have a relatively highly educated population and some relatively developed industries (like rockets, some chemistry, some machine-building). And we have our Marshall Plan in our soil—we have plenty of resources and we can use them for economic growth. No other economy which is experiencing anything like the Russian economy is experiencing, has this capacity. And that is why, probably, if some of us succeed, it will be Russia.

Foreign Policy Successes, Problems
In foreign policy we have achieved something remarkable for a country which is going through such turmoil. There is almost a consensus, and a few successes. Let me simply remind you of a few. We have good relations with China, China will be a problem, but relations are close. We have much better relations with Japan than at any single point during the last 50 years. We have a bit closer relationship with the Central Europeans. As for the Western European nations, in spite of some disagreements, we have relationships which are close to friendly. (That is unheard of in Russian history since the Holy Alliance when Russian troops were putting down one popular insurrection after another, being paid or not being paid by European monarchs.) The recent moves, though highly risky, in the area of the Middle East, and Iran and Iraq, have proven that Russian diplomacy is starting to play a more active and constructive role in the world arena. We are building up our diplomatic muscle. And in spite of the fact that on the surface we did it against our friends in the United States, we all
DISILLUSIONMENT IS MUCH MORE CONSTRUCTIVE... NOW THE CONSENSUS... IS CONSTRUCTIVE ENGAGEMENT WHERE NECESSARY, AND WHERE IT IS PROFITABLE FOR RUSSIA.

Another positive development in Russian foreign policy attitudes towards the outside world is the total disillusionment. I see the NATO Secretary-General here. He did many rights to my country; he did one great right. If anybody suspected that one could trust the West before the expansion of NATO, now nobody suspects that. There is total profound distrust, but it is a very constructive distrust. This disillusionment is much more constructive than the previous infatuation. Now the consensus which is being built: is constructive engagement where necessary, and where it is profitable for Russia. That is called cohabitation and friendship whenever necessary.

So I am pretty relaxed about our future foreign policy.

* * *

But the main question remains, of course: What will happen inside Russia? We are getting into a very long—hopefully not that long—period of political change. I am pretty sure that there will be a new president. The question is, which president? I am pretty sure that we have to go beyond the few names already on the table, that we need really a new generation of politicians ruling this country. They should all be under 50. And if we do not find anybody but Grigory Yavlinsky, we will vote for him!

Sergei Karaganov, a foreign affairs advisor to President Boris Yeltsin and a member of the Presidential Council, is Deputy Director of the Institute of Europe of the Russian Academy of Sciences and co-founder and Chairman of the Board of the non-governmental Council on Foreign and Defense Policy.
Germany as a Partner in Joint Policies

I would like to cordially welcome you all to Berlin and to Germany. In particular, I would like to warmly welcome the many foreign guests, especially the members of the Trilateral Commission and their spouses from North America, Japan and neighboring European countries.

I would like to extend a particularly warm welcome to the representatives of the five EU accession countries—Hungary, Poland, Estonia, the Czech Republic and Slovenia. The future membership of these countries in the Trilateral Commission is an encouraging development which would have been inconceivable only ten years ago....

25 Years of the Trilateral Commission
Thirdly, I would like to congratulate the Trilateral Commission on its 25th anniversary. You can be proud of what you have achieved during those years. Your work has perhaps not always been front-page news in the media but you have played a valuable role in the exchange of ideas between the world’s major economic centers—North America, Japan and Western Europe. The issues you have discussed at your meetings and introduced into public debate have borne fruit during those decades. For that I am grateful. You have thus also provided politicians with important impetus.

The central ideas behind the establishment of the Trilateral Commission in 1973—enhancing understanding between democratic industrial nations, assuming worldwide responsibility in cooperation with one another, strengthening the joint approach to key cross-border problems—were right then. They still are today and have lost nothing of their relevance.

The dialogue between North Americans, Japanese and Europeans is a special form of responsibility of economically strong regions. It has by no means anything to do with imperial ambitions or arrogance. The intense exchange between these societies, which are important for the fate of the world economy and thus that of the world, continues to be of particular importance in the age of globalization. This is evident every day, as we are currently experiencing with the discussions on developments in parts of Asia.

New Global Challenges
During the last ten years the world has undergone dramatic changes. Communism has collapsed, the East-West conflict has ended, Germany has been reunited, and the impending introduction of the euro will bring with it a fundamental alteration in the construction of the European House. We have every reason to be pleased about these developments, despite the problems which we naturally also have. I personally gain pleasure every day from being able to deal with the new questions and challenges, as well as the difficulties, arising from German unity or the construction of the European House—rather than having to discuss the stationing of Lance middle-range missiles as was the case ten years ago.

The world is moving ever closer together. National borders and conflicts still exist but they are of ever diminishing importance. It is becoming increasingly difficult for individual countries to resolve major social, ecological, economic and security issues alone. We witness
every day how diverse the challenges are. I say this with the hunger and hardship in the world in mind, as well as the issues of climatic change and international crime. The discussion on developments in Iraq and the proliferation of weapons of mass destruction is only one current example of how a problem affects not just one region but us all.

Growing World Population and Increased Migration
I would like to take a closer look at two central challenges which we must all face up to. The first is the dramatic upheaval brought about by demographic trends. The world’s population is growing—from 6 billion today to an estimated 8 billion by the year 2020. This will trigger off greater migration to wealthy countries and represents an enormous challenge for Germany in particular.

During the last few years migration to Germany has been higher than that to the United States. For example, 1.1 million people came to Germany in 1995 whereas only 720,000 people emigrated to the USA. Between 1988 and 1996 alone, more than 2.5 million people of working age came to Germany on balance. Another example is that on the conclusion of the Amsterdam Treaty we had a rather heated debate on the issue of asylum law in Europe. In 1996 117,000 asylum-seekers came to Germany, whereas only about 120,000 went to the United States and 110,000 to the European Union excluding Germany. In addition, we took in approximately 350,000 Bosnian refugees from the former Yugoslavia and offered them temporary shelter. Since 1991 we have spent about 20 billion German marks on helping these refugees.

These few figures illustrate the enormous challenge facing us Germans in particular. It is clear that we cannot cope with the unbridled flow in the long term. We must understand that the world’s problems cannot be resolved within the confined territory of the Federal Republic of Germany alone but, rather, must be mastered in the immigrants’ countries of origin. The aim of our policy, not only that of Germany but of the entire European Union and leaders all over the world, must be to help people in their own countries and offer them a future there.

Demographic Changes in the Industrial Countries
The industrial countries are also undergoing tremendous demographic changes. The proportion of older people will increase considerably during the next few decades due to falling birth rates and rising life expectancy. Take Germany for example: today there are about 13 million people in our country older than 65, i.e. 15 percent of the population. By 2030 this figure is expected to have increased to 19 million. Roughly one quarter of the population will then, by today’s standards, be pensioners. The demographic development in the foreseeable future is a particular challenge for our labor market and our social security systems. We must begin preparing for this today by taking the necessary adjustment measures. This is not a matter of party politics but, rather, a necessity.

Globalization
The second central challenge is the ever greater economic integration between countries. Globalization brings with it tremendous dynamism which is evident from just a few figures: world production has been growing by more than 6 percent annually since 1985. World trade has been increasing at a much quicker rate of more than 10 percent annually and cross-border direct investments by about 19 percent per year.

Globalization is being further reinforced by technological advances.... For instance, revolutionary developments in the communications field today have made it possible to transfer data and information around the world in seconds. One consequence of this is that even isolated locations are becoming increasingly attractive.

Globalization certainly intensifies competition. However, this does not cancel out its advantages. It opens up great opportunities for new markets, new trading partners, new fields of activity and thus also new jobs. We must seize these opportunities, on our own and togeth-
We urgently need large-scale tax reforms...
eigners invested a mere 32 billion US dollars in Germany between 1985 and 1996, almost 250 billion US dollars were invested in Britain—i.e. eight times as much as in our country....

Capital flows cannot be directed by government and parliamentary decisions. They are subject to the free will of the market and the individual investor. That we in Germany must change something here is underscored not least by the fact that our neighbors, for example Austria or the Netherlands, are openly attracting investors away from our country by pointing out their considerably lower tax rates....

The Deepening of the European Union
This year sees the realization of another decision of importance to Germany’s and Europe’s future, namely the completion of European economic and monetary union. For me this is also the fulfillment of a personal dream. I have been actively involved in politics since my school-days. As youths in the 1940s we reproached the older generation for allowing Hitler to seize power and for voting in favor of the Enabling Act. We decided then to push ahead with European integration and to prevent a return to the nation-state of old.

It was above all Winston Churchill, in his legendary speech in Zürich only eighteen months after the end of the Second World War, who called upon Europeans, especially Germans and Frenchmen, to join forces and end the hate between the peoples of Europe—between the French and Germans. A whole generation of great men and women epitomized the European vision after two world wars—Konrad Adenauer, Robert Schuman and Alcide de Gasperi, to mention just a few. History has shown that the visionaries of that age were the true realists. I say this in the light of the faintheartedness which I sometimes encounter in many parts, including Germany, when it comes to European questions.

For the Germans, and I say this in honor of all my predecessors from Konrad Adenauer, Ludwig Erhard and Georg Kiesinger to Willy Brandt and Helmut Schmidt, felt it was important to keep to our course on Europe over the years. Our friends and partners in the world, especially in Europe, trusted us in 1989 when the wall between East and West Germany fell. They knew that we Germans would continue to believe that, in the words of Konrad Adenauer, German unity and European integration are two sides of the same coin.

The Single European Currency
The decision to introduce the euro marked the beginning of another crucial period in European integration.... I am confident that, as agreed, the euro will be introduced on time on 1 January 1999. I would like to emphasize this not least against the background of the academics at German universities currently crusading against the euro. They should read what their predecessors said in 1948 about the introduction of the mark. History has proven those sceptics wrong. I am convinced that today’s euro opponents are just as wrong.

Of course, the euro is not the measure of all things. Problems such as those in the labor market will not be automatically resolved by it. However, its introduction will further improve the climate for investments and economic development in Germany and Europe. It will eliminate the exchange rate risks between the participating states and give investors more planning security. Furthermore, the new euro zone will further facilitate trade between the participating states and consolidate Europe’s standing in the foreign exchange markets.

The euro must, and I am sure it will, enjoy long-term stability. I am glad that we have succeeded in contributing our positive experience with the independence of the German Bundesbank to the European Central Bank. It is committed first and foremost to monetary stability. Its independence symbolizes the euro’s stability, just like the strict stability criteria of the Maastricht Treaty and the stability and growth pact....

Despite the attitude towards the euro reflected in some opinion polls in Germany, I am convinced that most Germans do realize the great political importance of the single European currency as well as its economic significance. European
integration is, together with our close partnership with the USA and Canada within the framework of the Atlantic Alliance, the guarantor of peace and freedom in Europe. The euro is one of the supporting pillars of a stable and weather-resistant European House.

What is more, we all need this Europe. However, we Germans need it more than anyone else as we lie in the heart of Europe. We have the most frontiers and neighbors and, with our 80 million inhabitants, are by far the most populous country on our continent. Our recent history has not always been easy.

Enlargement of the European Union

For us the question of the eastward enlargement of the European Union is therefore not an issue just like any other. We do not want the EU’s current eastern frontier and Germany’s eastern border to form a barrier. Rather, they should gain the same everyday normality as, for example, the Franco-German border between the Black Forest and the Vosges Mountains, between the Palatinate and Alsace. I do not want Cracow to lie somewhere in Eastern Europe but, rather, to be a city in Europe—just like, for instance, Bonn, Paris or Rome.

As a result of its geographical and geopolitical location in Europe, Germany has a special responsibility. This became particularly clear in connection with German unity...

What François Mitterrand said, and I have quoted him time and again, a few weeks before his death to members of the European Parliament in Strasbourg remains true today: “Nationalism is war”. Naturally, he did not mean that we are faced with imminent war in Europe. Developments in the former Yugoslavia during the last few years, however, have made it clear what he meant....

We must also live up to our responsibility to the eastern part of our continent. Our policies must focus on shaping relations with the new Russia. Our task is to work towards forging links between this giant country with its great tradition, history and culture, which is of key importance to Europe’s future, and the euro-atlantic structures. This also applies to other countries in Eastern Europe in a similar situation, such as Ukraine.

The radical changes of recent times raise new questions and problems.... Our neighbors and friends abroad expect us to live up to our responsibility in full and to help when the new Europe emerges beyond the divides of yesterday—a community of united democracies.

This Europe will be a continent of peace in which coming generations can live in freedom. That is why we want to advance the construction of the European House—a House with room for all European peoples wanting to live there and prepared to respect common house rules. We want a European House with permanent right of residence for our transatlantic allies—the USA and Canada. We do not accept the view expressed by some that the time has come for our transatlantic partners to withdraw from Europe.

The progress made during the last few years gives cause for realistic optimism. It is my wish, my vision, that we will make the new century a century of peace and freedom everywhere, as well as of economic prosperity for as many people as possible, including those in the Third World. We can achieve this. Despite the setbacks and problems we are experiencing, we will succeed if we all muster the courage to carry out necessary changes and work together closely.

Germany has mapped out its course and is making its contribution. We are facing up to the challenges of the 21st century. You have seen the numerous construction sites here in Berlin. I am convinced that Berlin will be a beautiful capital. What you have seen today is only a small part of it. Germany has invited the world to visit the world exhibition in Hanover in the year 2000.... Above all, we want to present Germany to the world as a country seeking to enter the new century together with its partners. I would like to end on this note and to express the wish that we will travel along this path together.
The closing event of the Trilateral meeting was a reception hosted by Germany’s President, Roman Herzog, at the Schloss Bellevue, the official seat of the Presidency in Berlin. The following is taken from the translation of his welcoming remarks.

You too, I am told, have been looking ahead to the 21st century. That it will have to be an era of joint action is beyond doubt considering the unstoppable globalization process. Such action presupposes a common awareness and a common understanding of the problems that lie ahead. The mature industrial nations in particular share quite a number of urgent problems which do not stop at national borders, which means no single nation can solve them alone.

In international relations, new challenges require a new policy. The key to such a policy is to be found, in my view, in a threefold strategy of communication, cooperation and integration.

Part of the communication element is, for example, the annual meeting of the Trilateral Commission. This exchange of views and experiences not only at the political but also at the economic and social levels mobilizes early warning systems. It is at the same time a source of energy from which we can derive ideas for problem-solving. Furthermore, if the dialogue is opened up and intensified mutual tolerance becomes easier.

A new policy also includes cooperation, the second element of the strategy. In the globalization era, a growing number of problems are beyond the scope of nation-states acting alone. The recent monetary turbulence, which originated in Asia but has affected all countries, reminds of the '70s. This means that when considering the international coordination of economic and monetary policies, the Trilateral Commission can draw on the experience of its early years. It is perhaps more obvious now than it was then that economic equilibrium—including on the labor market—can only be achieved by exploring new forms of growth, in particular growth based on knowledge. Ludwig Erhard’s motto “prosperity for all” is still valid, except that in the future it will only materialize if coupled with that of “education for all.”

The most demanding element of the threefold strategy is of course that of integration. By this I mean not only supranational integration along the lines of the European Union (the integration idea is about to make a big leap forward with the establishment of Economic and Monetary Union). Also conducive to integration in the age of globalization are international and transnational relationships in their many forms. APEC and ASEM are examples of such integrative tendencies which link North America, Asia and Europe. Here too, the Trilateral Commission has done pioneering work.
Germany is On the Right Road

Impression of Stagnation Not Accurate

"Habit and Change"—with these two words Arnold Toynbee once summarized the course of world history. Back in the 1930s, the great British scholar and historian wrote: "History is on the move, again." Since reunification we have witnessed the return of history, and more change than we dared to hope for during the decades of the Cold War—perhaps indeed more change than the individual can cope with. Nowhere has this change been more tangible than in Berlin—the city of division, the symbol of the Cold War. You only need look out of the window here to gain an impression of the speed with which the city has been transforming since 1989. The Brandenburg Gate—symbol of unity—is now open to traffic between east and west. And the Potsdamer Platz is one vast construction site. Yet, there is currently much talk of stagnation and lack of movement in Germany. The images of Germany in the international press of the past seven years are often not flattering. The descriptions range from "stumbling giant" and "Gulliver in chains" to "tame monster."

Is the impression of stagnation really accurate? We have in fact set a great deal in motion in recent years. We have reformed the system of social security and introduced new regulations on the payment of wages in case of illness. We have privatized the railways and postal services. We have also deregulated telecommunications and energy, amended the provisions on protection against dismissal, stimulated the setting up of new businesses, been more active in fighting crime, and extended shop-opening hours—an issue which prompted some of the most heated debates in the German Bundestag during the current electoral term. In fact, we have introduced so many changes that the Social Democrats recently had difficulties listing all the measures they intend to reverse. In their election manifesto, they needed several pages to list the changes they would roll back.

We Germans had to cope with a substantial amount of change. Yet, we’re not finished. That this has provoked and continues to provoke resistance, should come as no surprise. It seems almost natural in a country which for decades was accustomed only to struggle over the distribution of wealth and whose people, as everywhere else in Europe incidentally, responded to the loss of old certainties with a kind of helplessness and with a scepticism towards all that was new.

Positive Political Balance Sheet Since Unification

Understanding the new political realities in Germany has not been easy for us. We were not, after all, prepared for the new situation, and our first steps on the international stage were perhaps slightly tentative. It is not only that since unification we found ourselves confronted with sceptical suppositions and old fears amongst our neighbors. Since then, we have also faced rising expectations. Our political balance sheet since unification is, however, positive. Our reunited Germany has neither suffered an attack of Wilhemine affectation nor has it fallen prey to a "new assertiveness." There is no way of returning to Rapallo. Through its constitution, its institutional integration and the feelings and attitudes of its people, reunited Germany continues to be firmly anchored in the West. It remains an integral component of the European Union and the North Atlantic Alliance. This will not change at all when in the summer of 1999 the German parliament and government move here to the banks of the Spree. There will not be a "Berlin Republic"—a favorite object of journalistic speculation—just as there has never been a "Bonn Republic" or a "Paris Republic."

The long way Germany has come within the international community since reunification is best illustrated by the contribution the Bundeswehr is making today in Bosnia, promoting peace and
security in Europe. I still remember well the heated debates we had in the German Bundestag in 1995 on the question of German participation in the Rapid Reaction Force for Bosnia. Today, side-by-side with British, French, American and Russian soldiers, Bundeswehr troops are helping to implement the Dayton Accord. And for the great majority of the Germans, their participation is no longer a controversial issue. Young men from Germany, east and west, are today standing side-by-side in serving their home country and in helping to foster peace and stability. Although at times not fully understood, this too is a successful chapter in the history of German reunification.

Here in Berlin, German policymakers are directly confronted with the problems which determine political action in Germany. Germany is politically reunited, but it has yet to become one. Our experience of life differs in many respects. Often, in our daily lives, we are painfully reminded that it is not always easy to bring together strands of development that for four decades pulled us in very different directions. The laws of competition and the market take some getting used to. But in time they will be accepted, for they are the best guarantee for security and prosperity. This will take time, but I am firmly convinced that we shall succeed. At times when its political and social framework requires stability, democracy must and can prove its strength.

Firm Support for an Integrated, Active Europe

Foreign policy is the sum of a country's history, its geography and common experience. I have already touched upon our history and shared experience. What remains is our geography, the most determining feature being Germany's position in the middle of Europe. We have more neighbors than any other European country except Russia. And we are in direct proximity to the reforming countries of Eastern Central Europe.

We are advocates of integration, because only a Europe with a strong economy can compete with the other markets in an increasingly interdependent world. And we know that security is indivisible. The nation-state is increasingly less able to provide an adequate response to the many different challenges we face today. We have learned the lessons of the past. We know that we can never stand alone. Only together with our partners will we be able to master the challenges before us. Today, the majority of Germans do not wish to see any slowing down of the process of European integration. They define the goals and successes of this process no longer only in economic terms, but also in political terms.

For us, deepening and widening the European Union while strengthening the Atlantic Alliance is not a contradiction. As our experience in Bosnia shows, when Europeans and Americans are divided, security in Europe and on its periphery suffers. We know that in the future we Europeans must make a larger contribution to our own security. This is the best we can do in strengthening and consolidating our transatlantic ties with the United States. To achieve this, we need a Europe which is able to take effective and concerted action. Europe must assume responsibility, prevent aggression and safeguard peace.

Germany is aware of its responsibility. The response of our partners to German reunification, and the support and understanding Germany has experienced since then, are a sign of trust. For this we are grateful and it is for us both an obligation and a stimulus. On the basis of our convictions and to the best of our ability, we shall continue to make our contribution. This will be both to a united Europe and within international organizations, as a responsible member of the international community of states. An understanding of the need for a more active international role will grow among the people of Germany. Germany will neither be reduced to a mere civilian power, nor will there be a militarization of German foreign policy.

The Competitiveness Challenge

In global politics, the importance of economic factors is increasing and that of military means of power diminishing. As a country which has few natural resources and depends on exports,
Germany has always attached special importance to international trade. As an industrial country, Germany relies on free trade. At a level of US$6500 per capita, the export-intensity of the German economy is four times greater than in the United States and almost three times greater than in Japan.

The intensity of competition resulting from globalisation is therefore of vital significance for Germany. Holderlin once said: "Wo Gefahr ist, wächst das Rettende auch." (Where danger is, there is also help.) Germany is in the process of recognizing the profound truth of this saying. We must change if we are to adjust to a changing environment. On the road to a service-based society we fall behind the Anglo-Saxon countries, and in the field of education we must also intensify our efforts. In the long run we will only be able to hold our own at the leading edge of innovation and technology if our system of education and training once again becomes competitive internationally.

Despite its problems, Germany is still an attractive location for industry at the heart of an enlarged and politically united Europe—at the hub of the internal market with the highest level of demand in the world. The assets which we can use to our advantage are above all our people, their knowledge and skills; our high standards in the field of scientific and technological development; our excellent transport networks; and the quality of our products.

"Habit and change"—Germany is on the road to structural renewal. It is on the right road. Our past successes and the joyous reunification of our home country in peace and freedom are both an incentive and an encouragement to hold our course, to continue down the road we have taken—one that will lead to a safe and prosperous future for people in Germany and in Europe.

Wolfgang Schauble is a Member of the German Bundestag and Chairman of the CDU/CSU Parliamentary Group.

GÜNTER VERHEUGEN

If the SPD Becomes the Strongest Party...

As a representative of Germany's major opposition party, I will not try to present an analysis of Germany's current state of affairs in the political, social and cultural areas, but come precisely to the point: What is going to happen in Germany this year if change emerges as the word of the year in 1998?

The September 1998 Election

The situation of the SPD is really uncomfortable six months before the 1998 election—uncomfortable because we are again in the position of the front-runner. This happened in 1994 and it happened in 1990. Six or seven months before the election my party was leading in the opinion polls—the Christian Democrats trailing far behind—but we did not win. I cannot forget my experience in 1994 when I was the Secretary-General of the Social Democratic Party and the national campaign manager. I assembled the representatives of Germany's big opinion-polling institutes, and all these people told me it is impossible for Mr. Kohl to win the election. It is impossible for the Social Democrats to lose. But, as you know, it was possible. Therefore I am a little bit careful now.

But there are some important differences between 1998 and 1994. In my view, the biggest difference is that in the opinion polls people not only say they want a change in government, but also tell us that they do believe it will come. In 1994, there was a contradictory situation. In the opinion polls people always said, we want a change, but they also always said that they did not believe it would come—and therefore it didn't come.

Another difference is that the Social

SIX MONTHS BEFORE THE 1998 ELECTION... WE ARE AGAIN IN THE POSITION OF THE FRONT-RUNNER.
Democratic Party has decided to nominate Gerhard Schröder, State Premier of Lower Saxony, as the Chancellor candidate. Mutatis mutandis, one could say that Gerhard Schröder is a Tony-Blair-type of Social Democratic leader. He is not a traditional Central European Social Democratic leader. Nobody should think that the Social Democratic Party of Germany will not follow him. It is the smell of success that makes him so strong. He was extremely successful a couple of weeks ago in his home-state election. On the other side we have a party leader, Oskar Lafontaine, who can integrate the left wing of the party, the more traditional wing, you could say the French type of European social democracy. Of course there was some competition between Gerhard Schröder and Oskar Lafontaine, but now it is decided, and Oskar Lafontaine and Gerhard Schröder will cooperate closely.

Coalition Possibilities
The strategic aim of my party for the election this year of course is to break the majority of the government coalition and become the strongest party. We do not expect to win a majority for the Social Democratic Party alone. Our system makes that almost impossible. (You could say that landslide victories like in Great Britain are prohibited by the electoral laws in Germany.) So we will need the support of another party. Will it be a coalition between Social Democrats and the Green Party; will it be another coalition? It is not decided and it will not be decided before the election—this is a tradition in the Social Democratic Party. We have different options, and all these options are realistic.

The so-called Red/Green coalition is widely seen as the most probable solution, but I am not so sure. The Green Party created a terrible mess during its last party congress two weeks ago. It has a completely unrealistic and dangerous platform on the economy and on foreign policy, especially on foreign policy. The party is divided, between the so-called Realos supporting the leader of the parliamentary group, Joschka Fischer, and a strong fundamentalist wing, especially in the rank and file of the party. Symbolic of its completely wrong approach is the decision of this party congress to tell the electorate that they want to raise the price of gasoline in Germany to DM 5 per liter. (In my constituency now, it's DM 1.70.) DM 5 per liter of fuel is really a symbol, the wrong symbol of course. (The gasoline price is like the bread price used to be in France.) It demonstrates an old-fashioned way to run a government and to run an economy. Of course we will not do that.

Germany Foreign Policy will not Change
On foreign policy, there will be no change. The principles of Germany's foreign policy, whatever happens with the election, will not change. Germany will continue, if the coalition continues or if we win, to work on Europe's unity and European integration. We will preserve the close ties between Europe and North America.

NATO. We see NATO as an indispensable means to strengthen the relations between the United States and Europe. NATO is absolutely important and crucial for peace and security in Europe. I don't think the situation in Europe is as stable as is sometimes described in international papers. I have my doubts, after traveling a lot during the last two years in Russia, in Ukraine, and the other Eastern European countries. I cannot say that we are on the safe side in the so-called transformation countries. I am basically optimistic that we will have rule of law, stable democracies, and market economies there; but there is still a very, very long way to go, and the situation is absolutely not stable. So we need defense capacities in Europe in order to prevent others to build up new capacities. And we need the ability to start peacekeeping operations and guarantee peace agreements, like in Bosnia, if needed.

We are going to have a few major foreign policy decisions in our parliament during the next weeks. Next week we have to decide on NATO enlargement. It will be very interesting
to see how the Green Party will act and especially Mr. Fischer. The Social Democratic Party supports NATO enlargement, and of course we will ratify the protocols and make it possible for Poland, the Czech Republic and Hungary to join the Alliance. We see NATO enlargement as an open process. On this point I go a bit farther than my colleagues from the government parties. I told the Russians a couple of weeks ago in Moscow that a Social Democratic-led government in Germany would try to continue the process of NATO's enlargement and would try to include the Baltic States. I know that this is very difficult for our American friends, and it must be discussed, but our Russian partners should know what we have in our minds.

European Monetary Union. The next important decision is the European Monetary Union. Parliament has not formally decided to ratify it, but we have agreed that the government should ask parliament before it decides in Brussels. That will happen in late April. We will have, in my view, the support of more than 90 percent of our parliament for the European Monetary Union, in contradiction to the public mood in Germany — our electorate is not so happy with the European Monetary Union, with giving up the D-Mark. I don't think the majority of Germans are against the single European currency, but they are uneasy. They don't really know what will happen and what it means for their personal economic situation. So we have to explain to people more than we did in the past.

I should add that for the majority of the lawmakers in Germany, the European Monetary Union is not only an economic decision. There is a strong political dimension. I was the chairman of the special committee of the Bundestag that dealt with the Maastricht Treaty in 1992 and 1993, and I remember very well that the political dimension of the European Monetary Union was in the foreground of our deliberations. I remember that Count Lambsdorff, in the debate in Parliament, argued that we should not forget the economics; he was absolutely right. But for political reasons the major parties in Germany decided that we have to go along with it. It will come and we will fight for it.

European Integration. It's the same with European integration. Germany has not had a very deep-going debate on Europe because for 40 years there has been consensus in Germany that our future is in Europe, that Germany must struggle for a united Europe, that Germany's place is in an integrated Europe. Mr. Kohl could emerge as a pioneer for European integration among European statesmen because we share his vision of European unity. The SPD has never opposed in our parliament the European policy of this government. It makes the German government strong in Europe that our partners know there is a political consensus behind the policy of the government.

I hope sincerely that this consensus will survive. I have some doubts. Especially in Bavaria we see tendencies, in the Christian Social Union that is the sister party of Mr. Schröder's party, to campaign against some parts—not generally, but some parts—of the European integration process, to exploit fears of the people. It is dangerous because nobody knows how strong these fears would be in the future.

In my view, in our view, this process of European integration will become more difficult than expected. It will need more time than our partners in Central and Eastern Europe believe. I am just coming from Prague, where there are illusions. Our partners believe they can become members in 2001 or 2002. It will not be, for two reasons. (1) It is extremely difficult for the new member states to fulfill the needed conditions, the acquis communautaire. (2) It is extremely difficult for the European Union to complete its process of institutional and financial reform. In fact that process has not really started.

But the biggest problem is that Europe is still not able to develop a common foreign and
security policy. The Iraqi crisis showed clearly that Europe is still not able to act jointly and to have common views and to play an international role as Europe. It was divided between the French and British positions, and I think that is going to continue.

Don’t expect too much if there is the unique situation of Social Democratic governments at the same time in London, Paris and Bonn. My experience is that national interests are always stronger than ideological similarities. I’ll give you an example. We have working groups with the French Socialist Party. I am the co-chair of the working group on foreign and security policy. Our last meeting was after the French election, and even the body language of our French friends changed. When they entered the room, we saw power coming. It was not the French Socialist Party, it was la France. And it is the same with us.

The SPD Supports the Market Economy

Last remark. The Social Democratic manifesto for the election is not completed, but I can give you some catchwords and you will see that the direction is completely new. Mr. Schröder said last week after the meeting of our party executive, "This will be a platform that is based strongly on the idea of a market economy." There has never been a program in the history of the Social Democratic Party of Germany that is so much market-economy-oriented. The idea is not to change the system. The idea is not the old Socialist way of planning and big government and big spending. The idea is to bring together the social and economic forces, trade unions and the industries, to get a consensus on the reforms that we need in Germany. The idea is that competition in a market economy is the most efficient way to create growth and jobs. Of course at the center of the campaign we will have the question of creating and preserving jobs, not by financing public job-creation programs, but by supporting the initiatives of the industries and the market.

You might say that is too nice to be true. I have to say that our experience is that the old-fashioned way cannot win elections in Germany; people simply don’t like it. And experience shows that a social market economy is really the most efficient way, and so we will try to do it. .

Germany will remain a reliable partner. Germany will remain a cooperative country. Germany will continue to work for European unity and for a strong Western alliance.

Günter Verheugen, a Member of the German Bundestag, is Coordinator for International Relations of the Social Democratic Party and the SPD Parliamentary Group.

HEINRICH VON PIERER

A Global Player's Look at Germany's Competitiveness

I am not a politician—I am just a simple businessman. But I think I know Germany quite well. After all, we at Siemens have almost 200,000 people on our payroll in Germany. And since we do 70 percent of our business outside Germany, I also get around in the world quite frequently. Based on these experiences, I'd like to make a few remarks about Germany's competitiveness.

Active Berlin,
National and Global Siemens
On all my visits to Berlin in recent years, I have been impressed that Berlin is the only city in the Western world that has nearly as many construction cranes as Shenzhen or Shanghai. Berlin
is quite lively. This is a clear message to the people who say that Germany is not an attractive place for investment, or even have doubts about the future of the country. Seeing reality is better than believing stories about the "German disease." The old Chinese saying sums it up best: "Seeing something once is better than hearing about it a hundred times."

Siemens was founded in this city 150 years ago, but we quickly went international. Today our 400,000 employees are at home in over 190 countries. The United States plays a special role for us, because it is the world's most demanding—and most competitive—market. If you want to make it anywhere, you have to succeed there. That's why we are really proud of our achievements in the United States—with a workforce exceeding 65,000 people this year. By the way, we export as much from the United States as we import to the country. The situation is different for us in Japan. We have been there since 1887, but we haven't been especially successful so far. This is partly due to the market, which is more difficult to access for European companies than the United States. And—I have to admit—it is partly our own fault.

Naturally every company in the world has a special relationship with its birthplace: Siemens with Germany, Ford with the United States, Sony with Japan. But all of these companies are also global players—generating sales and value-added on all continents. For each of them, strong national roots and a global presence are not contradictory, but rather a necessary combination. That is also my strong personal conviction.

**Four Aspects of Germany's Global Competitiveness**

Today I would like to talk about four aspects of Germany's global competitiveness. There are many other important points, of course, but I will limit myself to four.

*First, conditions in all regions of Germany are quite good for investments.* In all of our states there are examples of projects that were approved and completed quickly and efficiently. Since we are meeting here in Berlin today, I would like to focus on the new German states. Massive investments in this region have created one of the world's most modern infrastructures. Since 1990, for example, over 4.500 kilometers of fiber optic cables and 10 million kilometers of copper cables have been laid. Today the region has one of the world's most advanced telecommunications networks.

Siemens, for example, has made two major decisions to locate future-oriented technologies in the new states. (1) In 1995, we opened Europe's most modern chip factory in Dresden. We invested 2.4 billion marks in the facility. (2) The latest news is that we are also locating our new joint venture with Motorola in Dresden. We will develop new technologies for manufacturing 300 mm silicon wafers there by the year 2000. This is the first private project of its kind in the world, and it is a very important project for the future of the semiconductor business.

We are also investing in other parts of Germany. What are the advantages in such investments? (1) First of all, Germany is Europe's largest market, a fact we should not forget. (2) Second, German workers have outstanding training, and are quality-conscious, reliable, and highly motivated. This is particularly true for east German workers. (3) Third, the country is a perfect base for activities in Central and Eastern Europe.

I think foreign companies are missing the boat when they ignore the excellent business conditions in Germany and especially in the new states.

This leads me to my second point: codetermination. People outside Germany are often highly suspicious of the idea. Many believe codetermination symbolizes the weakness of German business. This suspicion arose because of different mentalities and traditions—between the United States and Europe, for example. European societies very much value their tradition of social consensus. At its best, it can be a positive factor; and that is also our experience. Codetermination is not a barrier to economic success, particularly when it promotes constructive cooperation between employers and employees. But it functions only if there is a climate of trust with the
works councils. And this climate must be built up over time—not overnight.

Getting along with the functionaries of the trade unions is a different matter. I often wish they had a greater sense of reality. One must differentiate between the various unions, of course. Some are open to change, others not. Unfortunately, Siemens has to deal with one of the more difficult unions.

My third point concerns the different speeds of business and politics. For years, German business has been getting in shape to meet the new dimensions of global competition. We at Siemens, for example, launched our top program four years ago and have been quite successful in boosting productivity, pushing innovation, and driving growth. In the last three years alone, for example, productivity gains have saved us 26 billion marks. In the same period we have doubled the number of innovations to 6,000 per year. This is just the example of one company. Others in Germany have had similar success. Just look at the automotive industry, the chemical industry, and the machinetool industry, for example.

On the political front, progress has also been made in recent years. Mr. Schäuble referred to this quite rightly in his presentation. Deregulation has brought fresh air into important markets. The telecom market is a good example for that. In fact, the telecom liberalization has become more comprehensive than in some other countries which talk very much more about deregulation than we do. And interesting developments are also expected in the energy sector when deregulation measures take effect in the near future.

In other areas, however, politics are moving far slower than business. There are some cases where necessary changes haven’t been made yet. The failed tax reform has unfortunately become a symbol of this delay. It is true that politics are not always simple in Germany. In part this is due to different parties controlling the Bundestag and Bundesrat. As a result, our politicians often have to maneuver back and forth. And under these conditions, their strategies are not always quite clear.

My fourth and final point is one especially close to my heart: education. Germany has still a good reputation in the world for its educational system. Our broad spectrum of schools really is unique in the world. The same is true for our vocational training. The well-known “dual system” of practical and theoretical training is praised—and often copied—outside Germany. Siemens has introduced the system at various factories in Asia and in the United States. In fact, President Clinton has taken a personal interest in our program.

The situation is not as good when it comes to educating our elite. Our universities are overfilled, not efficient enough, and their curricula and degrees are not compatible with the Anglo-Saxon system. This unfortunately makes our universities less attractive for foreign students than they should be. Things are starting to change now. For example, there are moves to shorten study time, make curricula more practical, and introduce internationally recognized academic degrees. The goal is to put German universities back among the world’s best. This is extremely important for us. If we want to continue playing a leading role in the world, we need a steady source of young talent.

These four points are not, of course, the only ones crucial for keeping Germany competitive. But they show that Germany is taking action. Our speed in finding answers to the challenges of global competition is a matter of survival. Nothing sums it up better than a simple story of two friends hiking in the woods in Canada. Suddenly they run into a huge grizzly bear. Quickly one puts on a pair of running shoes. The other yells, “Don’t be ridiculous, you can’t outrun that bear!” His friend answers, “I don’t have to outrun the bear; I just have to outrun you!” Germany is putting on its running shoes.

Heinrich von Pierer is Chairman of the Managing Board, President and Chief Executive Officer of Siemens.
arnulf baring

Germany’s Crisis of Stagnation

Whenever one listens to German politicians these days, regardless of whether they belong to the Christian Democratic/Liberal coalition or to the Social Democratic opposition, their message is reassuring, especially in an election year like 1998. All is basically well-settled, they say. Germany is stable, has solid institutions—especially solid, responsible political parties. There are problems, yes; reforms are necessary; but they are on their way; they are being well-prepared; and we will execute them immediately after the election.

Reading German or foreign newspapers, one gets a different impression. Especially in American papers, you have found in recent months articles about Germany as a newly declining nation. And if you look at German public opinion polls, you find a remarkable split. A large majority of my countrymen are convinced that we live in a period of lasting stagnation, that we need many reforms we do not get. You find widespread disillusionment and annoyance. Political parties, all of them, are not held in high esteem. Dislike of political parties and politicians has grown to remarkable proportions during the last 20 years. All political institutions have, more or less, lost their reputation: Bundestag and Bundesrat, the Federal Government, and also to a certain degree the Federal Constitutional Court.

The most popular institution is still the Bundesbank in Frankfurt, but it will be reduced in importance very soon (50 years after the currency reform of 1948 which created the prestigious Deutschmark) because European Monetary Union will take effect on January 1, 1999—another reason for widespread displeasure. At the same time, when asked about their personal life, their individual well-being, the answers of our people are very different. They admit to being rather well-off. They find the general situation of our country lamentable, but they have no personal reason to complain. The overall picture is dark, but their standard of living is high. They live in comfortable circumstances, are content with their situation, and admit it.

What conclusion can we draw from these observations? Are the politicians wrong or right? And how about the public?

A Crisis in a Still-Prosperous Country

Let me try a tentative answer: We have in Germany an obvious crisis, but it is a crisis in a still-prosperous country. The mechanisms of the welfare state are still functioning and therefore there is no misery, no widespread poverty. Unemployment is a psychological burden, for many it is a catastrophe, and for young people it is unacceptable. However, according to a recent study of the Hamburg Industrie und Handelskammer, one third of the unemployed do not look for work; a second third are hesitant, often insufficiently qualified; only one third are really able and willing to accept a new job. If we generalize from these local findings, unemployment is still not an alarming phenomenon. It is unpleasant, but not dangerous. Many are better off with social security benefits and the second income from a moon-lighting job than they would be if they were fully employed.

Elements of the Crisis

What then are the most important elements of the obvious but hidden crisis? Germany, I think, is no longer a technologically advanced country. Our exports are still high but we excel only in branches where Germany was already leading decades ago. We mastered late the first industrial revolution, but with brilliant results in the end. During the second industrial revolution we were equal to the United States, if not ahead of the most advanced country in the world. Tempo passato.... In the new high-tech industries, however, we have
...It is hardly exaggerated to characterize our country as an old-age asylum in an industrial museum.

started late, or we are not present at all. (Heinrich von Pierer is one of the promising exceptions.) We stay behind in the new technologies and have to buy patents from more advanced countries like the United States or Japan.

Some knowledgeable observers have come to the conclusion that the Germans have lost their former ambitions and seem to be content with a second-rate, even a fourth- or fifth-rate position. This remains to be seen, because my countrymen are used to a high standard of living, long vacations, early retirement, qualified and expensive social services. We shall see what happens when all these privileges and benefits are diminished or at least seriously shortened because of the new lack of public funds. Already today, the public debts at the federal, state and local levels are exorbitant. Where there was no federal debt to speak of until the end of the '60s, it grew rapidly in the '70s and early '80s, diminished in the later part of the '80s, and grew fast again after 1989, largely because of unification with the former GDR, but also because of excessive demands for public benefits.

Germans enjoy a standard of living they cannot afford any longer. Germans are used to an extensive and expensive welfare system, which is more and more beyond their means. The German state distribution system includes not only social security and public health services but also DM 300 billion of subsidies mostly for outdated industries which were profitable a long time ago—coal, steel, shipbuilding, agriculture, former industrial centers in the GDR, and so on.

On the other hand, money is missing for basic research, for university libraries, for universities as such. Our whole educational system needs a thorough rethinking, a comprehensive reconstruction. One of the decisive reasons for the rapid and successful industrialization of Germany—also of Japan—was the quality, the efficiency of our primary school system in the 19th century. And the German universities of the 19th century became models in many other parts of the world, including the United States. These times past are nostalgic memories for us today. Our school and university systems have expanded enormously in quantity over the last decades; their quality has been diminished by the same process. Excellence is rare, exceptions notwithstanding. We lack universities like Oxbridge, the Ivy League or les Grandes Ecoles. Germany no longer hosts students from the advanced countries. On the other hand, gifted and qualified and enterprising young Germans leave the country to study abroad, to work and live and stay abroad for good, especially in the United States. Surprisingly enough, this remarkable brain drain has never interested our public, media and politicians. To this day there has been no open and thorough debate in Germany about the merits and defects of our educational system. Since the structural reform of the late '60s, no party was willing to look closely at the results of these organizational changes. Education is not a topic of political discourse—neither aims, nor means, nor values. This is all the more surprising since the only natural resource, the only raw material our country has are the brains and hearts of our young people.

However, the younger generations do not interest the German public. They are a shrinking part of the population, whereas the older generations grow in numbers and accordingly in electoral strength. They are voters, the old. The young, under the age of 18, are not. Parties which want to be elected have to be concerned about the old, not the young. Beyond this simple insight you also find the widespread belief that young German men and women are not really required for the future since immigration from abroad can easily fill our gaps. I cannot discuss here the special problems of our very peculiar immigration laws, which result from the asylum article in the Basic Law of 1949. Kurt Biedenkopf pointed out years ago the financial and psychological implications of massive immigration. As far as I can see, no European society is willing
to shoulder these burdens, and Germany is no exception in this respect.

In Germany 120 years ago there were 100 young people under the age of 20 for every 10 over 65. Today we have 10 under 20 for every 10 over 60. Together with our relatively small inventions and investments—neither Germans nor foreigners invest in this country these days—it is hardly exaggerated to characterize our country as an old-age asylum in an industrial museum. The widespread discontent, the lack of motivation and initiative in public life, the tax burden, the overload of laws and of time-consuming bureaucratic procedures, all this stagnation and immobility characterizes, in my view, a society which is growing old, looks back in nostalgia to the good old Federal Republic before 1989, dwells in the bright past and is afraid of the future.

Or are the new generations so spoiled, easygoing and lazy that their attitudes towards life and their motivation to achieve are different from the generations of their parents and grandparents? Have the Germans changed perhaps more profoundly than foreign observers tend to admit? Have the strains and burdens and sacrifices of the first half of our century exhausted our people? Or do we witness today the effects of half a century—the second half—of growing comfort and well-being? I do not know the answer.

Experience tells us that people react in unforeseen ways as soon as they are confronted with new and real challenges. This is particularly true for Germans. They have again and again surprised themselves and the world by unexpected turns of their behavior. Germans are enthusiastic beginners. They love new departures. They will not disappoint us in this respect in the future, I am sure. It might be a rather distant future, but who knows? For the time being let us be cautious. Let us avoid generalizations.

There are enormous changes taking place in our industry. Restructuring is going on in large segments of the private economy. It is not the private sector we have to be concerned about in the first place. The political system, the party system is in danger. Here we witness the most obvious crisis—a dormant crisis, not yet an explosive one. Parliament has neglected the task of being the platform of the public discourse, the forum of national attention. Germans begin to forget that parliament should be the center of political relevance, the backbone of a living democracy. There is a growing sense of public frustration, of alienation. There are many reasons for this. Politics have become more and more a career like others, a bureaucracy among others, as far away from the people as a tax office or the education department. This comparison is not far-fetched since the vast majority of our deputies are civil servants, public functionaries on leave—by origin, mentality and training distanced from the ordinary citizen.

What happens today to the German constitutional system of representative government? What explains the fundamental inertness, the lack of choice in our parties? Is it lack of political leadership? Even the Chancellor, more than 15 years in power, speaks like the leader of the opposition. What a difference between his performance and the energy and determination and clearness of Margaret Thatcher or Tony Blair. Britain and America are society-oriented. Germany, and France by the way, are state-oriented. The state is in the center of attention, not the citizens. And the German state is essentially defined as a Social Democratic state, the supplier of extensive, comprehensive social justice in the broadest sense, responsible for the well-being of its subjects. For centuries, the German state or its predecessors have shouldered this responsibility, have enlarged the burden over time, have bought the political consent of the citizens with larger benefits. Since a couple of years the desolate budget situation does not allow this mechanism any longer. One cannot buy consent any more. One has to offer Zumutungen (exactions or demands) instead of Zuteilungen (distributions) of former days.

THE POLITICAL SYSTEM, THE PARTY SYSTEM IS IN DANGER.
Both large parties, CDU and SPD, are, in spite of all their differences, very close to each other; both are Social Democratic in a very similar way. One can say this Social Democratic Federal Republic was a lucky, happy interval of German history during the time of the Cold War. However it does not fit at all in the very new internal and international situation since the 1990s. But it takes the Germans a very long time to comprehend their changed field of political action domestically and internationally.

The unexpected reunification of our country meant the necessity to reconstruct large German territories half the size of the old Federal Republic. It meant West German manpower and organizational talents were needed, but also enormous financial burdens had to be shouldered—DM 1,000 billions had been spent already by 1996 in the former GDR. At the same time this unification crisis intensified the hidden structural crisis, which a far-sighted, realistic leadership of the old Federal Republic should have solved in the years before 1989. Since this had not been done, the unification crisis deepened the structural crisis. For the last 7-8 years, we have been unable to meet these challenges. We have not even started to discuss them seriously and thoroughly. This lasting hidden political paralysis may lead to a potentially destabilizing situation of the whole political system. It is widely accepted by now that we cannot treat our difficulties as routine matters indefinitely. On the other hand, one should know that they will grow if their solution is postponed. The old truth that a problem postponed is a problem half-solved does not fit in this case.

Why the Hesitation in All Corners?
Why then the hesitation in all political corners? Are the politicians mainly responsible for our stagnation? Or is the public to blame, which doesn’t seem willing to accept the necessary sacrifices? Our people still ask for more extensive and expensive government programs, not less state interference. And under the impact of the East Germans, the West Germans seem to move to the left politically, become more demanding, more security-minded than freedom-oriented.

Interest groups of all kinds are a third explanation for our discontented immobility. I am not so much concerned about the big ones—the Federation of German Industries or the Federation of German Trade Unions. During the last two decades, single-issue groups have sprouted everywhere, defending with lots of noise and indignation the vast interests of their clients, keen on Staatsknete, on subsidies.

The fourth, perhaps most important factor explaining our mental stagnation is the media, especially the electronic media. Many journalists are status-quo-oriented; they look more backward than forward. They do not prepare for the future, do not induce their readers and listeners to accept unpleasant new facts, to accept the necessity for change and sacrifices. The media defend the old Social Democratic consensus; they are deeply conservative in their nostalgic impulses. They are perhaps the most relevant explanation for the timid, reluctant, passive state of mind one finds today in Germany.

Concluding, I would distribute the responsibility for our unpleasant situation equally among the four groups: the spoiled and demanding public, the mass of special interest groups, the electronic media and the political leadership of the established parties.

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