TOKYO 1994

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THE TRILATERAL COMMISSION

held its 1994 annual meeting in Tokyo
on April 9, 10 and 11. An underlying
premise of our work is that the Trilateral
countries, the main democratic industrialized areas
of the world, have a particular responsibility
to provide constructive leadership in the wider
international system. The Tokyo meeting
addressed several issues in this framework: (1)
the emergence of China as a great power and
of the Asia-Pacific region as an area of increas-
ing economic dynamism and integration, (2)
the situation in Russia and Russia’s interna-
tional relations, (3) structural changes in
Trilateral economies and their implications for
growth and trade, and (4) next steps for mul-
tilateral cooperation through the new World
Trade Organization, the World Bank and IMF,
and the G-7 Summit process.

The other part of the Tokyo agenda
covered developments in each of our three
regions, with a special focus on Japan. Prime
Minister Hosokawa announced his intention
to resign the day before our meeting began.
He kept his commitment to speak to us the
next day, as did Tatsuo Hata (who spoke as
Foreign Minister and Deputy Prime
Minister). Kiichi Miyazawa had opened that
first day in Akio Morita's absence. In sum, the
day included the previous, current and future
Prime Ministers. (Prime Minister Hata, who
took office in late April, was himself replaced
by Tomichi Murayama little more than two
months later.) In their brief summary issued
at the end of the Tokyo meeting, the Trilateral
Chairmen noted that “discussion of Japan
emphasized that reform in all areas is an
incomplete and ongoing process. In the long
term, deregulation, restructuring of the
Japanese economy, reshaping of Japanese
business practices, and reform of the political
system will reduce differences between Japan
and other Trilateral countries and provide a
stronger base for Japan to assume interna-
tional responsibilities commensurate with
its economic position. In the short term,
however, intense preoccupation with domestic
policies may make it even more difficult for
Japan to play an effective international role.”

The discussion of China at the Tokyo
meeting focused on a draft report entitled An
Emerging China in a World of Interdependence.
Prepared by Yoichi Funabashi, Michel Oksenberg and Heinrich
Weiss, it was published in May. As the
Chairmen's summary put it, “the thrust of the
Trilateral task force report on China was that
the Trilateral countries should continue their
efforts to integrate China more fully and
naturally into the international community.
China must accept the disciplines and
responsibilities associated with its large power
status. This challenge for China and for the
Trilateral countries is complicated by
uncertainties associated with political and
generational change in China, the division of
China into three parts, and the difficulties of
establishing a market economy with effecti-
vely functioning national economic
institutions to regulate monetary and fiscal
policies. Discussion during the meeting
reflected an awareness of the limits of outside
couragement and pressures in affecting
internal developments in China.”

“Discussion of the Asia-Pacific region,” the
summary continued, “emphasized that
regional integration has been driven largely
by privately-led forces of economic inte-
gration rather than government-led, rule-
interional cooperation will proceed on a gradual, step-
by-step basis. The leaders of the region are
committed to an open form of regionalism,
compatible with the strengthening of global
trade and economic relations.”
The Third Reform of Japan

I would like to speak briefly about the state of the Japanese economy and U.S.-Japan trade conflict, and then concentrate on current broad reform efforts. Reform has been initiated by Mr. Hosokawa, who yesterday expressed his intention to resign. But I believe whoever succeeds him will and must follow the reform path.

State of the Japanese Economy
Our economy began its downturn in the spring of 1991. This spring, accordingly, marks the completion of the third year of the recession, which is the longest and most severe since the end of World War II. The rate of growth, after recording 3.6% in fiscal year 1991, was only 0.4% in 1992 and virtually zero in 1993.

The current recession is due to multiple causes. In addition to the traditional cyclical factors of adjustment in inventory and plant and equipment expenditures, there was a steep decline in the prices of assets (the “collapse of the bubble”). Adding to this, we had abnormal weather last year and a rapid rise in the value of the yen. One could add another factor: economic misjudgment on the part of the government and the Bank of Japan, and the resulting delays in policy implementation.

If the recession is prolonged, various problems will arise. I would like to draw your attention to the following three points:

- The first is the deterioration in the employment situation. The official rate of unemployment in the recent months was 2.7%, meaning that 1.8 million persons were out of work. In addition, excess workers still on corporate payrolls total from 1 million to 1.5 million. This indicates that Japan’s effective unemployment rate has already reached 5-6%, close to that of the United States.

- Second, corporate earnings are sliding. Profits on recurring operations of the major corporations were down in 1992 by 25% from the preceding year, and dropped about 24% in 1993. For 1994, many observers expect a continued decline for the full year of around 5%, although an upturn may occur in the second half of the year. Under these circumstances, plant and equipment investment has shrunk steadily for the past three years, and many anticipate a further negative year in fiscal 1994. It should be noted that recent R & D expenditure growth is also negative. If that situation continues, there is cause for concern that Japan’s international competitiveness will weaken.

- Third is Japan’s trade and current account surplus. The current account surplus in 1993 passed $130 billion, making Japan the only G-7 nation with a surplus, let alone such a massive surplus. In Japan there are some who argue that it is necessary for the nation to run a current account surplus in order to supply the rest of the world with capital. Yet, given the circumstances of other countries, such as their high unemployment rates, that viewpoint is hard to accept. I think Japan should put its surplus to work for the benefit of Japan itself.

The government and the Bank of Japan have formulated a variety of measures designed to bring about economic recovery, but the hoped-for results have not yet materialized. (This is due to the fact that the Japanese systems have become inflexible, as I will explain later.) The government forecast for fiscal 1994 calls for a pickup in the economy beginning around mid-year, with a growth rate of 2.4% for the fiscal year as a whole. It is true that, recently, economic indicators have stopped their slide. Nevertheless
many observers, including myself, are of the opinion that a 2.4% growth rate for this year is not likely to result from just an increase in public works investment, interest rate trends, and the ¥6 trillion tax cut. I predict the growth rate for this year will be around 1%, with no substantial decrease in the current account surplus. Another uncertainty arises from yesterday’s announcement by Prime Minister Hosokawa of his intention to resign.

The United States is ahead of Japan in its economic recovery, but America’s budget deficit and current account deficit remain large. In particular, the U.S. trade deficit with Japan has reached $50 billion, accounting for one half of the total. It is for this reason that the United States is pressuring Japan to reduce its surplus, through expansion of domestic demand and opening its market. Discussions between the two countries are now on hold. I am personally opposed to the attempt to reach a solution through the establishment of quantitative targets in individual sectors, but I believe the discussion of macroeconomic issues is meaningful.

Three Waves of Reform
During the process of Japan’s modernization, three reforms have occurred. The first reform was known as the Meiji Restoration; that began in 1868. This was a truly revolutionary change that encompassed political, economic and administrative reform. The second reform started immediately after the end of the Second World War. That was a systematic reform, grounded in two concepts—demilitarization and democratization. Under those reforms, the speedy rebuilding of the economy was followed by the achievement of high rates of economic growth. However, the uniquely Japanese system that evolved in the postwar period has now begun to show signs of systematic fatigue. And the so-called 1955 System in politics, which supported this uniquely Japanese system, with the Liberal Democratic Party dominating Japanese politics since its formation in 1955, has crumbled. Moreover, on the world scene, the Cold War that provided the framework for Japan’s politics and economics has ended.

Rising to take the place of the postwar system is what is called the third set of reforms. The current reform, initiated by Mr. Hosokawa, is a three-pronged package, consisting of political, administrative and economic reforms.

Let me examine for a moment the characteristics of the Japanese postwar system, which evolved to push Japan to catch up with or surpass the West economically. From the macroeconomic point of view, it was a system of harmonization or cooperation among politics, administration, and economics. It was highly efficient for promoting industrialization in a short period of time, and raising the people’s incomes. Yet this system degenerated into one of collusion and intensified paralysis of economic society. To outsiders, the processes and methods of decision-making and policy implementation became unclear, rendering participation by the outsiders difficult. Assessing the economy at the company or microeconomic level, the Japanese system gave birth to corporations characterized by collectivism or labor-management cooperation. This system was efficient for earning profits and expanding market share. However, it tended to give short shrift to the individual and to the family life. Now is the time to reform this system, and bring back the human element. Besides this system has become inappropriate for a functioning member of the international community.

The Third Reform: Objectives, Policies
There are four general socio-economic objectives in this third set of reforms:

- A fair society that is open and transparent to those inside and outside its structures.
- A society capable of giving birth to and developing knowledge-based, creative industries.
- A society that recognizes the importance of people, both as producers and as consumers.
- A society in harmony with the international community; one that the rest of the world can understand and appreciate.
MORIHIRO HOSOKAWA

ON THE AFTERNOON OF APRIL 8, Morihiro Hosokawa announced his intention to resign as Japan’s Prime Minister. Nevertheless, he kept his commitment to speak to the Trilateral Commission annual meeting on the morning of April 9. In his opening words he noted that, when he was first asked to speak, he was unsure whether to accept, “because these days I am often told by my American friends about numerical targets and objective criteria, and more often than that European friends would thunder at me that we are turning our eyes only to the United States. So the words have been rather tough. But...I was told that the Trilateral Commission since its inception worked in order to deepen the mutual understanding between the three regions, and...that the discussion is conducted from a larger perspective. And I was very pleased to accept after all.”

Prime Minister Hosokawa spoke about “change” in the world and in Japan under his government. “Under the banner of responsible change, I have tackled three reforms—namely political, administrative and economic reform....The reason we would like to advance such change is that we know that it is in our own interest. And also it is in harmony with the Japanese responsibility within the international community.”

The Prime Minister closed with some comments on an international situation that is “still opaque and in a state of flux.” He spoke of the North Korean nuclear issue, a key global issue and test of the global non-proliferation regime. After referring to his recent discussions with Chinese and South Korean leaders, he spoke of the Asia-Pacific region “playing an increasingly important role in the international community of nations.”

Five policies are required to achieve these goals:

- One, the most important, is de-regulation.
- The second is the creation and development of what we call new social infrastructure, the core of which consists of expansion of domestic demand.
- The third is preparation of a comprehensive welfare plan for a society that will have fewer children and more elderly people.
- The fourth is that Japan’s economy must be in harmony with the great world economy, and Japan’s economic society must be one that others in the world can understand and appreciate. One of the key points here is that the massive current account surplus must be reduced to a level compatible with the rest of the world. To achieve that, domestic demand must be enlarged, and Japan’s market opened. I am, as I said before, opposed to setting quantitative targets for individual sectors as a means of doing that, but I believe there is merit in establishing reference values for macroeconomic indices, such as growth and investment. These types of adjustments should be determined in multilateral forums for negotiation, not bilaterally.
- Fifth is reform of Japan’s fiscal structure and reform of financial and capital markets.

It will not be easy to implement these kinds of reforms—not only because they will require huge amounts of capital, but because the people who benefitted from the old system do not want to change. That is the reason why eco-

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nomic, political and administrative reform must be conducted as a whole. Those reforms have just begun. If they are successful, it is quite likely that Japan's economy will make new strides.

Isamu Miyazaki, former Vice Minister of the Economic Planning Agency, is Chairman of the Daiwa Institute of Research. He was a key drafter of both the 1986 Maekawa Report and the 1994 Hiraiwa Committee Report.

YOTARO KOBAYASHI

Japanese Business Must Change

If Fuji Xerox' business is representative (I think it is), the Japanese economy is improving. Our business has been quite solid, starting from the late fall of 1993. This has continued into the first quarter of '94, indicating at least that the cyclical part of the recession is bottoming out. There are more important structural changes that particularly the big businesses are facing today. They're not easy, to say the least, but overall I think the lights are closer and brighter than they were a few months back.

I would like to talk about what some of those structural changes mean to business and business leaders. We are going through a very important phase of change. If the world is going through the process of change from the old world order to a new world order, certainly Japan has begun to move from the old Japanese order to a new Japanese order, whatever that new Japanese order might be. Although Mr. Hosokawa is stepping down after only a short period of running the government, I believe it is important to view his time as the first page in the story of that important process of change. And it's very important that there will be a second page and a third page. I'm not sure when the new Japanese order will be in place — by the fifth page — by the sixth page? I hope it will not be a hundred pages later.

From "Iron Triangle" to Four-Corner System

The old Japanese order has been described by some as "Japan, Inc." Recently the term "Iron Triangle" has been used to describe the very systematic, sometimes too close (and too closed) relationship among the political world, the bureaucracy, and the business world. The Iron Triangle has been described, particularly in recent years, as extremely negative.

There is another word that describes an extremely effective system: "machine." What we did have till Mr. Hosokawa's government appeared is something that you might call the LDP machine. If I may be allowed to simplify, until about 15-20 years ago that machine worked extremely well. It was very effective; it was alert; to a certain extent it was even open; it was flexible and responsive to many, many changes. But any machine that becomes old — and at the same time too effective, too well-oiled and lubricated — does develop other difficulties. The demerits eventually outweigh the merits; and the LDP machine was no exception. That is, I think, the assessment of not only myself, but of many people who began to feel that change was necessary, starting about eight to ten years ago. That change came suddenly last year.

When we talk about the new Japanese order, I think we are really talking about changing this Triangle, this system of three corners, into a four-corner system that will include the people — in addition to the politicians, bureaucrats, and business. Certainly nobody in the old system meant to exclude the people. Certain of the people's needs were supposed to have been taken care of by the politicians the people elected. Businesses were supposed to have been looking after their needs, particularly from the convenience...
TSUTOMU HATA

TSUTOMU HATA, who would become Japan’s new Prime Minister later in April, spoke to the Tokyo meeting as Foreign Minister and Deputy Prime Minister. He is also a former member of the Trilateral Commission.

Mr. Hata devoted much of his talk to change in Japan, and particularly to several dimensions of political reform. One aspect of the problem is the very large amount of money required to be a politician in Japan. “We have to change the system.” Mr. Hata also spoke of the electoral system. The old system led to campaigns “not based on policy discussion...but on how much service you can render to the voters.” He noted that he and his father before him have served the same constituency for about 50 years, so the old system was fairly secure for him. But “you have to go beyond your personal stake if you really want to reform the Japanese system.” Mr. Hata spoke about the implications of the new single-seat constituency system for political realignment, implications which are still unclear. “If possible, my ideal is to have two major political parties in Japan, so that they can have real competition. From that real competition, political dynamism will be generated.”

Mr. Hata also spoke about economic reform. He discussed various international economic and political issues. He relayed key points from his recent discussions with Russian and Chinese leaders. Mr. Hata stressed that change in the wider world is part of what is propelling change in Japan. He strongly emphasized that the next government will continue the reform path of the Hosokawa Administration.

Near the end of his remarks, Foreign Minister Hata summarized his perspective on Japan in the world: “Japan at present has come to have a strong effect and responsibility not only in the economic area, but on the fundamental issues faced in every area of the international society, including political issues and issues of a global nature. I believe that Japan must recognize this fact. The world is in a major era of change. Japan, rather than regarding the international framework as a given that Japan has to adapt to, needs to undertake an active and creative foreign policy of cooperating with the other major nations to indicate to the world our direction for the desirable form of a new international framework.”

...MY IDEAL IS...

...TWO MAJOR POLITICAL PARTIES IN JAPAN...
Japanese order put in place. In the meantime, what is going to be the internal system that will run the whole thing? The two corners that probably have become more important than before—and are acquiring much greater awareness of their own responsibilities—are the business corner and, I think, the people. When the Hiraisha Committee put forward its recommendations at the end of last year, the key word running through the recommendations—the Japanese word literally translated—was “self-responsibility.” In other words, we felt it was necessary—for the de-regulations to be effective—for business and the people (the consumers) to assume their own responsibilities. In layman’s terms, this means being responsible for the risks. If they want freedom, if they want open markets, if they want de-regulation, these will not come free. The price that has to be paid is that business and consumers assume responsibility for their own choices. This is going to be very challenging.

For people as consumers to assume that new responsibility, I will not be exaggerating if I say a whole new education might be necessary. I don’t think consumers will change overnight. A typical consumer now expects perfect services and products—in terms of quality and safety standards. If something goes wrong, they will blame either the business or the government (the bureaucrats).

Business will also be slow to change, but fortunately we have the environment of cold competition. Competition forces business to change. We just cannot stand still. Japanese businesses are being forced, gradually, to become more profitable. To put it another way, a shift of emphasis is underway in what you might call the stakeholder outlook. The typical stakeholders include shareholders, customers, employees, the community, and society in general. It’s been said that Japanese businesses have been primarily driven by an employee-first philosophy. That is true. But that is not to say the other stakeholders have been neglected. Rather it has been considered wise and most effective to start your activity from your employees. If you have happy employees, that will result in an ability to produce services and products that will meet the customers’ requirements. If the customers are happy, you will get revenues and profits. With profits you can repay shareholders. That’s a kind of ideal cycle. But Japanese shareholders, and shareholders outside of Japan who have shares in Japanese businesses, have felt, compared to non-Japanese businesses, that their interests have been somewhat lightly regarded. This is the new emphasis. In the years to come, the growth rate of the Japanese economy is expected to be somewhat low, and the shareholders will be expecting higher returns. Even Japanese businesses cannot ignore that.

When businesses try to meet that new challenge, this creates another problem, the problem of the employment. We already have a number of major “right-sizing” or “down-sizing” cases among major Japanese corporations. In Japan, where maintenance of the employment level has been perhaps the most important management responsibility of business leaders, it is not easy (and it is not right) to switch overnight from the so-called life-long employment system to a system with a maximum degree of flexibility. We cannot just tell our people, “Well, we are living in a new age; we just cannot afford keeping you; so good bye.” But long term, this is the reality that we will have to accept. Many businesses have over-capacity in terms of facilities, but more importantly in terms of manpower. On the other hand, if you look ahead fifteen years from now, we are absolutely certain that we will face a shortage of manpower, because of the very low birthrate in Japan. So you could argue that this employment adjustment is a medium-term challenge—for the next five, six, perhaps ten years. But can we go through that period maintaining the current system and hope and believe that, after this ten-year period is gone, the old system will work again? No.
KIICHI MIYAZAWA

KIICHI MIYAZAWA opened the 1994 Tokyo meeting on behalf of Japanese Chairman Akio Morita, who was still recovering from a cerebral hemorrhage. Mr. Miyazawa, who preceded Morihiro Hosokawa as Japan's Prime Minister, is a founding father of the Trilateral Commission. He recalled the very first Commission meeting, in Tokyo in October 1973, and noted some of the changes in the world since then. Now Japan “is undergoing soul-searching changes in terms of its political and economic make-up—and, as importantly and related, in terms of its global responsibilities.”

In the meantime we will have to develop a more flexible employment system and more flexible management. I think Japanese management in the future will have to have the ability to restructure their businesses. This may not be in exactly the same way as many Western businesses are doing it, but the principles are more or less the same. That flexibility is absolutely necessary for management to maintain the ability to improve productivity and therefore profitability and competitiveness in the coming market.

This is the challenge, and unless Japanese businesses ourselves—without depending on the government regulations that have protected many private-sector businesses so far—are willing and commit ourselves to the need for change, we will be doomed, in terms of our ability to change over to the new Japanese order, the new four-corner system. We have to have a system that is capable of generating the forces for change from within. We will welcome, certainly, help from the outside, but the primary responsibility rests not with the politicians, not with the bureaucrats, but with the people and particularly with businesses.

That’s the new challenge that many business leaders accept today. But honestly speaking, at the moment, we have a mixture of feelings in the business community. Many people continue to feel that politics is something that has to be left for the professionals, and that business people have to be totally concerned with how to run their businesses. Even today, many business people are concerned not about what will happen in Japanese politics in the medium term, but only about what the change of leadership means in the short-term to their businesses. This is human and difficult to fault. But at this particular juncture in the Japanese history—when we are looking at a very, very important process of change—my personal view is that it is wrong for the business leaders to be so short-term oriented, too narrow, just business-oriented.

This is the beginning of the change that we started a year ago. This change has to continue; the process of change has to be completed. I emphasize the part of the business leaders in this process.

Yotaro Kobayashi is Chairman and Chief Executive Officer of Fuji Xerox Co., Ltd. He was a member of the Hiraiwa Committee.

...PRIMARY RESPONSIBILITY RESTS... WITH THE PEOPLE AND PARTICULARLY WITH BUSINESSES.
The Transition in Politics

Editor’s note: Of the three presentations which opened the session on change in Japan, Motoo Shiina’s was most affected by the previous day’s announcement by Prime Minister Hosokawa that he would resign. Mr. Shiina “just threw away into the trash box” the notes he had prepared.

I'm supposed to talk about change and transition in politics in Japan; and we are certainly in the midst of that today. At the risk of offending participants from that country, I feel as if I have moved suddenly to Italy. But Italy is probably better, because you can identify the platform of each party—left-wing, right-wing, and so forth. Japanese political parties are so confused, their platforms are so ambiguous. We have difficulty discerning which party represents what.

The problem with us is the three unknowns. One, as I said, is which party represents what. Second is the relationship between the political leadership and the bureaucrats. The third unknown is whether business will become more independent of government protection and interference.

End of the 1955 Regime
The transition in politics will take a little time. As you well know, the general election last year gave birth to the Hosokawa Cabinet. It was a very significant event in Japan in that it put an end to the 38-year LDP regime—the ’55 Regime.” This regime was characterized not only by the LDP’s monopolization of the power, but also by the important role of the Socialist Party, a co-traveler in the ’55 Regime.

When the Hosokawa Cabinet was formed, opinions were divided as to its significance. Those who thought negatively said that it was a “rainbow cabinet”—it’s beautiful but multicolored and may disappear at any time. Others said that it represented a real change. For politics to be dominated by one party for such a long time was already an aberration of the normal process of democracy, they argued, and so this new Cabinet would inevitably entail real and necessary structural change.

The rainbow disappeared yesterday. Does that mean that there has been little change, as predicted by the negative observers? I think, in eight months, there have been some achievements. The change of Cabinet was already a major change. Although the LDP’s loss of the power is always mentioned, I think the more important thing which happened last year was what happened to the Socialists. They were defeated in the election. Their seats were reduced from 140 to 70—half were lost. So, they were defeated. But then they suddenly found themselves as the biggest party in the new coalition; and five members of the Party were appointed, for the first time, as Cabinet Ministers. So, the Social Democratic Party has been eroded—and they are still trying to find their identity in politics today and for the future. That process will continue.

Continuing Undercurrent for Change
More important than what is happening in the Japanese Diet is, I think, the undercurrent which is felt very keenly these days. One part of it is a change in the international environment around Japan. Second are the changes in the mindset of the general public. In what they call the ’55 Regime, the people really believed that Japan would go always upward. The famous lifetime employment and seniority system provided, when one was hired by a company, not only an immediate salary, but almost a promissory note for one’s lifetime. Over the years you would get more and more, it was said, so bear with this low salary when you are young, and work very hard. People believed
that. Recently, however, they have felt that this promissory note will not be honored; and that is a very, very important influence on the mindset of the general public. Coupled with that are these scandals in politics that fueled suspicion of mismanagement and incompetence on the part of the politicians.

This undercurrent for change is still here. Just before Mr. Hosokawa said that he would resign, a poll said that he still had 49% general support, which is very high, higher than most of the previous Prime Ministers. But when the people were asked to rate his policies, the rating was low—less than 50%. When the people were asked whether or not they want the LDP back in power, 65 or 66% said no. I think this is an indication of people’s expectation for change; it’s still there.

Conductors and Concertmasters
The remaining problem is, as always, the relationship between the political leadership and the bureaucrats and the people. It’s like the conductor and the orchestra. When a professional orchestra invites a new conductor, during the first ten minutes in rehearsal the musicians tend to ignore the conductor and play it safe, under the direction of the concertmaster. Direction by the concertmaster—the bureaucracy—has continued since the birth of the Hosokawa Cabinet. This new conductor did not succeed to really lead the orchestra. The orchestra players were still ignoring the conductor, while playing the music. So, the real test for whoever may be the new conductor is whether he has enough experience in some way to make the orchestra players follow his baton.

Motou Shina is a Member of the House of Councillors (independent) in the Japanese Diet.

SECTION 2
CHINA AND THE TRILATERAL COUNTRIES

One morning of the Tokyo meeting was devoted to a draft report to the Commission—An Emerging China in a World of Interdependence—which appeared in published form in May. The session was opened by the report’s three authors: Yoichi Funabashi, Michel Oksenberg, and Heinrich Weiss. Three presentations by Chinese participants opened the following session and are printed below.

YUAN MING

China’s Path

THIS MORNING we had three distinguished speakers talking on China from outside. Now, as an insider, I want to put forward some of my perspectives and views.

China is Undergoing a Revolution
It is always my feeling that no one from outside can feel as strongly as we insiders do the historical baggage. Many intellectuals at home, for example, have had very bitter experiences during the Cultural Revolution. I just asked Mr. Chen, “How many years did you spend in the countryside?”—and he told me, “Three years, plus two years under house arrest.” Mr. Zhou had four years in the countryside. I had almost ten years in the rural areas (and other persecutions) after I left Beijing University in 1968. And now, we are all here, joining this distinguished group. A lot of intellectuals from China are very active now in different kinds of international gatherings. Is that an improvement of human rights? I would think so.

Of course, we Chinese have a long way to go to improve in different fields. But very few people on the outside know China. For the general public outside, the most unforgettable thing about China is the unfortunate happening in the year of 1989, the Tiananmen incident. China
is such a big country. Even as insiders, we can’t tell how rich it is. I think China is undergoing a real revolution now, which brings profound changes in social lives, in people’s values, in education, and so on. But unfortunately, for some time, the outside world just misread those changes.

Three Big Dilemmas
I would say contemporary China is facing three big dilemmas now:

1. The needed open door policy also brings instabilities.

For so long a time, if we take a historical perspective, China was so isolated from the outside world. So when the door was opened, which is the only way forward, China was totally unprepared. When the door was opened, a lot of foreign things just rushed in. It’s so difficult for people to understand the outside immediately. A lot of conflicts were created. This is really a big dilemma: the open door is a necessity, but the opening brings instabilities.

2. A strong central government is a necessity, but there is a trend toward decentralization.

It is a necessity for China to have a strong central government with macro control of things, especially in this dramatically changing world after the disintegration of the former Soviet Union. To keep macro control, which also means to keep a basic stability at home which will create an environment for economic development, remains such a serious, big challenge for us. But, on the other hand, the decentralization trend is there—and I think it’s increasing now. So this is the second dilemma: the necessity of a strong central government, but the trend toward decentralization.

3. How can we manage the convergence of traditional Chinese culture and foreign cultures?

The third dilemma, as I see it, is the pursuit of material needs, and also spiritual needs. Needless to say, the open-door policy in the past more-than-ten years brought in a lot of things from the outside world, especially from the West. When they got introduced at home, people would think, “That’s something new and we should borrow; we should take all those models.” But while they concentrated on material needs, on what they thought of as modernization, it seems to me they lost direction in the spiritual dimension. What should we keep, or borrow, or explore in this spiritual field?

Take an example. In the past couple of years, some pop music from Taiwan and Hong Kong got introduced into China. It generated strong opposition from people at home, who said, “This is not good taste. This is so vulgar. This is not real culture.” What shall we take? If you travel to Beijing, every Saturday or Sunday you’ll see big crowds in the concert hall listening to Mozart, Sibelius, Dvorak, all that music. It’s amazing to see how many people, old and young, get together. Also in the newspapers, Western classical music was introduced in a very positive way.

So, I witness this zig-zag process. I think China now is experiencing the process of how to reach the convergence of traditional Chinese culture and foreign cultures. Of course, the way is so long for us to reach this final goal. I think China has a tradition to be tolerant of foreign cultures in my history, but it’s not the case from the middle of the last century, because of historical experience. In this regard, I am a strong opponent of the “Clash of Civilizations” rhetoric. I think it really does no good, not only for China, but for the world as a whole. Samuel Huntington is always very provocative, but in this regard, I totally disagree with him.

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1 China is facing a very different strategic situation around its borders. I have a research project to look at what is happening in Xinjiang province, which faces the Central Asian region, and what is happening in Northeast China, which has relations with Russia’s Far East, the Korean Peninsula, and Japan. It is really a very new situation.

2 Editor’s note: See Samuel P. Huntington, “The Clash of Civilizations?,” Foreign Affairs 72:3 (Summer 1993), pp. 22-49. There are related references in the presentations of Chen Qiiao and Chan Heng Chee.
A World of Interdependence

Now I turn to this excellent Trilateral report, *An Emerging China in a World of Interdependence*. The last word in the title—interdependence—is really a very key word, which points out what kind of a world we are living in now. I believe people at home fully realize this is a new world. It’s an interdependent world. The rules of the game we have to play are totally different from the past. It’s not a zero-sum game, it’s a win-win game. It’s an era of pragmatism, an era of cooperation, an era of brokers. To reach that kind of goal, China certainly has a big role to play.

There is one point in this report I cannot agree with. The report warns China not to make use of conflict between the United States and Japan. First of all, China is far from the position where China can hold these two huge economic giants, can play “cards” like that. More importantly, China now is determined to modernize itself. It wants so eagerly to join this international community, this international market system, GATT, etc. If we put our thoughts in this broad framework, it’s not good for China to see a very bad U.S.-Japan relationship (whose combined GNP is almost 40% of the world total). If U.S.-Japan relations deteriorate, it will have very negative impacts on China’s modernization process. I say these words totally on my own; but it’s my understanding that this is also the basic policy view of the leadership at home.

Succession and Reform

What about the post-Deng Xiaoping era? I have been hearing of this concern at different kinds of conferences repeatedly—and I totally share people’s concern. Who can predict what will happen when a big figure passes away from the scene? In the early 1970s, who predicted there would be such a great change in China after Mao Zedong’s death? So it’s a big question mark. What we are doing at home now is to push the trend of reform forward, which will become irreversible. That’s the top priority. That will set the base for future development. And also, we should broaden people’s vision about the outside world. People like us three, traveling around the world, do bring messages from outside home and inform people.

China’s Place in the World

The last point is the so-called China threat. China is not in a position to be a threat. We have so many problems at home. We have so many dilemmas. It will take several decades for us to accomplish our tasks, if I am optimistic.

So, for Chinese, I think we have to search and identify what the position of China in the world at the present moment should be. This needs to be made very clear, especially in the minds of the leadership. I think two factors are at work in influencing how China’s leaders identify China’s position in the world. The first is historical experience. One cannot ignore the trauma China experienced in the past. It is still so deep in people’s minds. Second, and I think more important, is the attitude and the behavior of the outside world towards China. This also has a very strong impact on China’s leaders. We should work together. Yesterday, Senator Roth said, “We need China.” We Chinese should say, “China needs the world.” This is a very crucial moment.

In the global scene, nationalism is at work. It’s not necessarily a very good thing for the world, for a new world. In China’s case, if things got out of control, if China or the outside world couldn’t adjust very smoothly, it will mean many turmoil at home, millions of refugees, irresponsibilities both at home and abroad. That will be a real China threat. Of course, it’s the worst scenario. I think we’ve got to think about what we can share with each other, and how can we share with each other.

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China's Security Policy

Overall Orientation

Generally speaking, China's security policy is peaceful and defensive in nature. Its main goal is to provide a long-term peaceful and secure environment for China's modernization and favorable conditions for her reform and opening-up policy. This is not only determined by China's individual leaders; it is determined by the national condition and the national interest. China faces the challenge of the global technological revolution. She lagged behind the Western countries for more than 100 years, and she also lagged behind the Asian NIEs in recent decades. Whether China can develop her economy, rapidly and sustainably, and narrow the economic and scientific gap, is not only an economic problem but also a political problem.

China also confronts the pressure of a large population, with an annual growth rate of 1.1-1.2%. That means an increase of 15 million people per year. According to the estimate by some Chinese scientists, China's territory can support a maximum of 1.6-1.7 billion people, a figure likely to be reached in 2025. Hence, the problem of providing basic necessities for her 1.2 billion people, already resolved in the 1980s, may recur if a large effort and new initiatives are not made in the modernization program, or if political stability cannot be maintained, and a big turmoil bursts out in the country.

So China has to accelerate its pace of reform and opening up and economic development. It's a matter of life or death for China. While some Western people talk about China's rise as a new world power, and say China may exceed Japan or even the United States in terms of economic size in the next century, the Chinese people (and Chinese leaders) are much concerned with how to meet the challenge so that China can stand firmly and further develop in the competitive new century.

For this purpose, China will promote good, neighborly relations with her neighboring countries, and will never seek a sphere of influence or to fill the political vacuum. China has adopted what we call an omni-directional diplomatic policy to improve relations with all countries, including developing countries and developed countries—the United States and Russia; Japan and Germany; West and Eastern European countries; Arab countries and Israel. China will play a more active role in the international community to maintain peace and stability and promote prosperity.

Defense Posture and Expenditures

Now let me say something about China's defense policy. As China has noted, although the threat from the north decreased to a great extent after the end of the Cold War, the world as a whole is far from tranquility. Some regional wars, military conflicts, and unpredictable incidents may occur time and again. Hence, China should continue to push forward her defense modernization program. To my knowledge, China's goal is to build up smaller but more mobile, well-equipped military forces, with stronger combat effectiveness, which can be dispatched to China's border and coastal areas to protect China's territorial integrity, promptly.

China had already cut 1 million persons from its armed forces in the late 1980s, and I know a further cut is under consideration. China's navy is still very backward; it can't even match Japan and India—not to mention the United States and Russia. China, of course, is planning to strengthen its naval forces, but this should not be exaggerated. As I know, the strategy of the Navy is to protect China's sovereignty in China's own maritime sea area. I don't think China has a plan to develop a "blue sea" navy at present. Qian Qichen, the Foreign Minister, openly denied that Beijing had tried to purchase an aircraft carrier from Ukraine or
Russia. China has neither the intention nor the capability to put the crucial sea route in the Asia Pacific region under her control; rather she will depend on some collective security arrangement in the Asia Pacific region to insure a safe route and oil supply.

With regard to military expenditures, people always talk about the increase of China’s defense budget in five consecutive years—yet they always forget to take inflation into account. For example, this year China’s defense budget is 52 billion Chinese yuan. That is equal to 6 billion U.S. dollars, according to the new exchange rate—an increase of 20%. But, the inflation rate in 1993 was 13%—and in big cities, it’s over 20%. So actually, the increase of the budget is offset by the inflation to a great extent. For maintaining the living standard and morale of the PLA, an increase is necessary. Only a little money can be used for weapon procurement. In addition, in the early ’80s China had cut her defense budget to a very low level, so as to save more money to develop the economy. In 1979 the defense budget accounted for 17.5% of the total budget, but in 1989 it only accounted for 8.2%. Hence, in 10 consecutive years, the PLA had to live by a very hard budget. Many military forces had to spend a lot of time on business, including running restaurants, hotels, and even disco-karaoke nightclubs! Of course, it is harmful to the PLA’s reputation and combat effectiveness! This is one reason why the government has to increase the defense budget. This year, the defense budget accounted for 11% of the total budget—and accounts for 1.7% of the GNP (even a little lower than last year).

Of course, in comparison with Western countries, China’s defense budget is worth more. Due to different calculations of defense budgets between China and the Trilateral countries, it is true that the actual size of China’s military expenditure is greater than the disclosed budget. But it should not be exaggerated. Some American experts have said that, according to the CIA’s estimate, China’s total military expenditure probably should be doubled. This may be close to the fact. If it is true, in 1993 China’s military expenditure was still only 6% of that of the United States and 39% of Japan’s total. The Trilateral report suggests, for diminishing some misunderstandings, that it would be preferable for the Chinese government to issue a White Paper annually, outlining her defense. I think it’s a good idea, and actually my colleagues in Shanghai raised the proposal two years ago, in 1992. We will continue to persuade the government to do so.

Territorial Disputes

In terms of border disputes with other countries, China’s constant policy is to solve such disputes with the neighboring countries peacefully through negotiation. As you know, China settled her border disputes with Burma, Nepal, Mongolia and Afghanistan in the 1960s. China had proposed a one-package settlement of the border disputes with India through peaceful negotiations. It is not China’s responsibility that the disputes haven’t been solved yet. However, we are pleased to see the tension along the China-India border greatly reduced. In 1992 China signed an agreement with Russia over the eastern part of the China-Russia border. China insists on its sovereignty over the Spratly Islands, according to historical facts. In this debate she has a common position with the Taiwan authority. But China also insists on solving her disputes with Vietnam, Malaysia, Brunei, and the Philippines peacefully. And our policy is clear: if it is impossible to solve the disputes at present, perhaps the countries concerned can shelve the disputes for some time to come—and maybe work jointly in the meantime to explore and exploit maritime resources. China’s position gets more and more understanding from the ASEAN countries.

“Clash of Civilizations”?

Some people allege that China is planning to unite with Iran or other radical Arab countries against the United States, or is trying to create a so-called Confucian and Islamic alliance
against Western civilization. This is, of course, absolutely groundless. China really regards Iran as an important developing country, and is maintaining good relations with her. We don't think to isolate such a country is a good idea. But that does not mean that China and Iran share the same views on all international problems. China would not like to see the rise of ultra-nationalism or to see religious fundamentalism prevail in the world, in Central Asia in particular. In this respect, China shares a common interest with many countries, possibly including the United States and Russia.

**China and Trilateral Countries**

Despite some serious disputes still existing in China's relations with some Western countries, I am optimistic on the future of China's relations with Trilateral countries. My main reason is that there are no fundamental conflicts of national interest between the two sides. The two sides don't threaten each other. In addition are the great benefits the two sides could gain through economic cooperation. China has a common interest with Western countries in the maintenance of peace and stability in the Asia-Pacific region as well as the whole world. China wishes to stabilize the world situation after the Cold War—in regards to emerging territorial disputes, ethnic violence, and religious conflicts that are serious threats to the peace and stability of the world. China cooperated mostly with Trilateral countries and ASEAN countries to make the peace settlement of Cambodia a success. China has made a contribution to alleviate the tense situation on the Korean Peninsula—and will continue to do so.

On arms control, China abides by its commitment on NPT and MTCR. Actually, China has a common interest with Western countries in the prevention of proliferation of mass- destruction weapons. China has expressed its willingness to negotiate with other nuclear powers to ban nuclear weapon tests under certain conditions.

Needless to deny, in the 1950s and 1960s China held that war and revolution is inevitable. But since 1979 China has changed her view. Now, China holds that a new world war is by no means unavoidable, and that the current period is not a time for revolution but a time for peace and development. There is no reason for China not to improve her relations with Western countries, assuming the Western countries abide by the principle of mutual respect for sovereignty and no interference in each other's internal affairs. Even if China really becomes a new power, according to Deng Xiaoping it needs at least 50 years. There is no reason for China to change her basic position to maintain world peace and stability. Of course due to differences of ideology and social system between China and the Western countries, some contradictions are inevitable, unavoidable. They will occur time and again. Hence the future relations of China and the Trilateral countries will be a mix of cooperation and disputes. Trying to eliminate all disputes is unrealistic. What is needed is to put cooperation prior to disputes, and to manage disputes and conflicts to a certain extent, in order to maintain normal, rational, stable relations between the two sides.

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China and the International Trading System

I am prepared to talk about China's economic size, foreign trade regime, inflation, the relationship between central and local government, and currency convertibility. But I don't have enough time to touch on all these questions, so I will concentrate on the first two, and especially the trade regime.

The Size of the Chinese Economy
First, I want to respond to the draft Trilateral report and this morning's discussion about how to measure the size of the Chinese economy. The Chinese economy is a miracle, but it's not a magic trick. Using purchasing power parity to measure the size of economies is, from an economist's point of view, a very difficult and very controversial measurement. One problem is that the quality of goods is very difficult to measure—the quality of living quarters (measured by square meters) in China, for instance, is very different from Western countries. And we need to collect a large amount of data. The second difficulty is that, when in an economy there is significant forced substitution of consumption, a lot of distortions happen to the measurement of purchasing power parity. There are still many other controversial issues. Actually, I believe we would need several hundred economists and statisticians working many years to collect the data which would then give us some approximate result about the size of the economy and the living standard. China, until very recently, had not joined the International Comparison Project, so nobody really carefully collected a very large amount of data to do the PPP measurement. So, any international organization should be very careful when they publish such data. There might be some contradictions.

For example, the Trilateral report's authors have to be careful in measuring trade relative to the size of the Chinese economy. If GDP (the denominator in this fraction) is measured by using current exchange rates, trade is large relative to GDP—38% is mentioned in the draft report. If we use PPP in determining GDP, the denominator must increase about four times, and then we find out that trade is less than 10% of GDP. Before the economic reform in 1978, China was a closed economy and the domestic currency was overvalued. But even in that case trade was also around 10%. So that means China gained a lot of economic development, but the foreign trade share in GDP—using the PPP measure for the present—has been shrinking! It's certainly not correct.

China's Foreign Trade Regime
Many participants have already mentioned that the economic development and export development of China is extraordinary. That implies some people still don't believe it. They tend to suppose there must be something wrong, or such export growth rates are probably caused by fiscal subsidies, or by dumping, or unfair practices (including prison labor) violating international trade law.

To address this issue, I have to ask two questions. First, how much of China's export foreign exchange earnings can be related to unfair practices? Of course, China is a very large economy, and the administration is very difficult to carry out to each corner of China. There is bureaucracy, some bribery, some corruption. So, there might be some unfair behavior in foreign trade. But, to estimate the impact of these practices on the total volume of foreign exchange earnings, we have to obey the discipline of empirical analysis. If you collect the data, I believe you can find out that such unfair practices cannot generate any significant share of export volume and export foreign exchange earnings.

... unfair practices cannot generate any significant share of export volume and export earnings.
Second, suppose we eliminated all these bad practices. Some people may think that China would experience a reduction in its export foreign exchange earnings. But many Chinese economists and decision-makers believe that if we eliminate bad practice, China's export foreign exchange earnings will increase. Because China is a very large economy, for any export good, very often there are more than a hundred export producers and export firms. So if one of them is using a dumping method, or the unfair competition method, or using prison labor, then it must cause bad competition among ourselves. It's lowering our export prices for the specific goods, and it's lowering our export foreign exchange earnings. That's the reason the Chinese government tries a lot to use administrative measures and the chamber of commerce to eliminate these bad practices.

In the middle of 1980, the Chinese government already realized that export subsidies were bad for foreign trade development. Only by eliminating any kind of direct export subsidy could we create the best foreign trade regime. So finally, in the end of 1990, the Chinese government eliminated all export subsidies. Of course, some foreign economists still say that there might be some cross-subsidies or indirect subsidies, because in China—considering the basic needs of the Chinese population—some basic goods prices (for example, house rent) are still low. Such subsidies may transfer to labor costs and have indirect impacts on export prices. However, China already set an economic reform program which says that all prices which can be commercialized—including crude oil, electricity, coal and house rent—should be liberalized.

Another skeptical question about China's foreign trade regime is that China pays a lot of attention to encouraging export development, while at the same time maintaining a lot of import barriers. These people suppose China does not want to have import liberalization. Let me cite a report from the World Bank. It says that among many export incentive reform measures, the most effective measure is import liberalization. Without import liberalization, the export encouragement program can hardly play a positive role; because, if there are very strong import protectionist measures, the exchange rate must be distorted. The domestic currency has to be overvalued, and then it discriminates against exporting. Secondly, the export producers can hardly get the foreign exchange to import what they need to import, such as raw materials and component parts. And thirdly, if there is not import liberalization, much information—about product innovations, marketing, and after-sale service—is blocked; then it's very difficult for developing exports.

This is also my observation of Chinese experience in developing foreign trade. A lot of reform on the imports side already started in the end of the 1970s and early 1980s. At that time, we allowed to establish more than 2,000 new foreign trade companies, and those companies could hardly find export opportunities. What they did was they imported a lot. Also, we had a significant import reform in 1985. And very recently the foreign exchange rate was unified into a single exchange rate, which is more convenient for many importers.

Both economic theory and empirical analysis provide that, under certain conditions, developing countries can rely on an outward-looking development strategy to gain extraordinary growth of exports. This already happened in Korea, in Taiwan, in Singapore, in Thailand; and now it is happening in China. So, I think people don't need to find some wrong practices to explain such extraordinary growth. I have already mentioned that China—the government and also the chamber of commerce—pay a lot of attention to controlling bad practice. But, of course, sometimes it is difficult. It's related to tradition, to the thinking mode of traditional planners. And China also has a similar problem to what our Japanese colleagues talk about: we have to fight with bureaucracies.
Membership in GATT/WTO

We believe that the GATT/WTO system is very productive and very useful for promoting economic and international trade development. If China can join, its economy can develop faster and more smoothly. But it's not the case, as indicated in the report, that after joining GATT, the growth rate of China's exports will slow down. And the GATT and the WTO (and also APEC) may not be useful for solving specific bilateral trade imbalances.

The draft report says that China greatly desires GATT membership. If that is right, somebody may think to take advantage of this desire to raise the price for China to join the organization, to ask China to make more compromises. I think it is not a question that China does not want to accept the rules of GATT. It's rather a question of whether some additional requirements should be added as pre-conditions for China to join GATT. The Chinese government is ready to accept some additional requirements such as selective safeguard clauses and the treatment of developing countries, or the extent of tariff reductions—even some additional requirements. But it is not good that the price of entry is always, continuously rising. Today it's this price and tomorrow it's a higher price.

My personal observation is that in China there are two groups of opinions. One group is strongly against China joining the GATT. Another is supportive of joining. Those against include some in protected sectors and central planners, and some who traditionally had an ideological inclination against anything that Americans say is good.

I think the group which stands for joining GATT has a little advantage over the those against. It's not an overwhelming advantage. After Taiwan applied to join GATT, China became more anxious to expedite its application. And when the top leadership made up their minds, all major newspapers reported that it's a Chinese desire. But I think it was only a very delicate balance.

The arguments raised by those against are still persuasive. They can say that some infant industries still need protection. They point out that Taiwan hasn't joined the GATT for many years, but has got very good export development and export-oriented development. They argue that the GATT is a multilateral system. It's not like a club (only if you join a club do you get the club benefits). The GATT established a world system. Those who are not members can still be free-riders. And also, they don't believe there can be any kind of unified action to retaliate against China among industrial countries.

Personally, I completely disagree with these arguments. But no matter what I say, and no matter what you say, we have to recognize that these arguments are still quite influential in China. They are influential to the decision-makers. So there is a possibility that this delicate balance can be changed, under circumstances in which China feels it costs too much to be a contracting party in GATT. The decision-makers may change their attitude.

I think this also applies to the MFN issue. Therefore, it has been always my proposition for American policy advisors that you may choose other less destructive instruments—anti-dumping or countervailing duties, super 301, 301, whatever you like. This is wiser than putting obstacles for China in the way of entry into GATT and for MFN status.

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SECTION 3
ASIA-PACIFIC PROSPECTS

CHAN HENG CHEE

Asia-Pacific Regionalism

Economic Restructuring
and Security Restructuring:
U.S. Policy May Disrupt Both

Before turning to the main part of my presentation, I would like to start by stating the obvious. The Clinton Administration is losing sight of the obvious in the case of economic foreign policy, which explains why it is pursuing an inexplicable course in the Asia-Pacific.

I see two movements in the international system today. First is a restructuring of the international political system, and a search for new security relations after the Cold War. Second is a restructuring of the economic system. For the first time in world history, we are witnessing simultaneous restructuring of the economies in the United States, Europe, and in East Asia. This is to deal with stiff competition, structural problems in the economy, the recession, or (especially in the Asia-Pacific) simply to enable faster economic growth. The danger is that restructuring “number two” may have a deleterious impact on restructuring “number one,” at a time when we are groping to build a more stable post-Cold-War international order. Indeed, the economic restructuring has all the signs and potential of creating great tension between the different regions, and even between countries within a region.

The economic restructuring in the Asia-Pacific will lead to the rise of new dynamic Asia-Pacific economies: China, Vietnam, Malaysia, Indonesia and Thailand are recognized as new NIEs. Even Myanmar is stirring today. All these economies have now some understanding of what policies will and will not work. This accounts for their dynamism and growth, which is seen in the West with some consternation, and as a threat to competitiveness.

Restructuring economically has two aspects: domestic and bilateral. The danger comes when countries cannot deal with restructuring internally and attempt to pass on the problem externally. We see the consequences in the relations of the United States with China and Japan. And recently there was an attempt to introduce social costs in the discussions of GATT, despite the agreement not to bring in any other issues as the signing of the Uruguay Round agreement approaches. Fortunately, good sense has prevailed, and there seems to be some compromise that is emerging.

If economic relations are disrupted, how will it affect security? Security is far too important in fact to be linked in that way with economics, but surely there must be some spillover. So there must be more congenial ways of dealing with the emerging Asia-Pacific.

What is Asia-Pacific Regionalism?
What is this Asia-Pacific regionalism? Is it more than a geographic concept? What drives regional economic cooperation? Are there shared common values? Is there a sense of shared destiny in the Asia-Pacific? What role can other countries, especially the Trilateral countries, play in this regional development? What can threaten the momentum of regionalism? Let me try to answer all these questions very quickly.

It may be premature to talk of the Asia-Pacific regional “community.” In Seattle last year, at the Asia-Pacific Economic Cooperation meeting, there was an attempt to turn the word “Cooperation” into “Community”—but that idea was rejected. As Gareth Evans, the Foreign Minister of Australia, put it, “APEC is three adjectives in search of a noun.”

“Asia-Pacific” means, in one sense, a geographic entity, from Japan to Myanmar. This geographic region sometimes includes Australia and New Zealand, and sometimes does not.
Asia-Pacific is sometimes used in the sense of the entire APEC grouping: the ASEAN six, Japan, South Korea, China, Taiwan, Hong Kong, Canada, the United States, Australia, New Zealand and Mexico.

When did the Asia-Pacific regionalism idea begin? I think successful regionalism began with ASEAN in 1967. Security was the driving force. There was a search for a political mechanism to normalize relations between countries that were formerly hostile. ASEAN became a success in the 1970s and it was through ASEAN that the idea of regionalism was established. ASEAN Foreign Ministers Meetings established a post-ministerial meeting dialogue (PMC), with Japan, South Korea, the United States, the European Union, Australia and New Zealand. ASEAN reached out. ASEAN interacts with the region.

In the 1970s the idea of the Pacific Community also came about, but this included Chile and other Latin American coastal countries. This was soon dropped, because it was just too amorphous. The idea was cut back to the Asia-Pacific. In the 1980s, the idea was given intellectual substance. I would say the Asia-Pacific idea was born of what we could call two-track diplomacy. One track was the interchange among intellectuals, business people and officials at the lower level. PECC (Pacific Economic Cooperation Council) gave this idea some substance, exploring trade in the region. From that, APEC was formed. At this time too, strategic studies institutes in the ASEAN countries got together to talk of common ideas, to talk of the region as a security area. I think the scholarly exchanges created the sense of a regional identity. Korea and Japan came in in this way. I think that was very useful.

Not only was the intellectual track important for creating the idea of regionalism. Economies helped a great deal. In the 1980s and '90s there was new growth in economic interdependence in the region, led by private foreign direct investment. It began with Japan investing in the ASEAN countries, followed by South Korea, followed by Taiwan. Much of this was export-oriented investment. It later grew into market-oriented investment. Now in the '90s, everyone is investing in everyone else's backyard—so much so that there is a genuine economic interdependence developing in this region. It has been pointed out by economists that the growth rate of this region is somewhat de-linked from the global growth rate. The lower global growth rate in recent years did not affect the growth rate of this region, which shows that there is a certain integrity in the region.

Today the Asia-Pacific economic region is strengthened by a further development of sub-regional groupings—"growth triangles." Do these regional sub-groupings weaken the larger regional concept? I would say "no." They are like piles in a construction site. They simply strengthen whatever is growing in the region. And a network is developing.

Are there common values and a sense of common destiny rising from this growing network and interchange? It seems to me, apart from a sense of general Asian-ness (and maybe a convergence of investment policy and growth strategy to a large extent), there are no real common values. We are talking, after all, of diverse countries—Buddhist, Islamic, secular, Christian and Shintoist. But I believe that the sense of Asian-ness is there, and this Asian-ness is activated at a time when we face a heightened and aggressive Western agenda. There is no sense of common destiny, I suspect, in the sense of a "common European home" among Europeans. But there is a sense that Asia's time has come. Asians talk with a sense of pride, with self-confidence.

The Chinese panelists today said that there is no "clash of civilizations." I beg to differ. I think there is some clash that is taking place, but war is not inevitable. There is now an assertiveness, a talking back. I think this is healthy. I also think this is temporary between the West and Asian countries. Once we understand where we each stand, I think we will proceed to get on. Huntington's article should not be taken as intellectual justification for the view that we cannot get on.

...THERE IS A SENSE THAT ASIA'S TIME HAS COME.
What Roles for Trilateral Countries?
What roles can other countries play in the region and in this dynamic Asia-Pacific growth? Japan and the United States and Canada are themselves Asia-Pacific countries. They are members of APEC.

The European countries certainly can play a role in our growing trade. If you look at the countries in the Asia-Pacific, their trade with Europe is in the area of 15-20% of their total trade. Europe sells more to Asia now than does across the Atlantic. (And the United States sells more to Asia now than that does across the Atlantic.) So in fact we are interacting a great deal. There is another area where I think Europe (and the United States and Canada) certainly has a lot of potential in the region of the Asia-Pacific, and it is in the area of education services. Right now the biggest providers are the United States, Canada, Australia, New Zealand and Britain. The Asia-Pacific is hungry for education. Think of the Chinese market. I think Europe has to develop this more. There is a language problem at the moment, but I am sure you can learn to market yourself. I think that is what the Asia-Pacific would want from Europe, to a large extent.

Economics does provide foundations for security, but economics alone is not enough. A security focus is needed to provide security. For that, countries in the Asia-Pacific have no doubts that—given the complexity of the Asia-Pacific region (we've been talking about the emergence of China)—we do need some sort of balance in the region. All these countries want, to some extent, a U.S. presence. In the past, Singapore was one of the loudest countries in saying this. Today, other countries are repeating this message. The United States is seen to be a guarantor of Asia-Pacific peace. It was, and it will be. The United States is seen as helpful in relations between Japan and China, and between China and Southeast Asia.

Regional Arrangements
Last year we created the ASEAN Regional Forum (ARF), about which some skepticism was expressed this morning. A forum of some 18 countries is not a cohesive body, but it was inconceivable a few years ago that 18 countries could sit at one table: the six ASEAN countries, the United States, the European Union, Australia, New Zealand, Japan, Canada, China, Russia, Vietnam, Laos, Papua-New Guinea and Cambodia. I think there is a recognition among these countries now that their security is interlinked. This is a conceptual leap that has taken place since the end of the Cold War, and I think it shows an interest in creating peace. When it started, everybody was skeptical about ASEAN. ASEAN has a socializing impact. When leaders shuttle to each other's capital, when they meet each other all the time, it does have a domesticating effect. You really can sort out your problems in a face-to-face setting. We hope the ARF is going to do that. It will take a little longer. I cannot imagine in Bangkok this year (the first meeting) that they are going to raise the Spratly Islands as an issue, but I think we are on the way there.

APEC also has a strategic meaning. It is largely about trade liberalization, but it must be seen in its strategic context. It is about the positive impact this will create on the promotion of security, on a sense of confidence in each other. It is this loose, open gathering; it is not regional integration. I don't think we need to fear that it is about the creation of a trading bloc, but in fact it is a recognition of a pattern which already exists. But that sort of loose grouping will reinforce this linkage to the strategic context.

What can go wrong? What if war should happen in Korea? What if one country seeks to establish hegemony in the region? If that happens, then we hope that the ARF, within the region, can come up with the diplomacy that would deal with this problem.

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Security Concerns

The end of the Cold War has been much less dramatic in Asia compared to Europe. We didn’t have the Berlin Wall coming down. We didn’t have the dissolution of the Soviet Union. Nevertheless, I think the end of the Cold War has provided a certain momentum which will bring a slow but profound change to the region.

Asia is a vast region. Also, we don’t have the regional institutions that Europe has, such as CSCE and NATO. Therefore, in the past, and even in the present, we tend to view Asia in terms of sub-regions: Northeast Asia, Southeast Asia, and South Asia. It’s very difficult to talk about security concerns for all three sub-regions in one breath. In some sense, the three regions have distinctly different security concerns, and the end of the Cold War had a different impact in each. Southeast Asia didn’t get involved in a Cold War contest between the United States and the Soviet Union; therefore the end of that contest didn’t affect the region that much. On the other hand, Northeast Asia has felt much more impact from these changes.

Positive General Trend, But Worrisome Arms Race

The new era coming after the end of the Cold War has given much more emphasis to economics. That is to say, the globalizing or regionalizing trend in economic activities tends to bring a new dimension to various aspects of international relations, particularly security aspects. In the last few years in Asia, we see generally positive developments on the security front. In Indochina, for example, Vietnam is now concentrating on economic development. Cambodia has come to at least a much more accommodating situation. Across the Taiwan Straits, there is $14 billion of trade a year. We don’t hear much about the South China Sea in recent months or days—that’s good news. About the relationship between Japan and Russia regarding the Northern Territories, the prospect is somewhat promising for peaceful resolution. And we don’t hear very much about Sino-Russian border disputes. So all in all, the general trend is somewhat positive. And we have reason to believe that this trend may continue.

There is concern for the continued arms race. If you were to ask each country about its military budget, each one will say that she is not eager to put more money into it. Nevertheless, all the statistics tend to show a continuing arms race. This is a somewhat alarming situation, particularly in the aftermath of the Cold War.

Japan, for example, using current exchange rates, may have the third largest defense expenditures in the world. China has doubled its expenditures since 1988. We have been given a good explanation why the figure has gone up. Nevertheless, this is a source of concern for everybody. China occupies a very pivotal place. If Chinese decide to go ahead with a reduction of armaments, then it could put both moral and political pressure on all the other parties in the region and bring a general trend toward reduction of armaments. Therefore we have a great deal of hope for the Chinese leadership in this regard.

The Asian arms race problem is not just limited to the Asian countries, but also is a global problem, because much of the equipment purchased by the countries in the region is coming from the United States and Europe. Therefore it’s a question of the global arms trade, not just the arms race in East Asia.

Regional Arrangements

Since the middle of the 1980s there have been some discussions about forging a new regional security arrangement. Interestingly outsiders said more about this than the Asian countries themselves. For example, the Soviet Union, Mr. Gorbachev and Mr. Shevardnadze, proposed the Asian Collective Security Scheme in 1986. Joe Clark from Canada talked about...
this in 1990, so did Gareth Evans of Australia. These proposals to create a multilateral security arrangement in the region didn't really draw a positive response from the United States, nor did the idea bring a great deal of reaction from the Asian countries.

Inside Asia, the ASEAN PMC has become the most important forum to discuss these issues. And since it has now created this ASEAN Regional Forum with 18 countries, we think some progress could be made in the coming months. The activities of NGOs in this regard are very important. In the economic sphere, particularly in the trade sphere, the development of PECC—the Pacific Economic Cooperation Council—has been very successful. And the creation of CSCAP (Council for Security Cooperation in the Asia Pacific) by ten institutes representing different countries in December of last year is also a very promising move. Therefore, we expect in the coming months and years a concerted effort to plan a regional security arrangement.

**United States, Japan, Russia, China**

Of course the role of the big powers cannot be ignored. In fact they are always decisive. The U.S. has a continued interest in at least four areas. First are its bilateral treaty commitments to Japan, South Korea and so on. In recent months, President Clinton has made rather a clearcut statement about the treaty obligation in regard to the defense of South Korea. He said, "Any attack on South Korea will be construed as an attack on the United States." Second is the long-standing U.S. policy to prevent any regional power becoming an hegemonic power. Third, the U.S. certainly would like to protect the smooth operation of global economic transactions. In this regard may I point out that, compared to Europe, Asia has a vast Pacific Ocean (and an Indian Ocean as well). Therefore the question of maritime security is a very important issue, which may not have an equally important place in European discussions. Finally, nuclear and other mass-destruction weapons—if they become a global threat—are also a great concern of the United States. All in all, the U.S. has really a big role to play. How the Clinton Administration will map and execute its international policy, and particularly its Asian policy, is perhaps a decisive factor in the coming months.

Japan is a great economic power, and how it is going to play this card in the political and security area is a very important issue. We have noted with interest that all the contending candidates for the Prime Ministership have said that to deal with North Korea wisely is one of the most important challenges the future Prime Minister will face. Nevertheless, there is a certain amount of ambivalence in Japanese attitudes, partly because of the Asian reaction. A neighbor like Korea says it likes to have strong leadership in Japan, but if a strong leader emerges in Japan, the Koreans quickly become rather apprehensive about future developments. Given such ambivalence on the part of Asian neighbors, it's no wonder that Japan cannot really map out a very clear course of action when it comes to security problems.

It may be an unkind thing to say, but I detect a great deal of relief on the part of many Asians when they see a rather weak Russia. They always feel that a strong Russia constitutes a potential problem. I am running out of time to talk about China.

**The North Korea Problem**

I have to say something about the North Korean problem. The North Korean problem has three dimensions: the relationship between North and South Korea, the regional implications, and the global implications.

What I would like to emphasize here is that the North Korean problem is not limited to the nuclear problem. In the last few months, so much attention has been given to the nuclear question, people forget the true nature of the problem we face in regard to North Korea.

To put the matter in a rather simple manner, the Korean Peninsula seems to be an exception to the post-Cold War trend of relaxation.
around the world. In some sense, the Cold War continues on the Korean Peninsula. Why? Perhaps we have to say that the North Korean system is an exception to the current trend in world history. I characterize the North Korean system as the most successful totalitarian experiment in history. It almost followed the textbook definition of totalitarian government: one absolute leader, one absolute ideology; one absolute party; total mobilization of the population; total isolation of population. In all these departments, North Korea succeeded. And in some sense it succeeded in creating an autarkic social and economic system.

What the North Koreans face now is that this very success is the biggest hindrance in making the necessary adjustment to the changes in the global environment. Could North Korea make an adjustment? This is really the big question. We have seen, and they have seen, that other Communist states (notably China and even Vietnam) have successfully made or are making the adjustment. But could North Korea do it? Many people believe that it may be very difficult for North Korea to change the gear. If that's the case, North Korea could be called a terminal case—it's slow but sure process of death for the system.

Now why nuclear development in North Korea? Why does North Korea insist on the continued development of the project? It's because she considers it directly relevant to the survival of the North Korean system. That's the only way she thinks she can really contest with the South Korea for superiority on the peninsula. And also that's the only thing with which the North Koreans can negotiate with the outside world. Will they give up this program? It will be very difficult. Not only are there the systemic limitations I mentioned. They have invested too much to scrap the program at this point. So it's really a very difficult issue.

The whole issue has now put others to the test. South Korea is tested. South Korea has succeeded in modernization and democratization, but how are we going to handle this issue? We have signed the nuclear-free Korea pledge, but if North Korea goes ahead with the current nuclear project, are we bound by this agreement or are we free from this agreement? This is just one of the issues which will face South Korea.

Japan faces the problem because North Korea is not only developing a nuclear capability but also a missile capability. China faces a problem, and maybe this is a chance for China to show leadership in exercising its influence to change the course of development in North Korea. The United States is the sole superpower, but what can the sole superpower do in this type of situation? What could the United Nations do? The U.N. has passed a resolution 140 to 1 (the 1 is North Korea), but such a vote doesn’t mean very much. What could the Trilateral countries do?

No simple answer has been provided so far, but I don't think we need to be very pessimistic. In some sense this is a blessing in disguise. On this issue we see the opportunity to harness the common interest of all the big countries involved: China, Russia, Japan, the United States—and all the small countries, and all the regional countries. No one wants to see the sudden collapse of the North Korean regime. Everybody is trying to help North Korea to make the necessary changes. So, while we seem to be moving to the brink of another war in the Korean Peninsula, there are many, including the South Koreans, who tend to be a bit more optimistic, because the general world trend is such that this may provide a turning point in nurturing a new security arrangement which will bring a more stable and permanent peace to the region.

Lee Hongkoo, at the time of April Trilateral meeting, was Senior Vice Chairman of the Advisory Council on Democratic and Peaceful Unification. He subsequently became the Republic of Korea’s Deputy Prime Minister and Minister of National Unification. This April presentation was given a few months before the death of Kim Il Sung in early July.
APEC

I am going to discuss two subjects and add a final point. First, why do we have APEC? I am going to conclude that APEC grew out of the commercialism among these countries, and not regionalism. So APEC is a commercial arrangement, not the kind of regional arrangement that you see elsewhere. The second subject is the institutionalization of APEC. My conclusion is that the institutionalization process will be slow and gradual, because of basic differences in business culture and levels of economic development. My final point is that it will be of interest to the Trilateral discussion to include other East Asian economies in future discussions.

Why Do We Have APEC?
There are two reasons for APEC. Number one is the growing economic interdependence among these countries. Number two is that the business practices in these countries are so different that they need APEC to have some way of minimizing the problems among themselves.

Growing Economic Interdependence
We see more and more countries in this region coming to rely upon free enterprise and market economies as a part of their development process. In the 1960s, the North American countries, Australia, New Zealand and Japan were very much involved in that process. In the 1970s, you have Korea, Taiwan, and Hong Kong becoming more important; in the 1980s, ASEAN and China; in the 1990s, Latin America. So all these countries are joining this free enterprise and market economies process. Even Burma today is trying to join this process. This eagerness for free enterprise and market economies basically means the reliance on foreign trade and foreign investment. Foreign trade and foreign investment are being facilitated and accelerated by the process of “economic globalization,” in terms of development of telecommunications and transportation. The exchange rate realignments of September 1985 created the foreign direct investment boom in Southeast Asia. Developments in China and in the Soviet Union have helped in this process of economic integration. So in the region you have more and more countries wanting to do trade and investment among themselves, and following the system of free enterprise and market economies.

Differences in Business Practices
The existing differences in business practices or business culture are also very important, and are part of the reason why these countries need to have an organization like APEC to help themselves. There are many areas of business differences. First, we do not have the same trade regime. Although we say that we would like to have open trade, our protection levels and non-tariff barrier practices are different. Second, we do not have similar product standards which can be easily verified. Third, which is extremely important, we do not have the same legal practices. Many of the countries in this APEC grouping are not very legalistic, and think lawyers are a nuisance! Fourth is the difference in the intellectual property rights practices. Somehow many countries feel that they are not intellectual enough to honor the rights of the others! Fifth are different human rights and democracy standards. Sixth are different environmental and safety standards.

All these differences continue to exist while trade and investment have been growing very fast. These problems are not being handled satisfactorily by GATT or other international organizations. This is a reason why these countries have decided to form APEC, and why more and more countries would like to join APEC as members. Their intention is to further promote foreign trade and investment by means of trade and investment facilitation. Also there are countries who join because they would like to promote more technical cooperation among these countries in order to help the less developed countries.
Institutionalization of APEC

What can we expect with regard to the institutionalization of APEC? As I said before, APEC consists of countries with a lot of differences. You can group them into the Western Anglo-Saxon and advanced countries (the North American countries, Australia and New Zealand) and the Oriental countries. In this second group there are actually three sub-groups: advanced countries (namely Japan); Asian newly industrializing economies (Hong Kong, Korea, Singapore and Taiwan); and the developing economies of ASEAN and China.

The Western Anglo-Saxon countries always insist on APEC being legalistic, structured and institutionalized. The Oriental countries are more flexible and less legalistic, relying more on developing personal relationships first. So, it's easy to understand why it's very difficult to reach agreement on which way APEC should be going.

The Western Anglo-Saxons are interested in expanding trade and investment by means of the legalistic approach. That's the reason why there is a proposal about a trade agreement, an investment count, and so on. In the Oriental group, the developing countries are interested in trade and investment, but they are more interested in technical assistance. And they would like everything to be non-binding. In the middle you have the advanced Asian NIEs, who are interested in trade and investment. Singapore, a good example, is afraid that if it supports the Western side too much, it would not be well-received by the ASEAN side. These are the differences.

When you look at the historical development of APEC as an organization, you understand how and why APEC is what it is today. At the beginning, the North American countries and Japan and Australia were interested in something like APEC for economic reasons. The ASEAN countries were trying to extend their dialogue to cover other countries, mainly for security but also for economic reasons.

The leaders of Japan and Australia tried to promote this APEC as an organization as early as 1980, at the Canberra meeting, but that did not result in the countries agreeing to have such an organization. They decided to adopt something less formal in the form of PECC instead. In 1989, Australia came back and proposed an APEC Ministerial Meeting. (Every time you look at the history of APEC development, you find Australia taking a leading role.) ASEAN was also trying to do the same thing, but somehow Australia succeeded and APEC was formed as a loose consultative forum in 1989.

Each member country proposed to host a meeting. In 1990 there was a Singapore meeting. The nature of APEC after the Singapore meeting remained a consultative body. In 1991 Korea hosted a meeting, in Seoul. The Koreans do not want just to consult. At that meeting, somehow they succeeded in having a little higher degree of formality in APEC, and we also agreed to establish a Secretariat. In 1992, Thailand hosted the meeting, in Bangkok. There was a fight for the Secretariat between Singapore and Thailand, and finally Singapore won (people say that if they have the Secretariat in Bangkok, the traffic jam would be so bad that it would not be possible to have any meetings!). At the same meeting, in 1992, the so-called Eminent Persons Group was appointed. In 1993 the Americans hosted a meeting, and you can easily guess that anything done by America would have to be a big, big bang! So the Seattle meeting was a very big meeting highlighted by the "leadership conference" (not "summit," so that not every leader had to come). It worked very well, very well (and the meeting was referred to as a "summit" nonetheless). Also in Seattle (again, this is an American-style approach), these countries agreed on this trade and investment "framework" (a watered-down version of the trade and investment "agreement" proposed earlier). They also agreed to set up a committee on trade and investment. They initiated a meeting of Finance Ministers, and a meeting of Environment Ministers.

In 1994 you will find definitely the proliferation of meetings and work groups in APEC. If you start only with finance and environment...
or trade, I can assure you that every other ministry will also want to have its own ministerial meeting. It was already evident a few weeks ago. When they were preparing for the meeting in Hawaii of the Ministers of Finance, every ministry wanted to go along. The reason given was that they do not want officials from the Ministry of Finance to commit to anything that would affect their own territory. I am sure you will find after the 1994 Jakarta meeting a series of other ministerial meetings.

Also, in the leadership conference in Jakarta, which is to be held in November, the emphasis will be on technical cooperation rather than on trade and investment liberalization, as was the case in Seattle. This is in order to balance the so-called two groups in APEC: one more interested in trade and investment, the other in technical cooperation. I am sure that after the Jakarta meeting, we will have a much more balanced APEC, as an organization.

So, institutionalization will be gradual. After a series of these meetings, there will be a more professional Secretariat and so on, with the people and budget allocated. But these countries will be able to achieve many things that they want to do without having to have a formal organization at this time.

**East Asian Leaders in the Trilateral Process**

APEC is a good example of how the North countries and the so-called South countries could work together. I believe you will continue to see the growth of the economies of the East Asian members of APEC. That would make the world more balanced. I think it of interest to the Trilateral Commission to consider inviting East Asian leaders—business or government or otherwise—to join in this process. I think it should help strengthen the world economy in its entirety.

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Russia’s International Relations

The world picture as seen now from a Russian viewpoint is bleak. China, with whom we have now very friendly relations, either does not need us in the future, if it succeeds, or, if it does not succeed and starts to fall apart, will be a challenge of mammoth proportions. We have very few, if any, potential allies in Central Asia and that area will be unstable for decades. Western Europe is experiencing a deep crisis; Euro-pessimism is returning; politically the European Union is too fragile to withstand a real crisis and is growing preoccupied with its own affairs; Germany is still digesting its eastern lands. As seen from Russia, the West has proven to be incapable of devising and implementing a cohesive strategy of integration of Russia, and other East-Central European countries. It appears highly likely that the West is losing the capacity for any long-term and coherent strategy, be it friendly entanglement or hostile containment. The world in general is living through a general erosion of the system of relationships created after the Cold War. And though this erosion is very gradual, it is clear that in twenty years we will have only vestiges of it, and not very much is being created in its place.

With this world picture as the background, Russia itself is experiencing a backlash against “only-yes” policies and a revival of nationalisms. This backlash is, I believe, very natural for a country which has experienced such a deep trauma. And the radical Westernizers of the first year of Russian history and Russian foreign relations, with their “only-yes” policies, have undermined the Westernizing cause in Russia—a little bit less than Genghis Khan, but nevertheless seriously!

Russia and Its Periphery: A No-Win Situation

To make things worse, we are witnessing among most of the countries on our periphery—except for the Baltic countries, gas-rich Turkmenistan, authoritarian Uzbekistan, and Belarus (which is effectively joining Russia)—a process which I would call gradual degradation of statehood. Most of these states are gradually sliding towards economic collapse and degradation of state structures—and in some cases, political disintegration.

Most of the causes for this degradation are systemic. The changing of the pricing system has put Russia in a much more favorable position than it used to be: It used to be a milk cow for the whole Soviet Union; now it is being transformed from an economic colony to a dominant economic power.

In addition these countries are experiencing the absence of reforms. The smaller republics of the former Soviet Union have been hit harder by the curtailment of traditional links; and all experience a grave lack of technically capable and politically capable elites, because the Soviet Union was a centralized state in which most of the talent was sucked to the center.

Russia is blamed for this situation naturally, but the transformation of Georgia, for example, from the richest state of the former Soviet Union, happened before the Russian military started to play games in Abkhazia. Ukraine ruined itself before Russia started to increase prices for oil. And Russia is still trying, though with less and less willingness, to help these countries.

Thus multiple vacuums are being created—not only in military-political terms,
but also in social and economic terms. The most striking case is, of course, Ukraine, which is already half-dissolved. Ukraine is rapidly sliding towards chaotic conditions with basically no hope for getting out in the foreseeable future, because there are no forces there which could start a reform. Maybe the time for reform has passed. Of course, all that creates a powerful impetus in Russia for those people who want to intervene.

Two years ago Russia had several choices in forming its policy toward former republics of the Soviet Union. One was disengagement—complete disengagement. One was imperial revanche. Third, and most popular, was creation of some kind of EC-like structure.

I think that time has passed. Now we have only two choices; and both are stark and very unpleasant. Disengagement is not a choice. In most neighboring countries there is very little democracy, virtually no reforms, and declining sovereignty due to the weakening of the governments. Full imperial revanche is not a choice. It is very popular in debates about Russian policies and among people like Zhirinovsky, but most elites in Russia understand that Russia simply cannot afford to take these countries back—because that means death for Russia. And that opinion is growing.¹

Now the choice is between partial takeover, partial re-integration—even unwilling in some cases—of parts of the former republics (while managing instability in the rest) or the creation of a group of cohesive sovereign states around the Russian periphery (states which will remain independent but will be heavily dependent economically, and thus politically, on Russia). A year or two ago, people like myself called for an EC-like structure (or a NATO-like structure in the military field) where Russia would have played the role of Germany in the EC (or the U.S. in NATO). Now it is clear that the best we can hope for is playing the United States’ role vis-à-vis Central American countries, with Ukraine (if it survives) playing the role of Mexico. Two million Ukrainians are already illegally working in Russia now. Narcotics are coming. The parallels are stark. But that is probably the best choice we have. The other choice—taking over some places if the Ukraine state falls apart—means Russian disintegration at worst, or a dictatorial regime at “best.” We cannot manage such a challenge without some kind of dictatorship.

This dilemma will face Russia irrespective of those who are in power. If Clinton is our President, or Balladur is our Prime Minister, or Douglas Hurd is our Foreign Minister, the choice will be the same. We are in a no-win situation.

**Russia and the Trilateral Countries:**
**New Cold War or Strategic Association?**

Of course, the West is unpleasantly surprised and irritated by the change of the Russian tune from “Mr. Yes,” and is disillusioned in the course and speed of Russian reforms.² And there are also signs of revival of Russia’s ability to compete. People are concerned about Russian dominance, if not neo-imperialism. And so there is a possibility that the West will try to forge a policy of neo-containment.

That would not be the choice of the majority of Russian elites because we have no prospective allies except in the Trilateral world.

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¹We are now witnessing the opposite trend in the neighboring republics. Already 40% in Ukraine want re-creation of the former Soviet Union, with 40% wanting re-creation of some kind of a confederative state. That is 80% altogether.

²These reforms were very limited. We had some privatization and price liberalization. We didn’t have structural reform. We didn’t have de-monopolization. And we didn’t have anything like the creation of a modern legal system (I think that is the core of any reform in a society like ours). Nevertheless, as we are now partly reneging on the previous reforms, people are irritated.
We have nowhere to go, reasonably thinking, but along the Western lines (of course not exactly along the Western lines, with all our peculiarities). And we have nothing to win in such a confrontation. Only the ultra-imperialists or "iron-handers" would secretly applaud a harsher Western policy towards Russia. But more benevolent Russians are contributing to such an outcome. As we all know, very liberal Russians have recently started to talk about spheres of influence, "Monroevsky Doctrines," etc. I think these statements are dangerous, superfluous and empty. They are empty because Russia has no resources to defend with force its sphere of influence. They are superfluous because nobody wants, basically, to take this sphere of influence from Russian hands. And they are dangerous because they create a backlash in the Trilateral world and in East-Central European countries. At the same time, they are creating a psychological milieu in which Russia could start to use force indiscriminately.

So, if the West makes a choice for a new Cold War, it will definitely strengthen conservative elements in Russian society, but it will not achieve any of the West's goals. Russia will dominate (under those circumstances) its periphery—or fall apart. Both outcomes, I believe, are not in the interest of the West. I don't think that this new Cold War would recreate the Western security structures which are now weakening, because the causes for this Cold War would be very shallow. The ideological differences are missing. We do not have basic geo-strategic differences anymore; and Russia will not, in the foreseeable future, be able to pose a meaningful military threat to the West. Russia's active peace-making role in the former Soviet Asia is actually in the West's interest, in curtailing the spread of instability and extremism. The situation is more complex in the Caucasus (with the Caspian oil), but I am not sure the West has any possibility to influence that vortex of wars, and the trend towards Western disengagement from this area will continue. The Baltic countries are a special case, but nobody—almost nobody—in Russia challenges the Baltics.

The real Cold War could start over Ukraine. But take into consideration the inability and unwillingness of the West to help Ukraine and the unwillingness of the West to form a common strategy vis-a-vis Ukraine, other than on nuclear matters. I believe that with the gradual deterioration of the state and social order on Ukrainian territory, the resolve of the West to stand up for Ukrainian independence will be reduced. That is not to say that I believe any kind of re-unification with Ukraine is in Russian interests. As I already said, that reunification could deal a coup de grace to Russia proper.

So what is the alternative to a new Cold War?

- First of all, conceptually the West should understand that Russia is in for a long historic evolution, with its ups and downs, with its breakthroughs and reversals. If the West is unable to help, let it adopt a policy of not hindering the evolution. Stop talking about aid. I beg you.

- The Trilateral countries should act upon your interests and expect Russia to act upon her interests. These interests largely coincide. When they do not, we can deal with them case by case.

- Be prepared for Moscow's influence to be reinstated on the territory of most of the USSR, but most probably this will be domination of peripheral weak states rather than re-creation of an empire.

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3To judge the social transformation of the country, one has to consider not only the obvious shortcomings, but the unbelievable achievements, such as effectively doing away with Communism in three years. Russia is not a full democracy, and will not be one for many years. One could regret that, one could condemn that. I do both. But we are simply living through a different period of history. Britain in the 19th century, or even the United States at the beginning of this century would have been condemned by contemporary democratic purists. And one has to understand that Russia does not fully belong to the Western civilization. For centuries defending Western civilization and itself from Asian invasion, Russia has become partly an Asian country.
• Do not isolate Russia, thus making her automatically a revisionist state striving to undermine the already growingly fragile European order.

• The only viable strategy towards Ukraine is massive and coordinated Western and Russian aid, given with conditions concerning reform. If the West is not ready for that, do not expect Russia to pay for Ukrainian independence. Let the West be prepared for the consequences, including possible disintegration of the Ukrainian state—and do not pretend that Russia is to be blamed for it. There are many in Russia who want to show Ukraine the price of independence, but Ukraine is ending up paying the price on its own.

The main thing the Trilateral world has to decide is: do you—in historic, geopolitical, and (later) economic terms—want Russia to be on your side or will it be left wandering alone or joining somebody else? If one compares, between Russia and the Trilateral world, the list of contradictory interests and the list of interests which converge, one is struck by how much the latter outweigh the former, especially in the strategic sphere. I have done this several times with colleagues in the military and in strategic circles in the Trilateral world. I’ll give you the short list of interests which coincide: non-proliferation, containment of regional conflicts and Islamic extremism, managing the nuclear legacy, joint friendly management of the Chinese leviathan, creation of a new stable core of the international system (which cannot be built around institutions of the West anymore), prevention of disintegration of Russia (and thus creation of a strategic “black hole” in the center of Eurasia), linking of Russian resources (and later its human and economic capital) to that of the Trilateral world.

The list could be lengthened, but even
Trilateral Policy vis-à-vis Russia: The Balance of Power Option

Western Political and Intellectual Confusion

Leaving aside the extraordinary confusion in Moscow itself and the inherent difficulty of apprehending and influencing a revolutionary situation from outside, the West itself had been used to a well-established, rather comfortable strategy of both passive and defensive containment of the USSR for nearly half a century. Western armies, protected by the nuclear shield of the United States, were sitting on Europe's dividing line waiting to react to a direct aggression that never came. Meanwhile, the unprecedented freeze of the continent's geopolitical landscape brought bad intellectual and political habits in our countries, which did not prepare our leaders and public opinions to deal, in a bold way, with the massive geopolitical revolution of the past few years.

• First, we equated the Cold War and the division of Europe with the nuclear stalemate between the two superpowers. The enormous "strategic" literature devoted to nuclear weapons and East-West relations over the past 50 years described just about every possible scenario of confrontation and war except what actually happened in the end: the disintegration of one superpower from within, leaving an enormous "inheritance" of nuclear and conventional arms. Accustomed as we were by the American-bred "strategic community" to view East-West relations through the lenses of nuclear nuts-and-bolts freaks or "gurus" in the intricacies of the Soviet regime, Western nations (and that includes Europeans and Japanese) forgot such basic elements of policy as history, nations, borders and religions. When the collapse came, we were totally unprepared, not just politically but intellectually, to deal with the sudden resurgence of real people and real historical reflexes from past periods.

• Second, hooked on the passive habit of reacting to something bad the Soviets would do, we were (and still are) totally unprepared to conduct anything more than a reactive "policy" to events we prefer to watch unfolding before our eyes. As Churchill pointed out some 60 years ago, democracies are both reactive in nature and very slow at budging even when a threat is rising on the horizon. Fifty years of passive containment have only made this tendency worse.

With the disappointing results of the much-anticipated Russian legislative elections of December 1993, the West is suddenly discovering that the bride it had embraced so warmly is not as loving or as docile as it thought. The elections brought a stunning defeat for the four reformist blocs. Polls show a continued erosion of pro-Western feelings in Russian public opinion. A series of pronouncements and initiatives on the part of Russian diplomacy is pointing to a pattern of behavior which does not fit either Western interests or what the West (the Americans in particular) had expected of the "new" Russia.

The result is that Trilateral countries are as confused today about how to deal with Russia as they were nine years ago when Mikhail Gorbachev came to power. A caricature printed in a recent issue of The Economist, picturing Strobe Talbott and Zbigniew Brzezinski each pointing at "their" bear (a teddy bear and a vicious-looking one), perfectly illustrates the intellectual and political impasse we are in: What kind of "animal" is the new Russia turning out to be? And how should we, in the West, deal with it: by being...
understanding and helpful and by continuing to close our eyes when Russian behavior abroad does not please us, or by being tough and ready to draw the line (on Ukraine, for instance)?

The view put forward in these remarks is that we ought to go beyond this black or white caricature, typical of the current U.S. debate. The new Russia will neither be a powerless toy, subservient to Western interests, nor necessarily a revamped Soviet bear, systematically anti-Western by nature in its intent and actions. The simple truth is that Russia—by its sheer size, the quality and education of its people, its history and considerable military forces—will remain a great power on the world scale. Though temporarily weakened by its internal revolution, it will eventually regain a dominant role on the Eurasian landmass, and it will pursue its own interests, which may at times clash with ours.

A Tougher Nationalistic Russian Foreign Policy

A gradual shift in Russian foreign policy towards a tougher nationalistic line has been going on since 1992. There are at least three main reasons for this.

The first is that most Russians are basically Great Russians. Russian nationalism has always been—even in the Soviet period—a strong feature of the national consciousness. Lenin’s “nationality” policy, for instance, was in fact a form of Russification (the same kind of colonialism the French used in Algeria) under the guise of Sovietization.

The second reason is that the definition of post-Communist Russian foreign policy touches upon the very borders of the new state. It is not generally appreciated in the West how much change was brought to Russia’s geopolitical landscape by the disintegration of the Union. As Allen Lynch pointed out recently, while in the spring of 1991 the political-military boundaries of the Soviet-Russian state extended in effect to the Elbe River, “less than three years later, these boundaries had changed to a greater extent than in the disastrous summer of 1941 following the Nazi invasion.” Of Russia’s major historical borders, only that in Siberia remains unchanged.

The collapse of the Soviet state has taken with it the historical legacy of modern Russia. What has happened to the Russia empire in 1991 resembles much more the fate of the Austro-Hungarian and Ottoman Empires after 1920 than it does the British and French decolonizations, which (even with the Algerian war) never directly threatened the national identity of the metropole.

The third reason why foreign policy is taking such prominence in Russia’s evolution today is precisely because Russian identity has always been an obsessive question in Russian thought. As Georges Nivat reminds us, Russia is the product of a centuries-old symbiosis of a large number of peoples, without any parallel elsewhere.

In terms of actual policy, the tougher, more nationalistic trend began to manifest itself in 1992 and developed in 1993 in what the Russians call the “Near Abroad,” in Eastern Europe, and in the rest of the world.

The Near Abroad

With respect to former Soviet Republics, Russia began to assert—and execute—a policy which Russian officials explicitly compare with the Monroe Doctrine: broadly speaking, a reconstitution de facto of the Empire while formally respecting the “independence” of the states in question. This has been done in a variety of ways, and often in the most cynical fashion. The Caucasus, Central Asia, Moldova and Belarus are already back in Russia’s fold. This process has yet to be worked out in Ukraine and in the Baltics. Far from hiding what it is doing to its immediate neighbors, Russia is openly claiming a special right to do so. Boris Yeltsin’s speech to the Duma on February 24 of this year is quite explicit: “Relations with independent states which have recently appeared on the borders of Russia, and the development of the
CIS in all fields, will constitute the cornerstone of external policy in 1994... Our links with these countries are much tighter than those that exist ordinarily between neighboring countries. This is a reality which we must take into account in order to keep control of economic and social processes, and to ensure an adequate level of security.

Claiming that "the prolonged economic crisis and even the crisis of the state structures of several CIS countries are creating a heavy threat to Russia's security" and that "no one, with the single exception of Russia, is ready today to carry the burden of peacekeeping in the former space of the USSR," the Russian President went on to claim a specific Russian right of intervention in these countries "without asking the international community's prior authorization before intervening in this or that operation." Yeltsin concluded by putting forward a doctrine reminiscent of very unpleasant times in Europe before World War II: "the fate of Russian nationals, wherever they are outside the Russian Federation, must inevitably be at the center of our attention in all our relations with CIS states and the Baltics. Wherever they reside, our fellow countrymen must feel like full citizens, equal in rights."

Eastern Europe and Beyond

While most Russians consider their former Warsaw Pact allies as definitely lost (contrary to the Near Abroad republics), this does not mean that Russia has given up what it believes to be its "natural" sphere of influence. Russia has managed to effectively block any enlargement of the Western Alliance to the East, thereby securing a de facto veto right on the security policies of Poland, Hungary and the Czech Republic. In January 1994, the much-awaited NATO summit offered them—as well as Russia!—a new institutional gadget called "Partnership for Peace" which is of no strategic significance whatsoever for the future stability of Central Europe.

Russian diplomacy has also showed signs of renewed activity elsewhere. In the Middle East, Russia is obviously attempting to recapture the major influence the Soviet Union used to have before 1991. In the Far East, Russia is busily improving relations with China and ASEAN countries, though no progress has been made with Japan, given Moscow's refusal to negotiate seriously on the Northern Territories issue. The Kremlin has apparently decided to unearth an old treaty of cooperation signed with North Korea back in 1961, just when the international community is about to decide sanctions against Pyongyang's refusal to implement IAEA safeguards.

Trilateral Policy

Given this reality, it is premature indeed to talk of a "strategic partnership" with Russia, as was done by the Clinton Administration—unless that "partnership" means that we close our eyes to their reconstitution of their empire and of their sphere of influence elsewhere.

The West as a whole bears a share of the responsibility for the trends we see developing in Russian external policy. On the question of economic aid to Russia, in spite of the publicity made around the big G-7 promises, the money actually given was essentially European (80%), and mostly German. The Japanese essentially kept out, while the United States did very little. At this critical juncture in history, when a unique opportunity was there to actually help the transition of the largest Communist power to democracy, the West was actually very mean and very slow to provide the kind of assistance which could have made a difference in the way Russian citizens had to live through this difficult period.

On Near Abroad questions, Western divisions and passivity clearly encouraged the Russians to believe they had a free hand. Both the United States and Europe (not to speak of Japan) were totally silent in 1992 when the Russians began to use military pressure in Moldova. We all let Georgia be carved up and...
...an error of historical magnitude in closing NATO's door to the Visegrad countries... 

Armenia starve. Following America's misguided leadership, we all viewed Ukraine only as a non-proliferation nuisance, not as a potentially major European state. With Western policy essentially silent, the CSCE has achieved nothing in settling these disputes.

On Eastern-Central Europe, the United States, followed by its European allies, is responsible for an error of historical magnitude in closing NATO's door to the Visegrad countries, and to have done so under Russian pressure. This, in the medium and long term, can only invite more destabilization and trouble in East-Central Europe, particularly if Ukrainian-Russian relations deteriorate, as is likely. Reflecting on that massive mistake, I cannot but wonder what would have happened three years ago had the West taken the same weak course when dealing with German reunification. Sadly, the reasons for the West's yielding this time around do not need much elaboration. The United States, engaged as it is in a massive strategic withdrawal from Europe, has no intention to extend any security guarantees beyond the current NATO members. As for the Europeans, despite all the talk of a “common foreign and security policy” and all the agitation around WEU, they are simply in no position to carry these commitments themselves. Neither the political will nor the military means are present at this point in Western Europe to protect Poland or Hungary, let alone the Baltic states.

Three Options
Looking to the future, Western nations should avoid two equally disastrous temptations in the months and years ahead.

Strategic Partnership
The first is to continue to pretend that a strategic partnership is in the making with the new “democratic” and liberal-minded Russia. In its cynical variant, this option can be described as follows: “Since no one in the West is prepared to invest heavily in the Russians, nor to stop them from interfering in Ukrainian, Georgian or Baltic affairs, let them have these countries.” One could push the cynical argument one step further: by taking on the huge burden of reconstituting its former empire, Russia is doomed to fail in its own economic modernization. At best, like Turkey in the latter part of the 19th century and in the early 20th century, Russia will be the new “sick man of Europe.”

The trouble with that option is that it carries huge risks for Western security as a whole. First, imperial reconstitution may end up in war (possibly nuclear) with Ukraine, which would send shockwaves through the whole of Europe. Second, living with a huge, nuclear sick man next to oneself is not a very reassuring prospect. In a Europe profoundly shaken by economic difficulties, by the rise of nationalistic forces all over the Continent, and by major uncertainties as to the future of the European Union, the prospect of an unchecked, poor, fragile and insecure neo-imperial military superpower to the East is potentially very destructive indeed.

Re-Launching Containment
The second option, diametrically opposed, is to react to recent Russian trends by simply relaunching a Cold War-type containment policy. This would entail severely curtailing economic and technological transfers to Russia, building up once again NATO defenses, and re-inventing, so to speak, a front line. Is America prepared for this? (I doubt it.) Would this option be followed by its allies? (Germany is very doubtful.) And where do we draw the “line”—on current NATO borders, around the Baltics, at the Polish-Ukrainian border, at the Ukrainian-Russian border? Such a policy would definitely close the door to any peaceful transformation of Russia toward democracy and a market economy. Is this really in our long-term strategic interest?
Balance of Power Option

There remains a third, much more difficult option: which I call the "balance of power option." The Trilateral countries would aim at exploiting areas of cooperation with Russia wherever possible, while clearly marking and protecting our interests however we choose to define them. This assumes, of course, that we are capable of offering real carrots (in terms of real money) and that we are also prepared to show (and use) our stick whenever necessary.

The carrot will be real only if Trilateral countries all agree to contribute (including Japan and North America). It would be useful, given the state of public opinion in Russia, to be very specific and very clear in stating the readiness of the West as a whole to help Russia, and to treat it as an equal partner. It might be useful in this respect to invite Russia to join the OECD, which could be used as the institutional channel to support significant aid and investment. Meanwhile the Western side should learn to work directly with regional authorities and firms inside the Russian Federation, rather than continue to work exclusively through the Center. The problem in Russia is to show real gains in the standard of living of the greatest number of people. This is the single most important condition for any prospect of real political change in that country, and aid can best be provided by going directly to the towns, regions and firms, not to the bureaucracy in Moscow or through the intricacies of the political battles between the Duma and the Presidency.

The conditionality of that aid must be emphasized much more than in the past—first, as Alain Juppé recently did, by insisting on Western strategic interests as we see them. There is no reason whatsoever why the West should accept as a given Russia’s claim of special rights in its Near Abroad or of special interests in Eastern Europe. There is no reason for us to need Russia’s authorization before we admit those wishing to join into the European Union or NATO.

This has several implications, which we should make very clear to the Russians. In particular, any use of force by Russia in former Soviet Republics must be conditioned on a prior mandate by either the United Nations or the CSCE. Such operations must be limited in time, and closely monitored by international observers. The West should be prepared to back this rhetoric by being ready to actually use the United Nations and the CSCE. This means contributing money and forces when necessary. It is useless to criticize what the Russians are doing, if in fact the United Nations and the CSCE are crippled because of our own passivity.

Trilateral nations should also work actively on the establishment of the next security order in Europe and the Far East. In Europe this means accelerating the reform of NATO, both through enlargement to include the Visegrad countries and through a greater contribution by the West Europeans themselves to their own defense. In the end, strengthening the stability of East-Central Europe from the West will provide a key condition for the success of Russia’s transition. Russia has nothing to gain from the maintenance of a highly unstable Central European region.

The G-7 Summit meeting in July provides the proper place to offer such a Grand Deal to Russia.

This assumes...we are capable of offering real carrots...and...prepared to show (and use) our stick...

Pierre Lellouche is a Member of the French National Assembly, where he is Defense Spokesman for the RPR. He is Diplomatic Advisor to his party’s leader, Jacques Chirac.
Russia is a “Society of Sand”

Russia is now in a state of confusion and turmoil—politically, economically, socially. There is a rapid increase in crime. (The population of Russia is only 20 percent greater than the population of Japan, but while the number of murders in Japan last year was 1,200, there was a total of 30,000 murders in Russia. These are only reported cases, so actually I think there was a larger number of murders last year in Russia.) The dominance of organized crime is being seen at the current moment. Zhirinovsky is gaining great support among the people of Russia not primarily because he supported an imperialistic foreign policy, but rather because he advocated that criminals should be immediately shot to death without even going through a trial. That was greatly applauded by the population of Russia. I went to Russia recently and many people told me that any kind of dictatorship is better than the current vacuum of power.

The Fundamental Defect in Our Understanding

The reformers in Russia, since the days of perestroika, as well as the Western countries that supported perestroika, are now seeing an unexpected state of affairs evolving in Russia. That these events were unexpected can be traced back, I believe, to the fundamental defect in the understanding of Russia in the Western countries as well as among the reformers in Russia.

I would like to discuss with you the characteristics of Russian society in comparison to the characteristics of Western societies and Japanese society. I would like do this in as visual a way as possible.

- The civil societies in European states, based on individualist principles, can be likened to a “society of stone.” The stones can be used for constructing stone structures; a firm shape can be created. The individualism of the European countries is not an anti-social type of individualism.

- Japanese society dislikes having people stand out as individuals. I think this stems from a difference in cultural tradition. Japanese society is based on a tradition of trying to avoid emphasizing one’s individual traits. I describe Japanese society as a “society of clay.” If you use clay, you will be able to create a more refined and subtle form, more so than with stone. We have a unique sense of order and discipline in Japanese society.

- In contrast to these two types, I refer to Russia as a “society of sand.” Sand alone will not enable you to create a shape. You have to support it with a firm and sturdy framework from outside (the dictatorship in Czarist Russia and one-party dictatorship during Communist rule). However, a sturdy framework by itself will not enable you to create a shape out of sand. You need to pour cement into it (that role of cement was played in the past by religion as well as by Communist ideology). The tragedy of present-day Russia is the fact that this framework has deteriorated and the cement that was serving as the adhesive is no longer playing the role of the cement.

Why have the reformers in Russia not been able to fully recognize and understand this underlying characteristic of Russian society? Why were the Russian reformers so optimistic about Russian society? The optimistic Russian reformers tended to think that, once the old framework for the society disintegrated, this would lead to the spontaneous development of an orderly, autonomously supported Russian society. In contrast to the older thesis in Russia that control is precisely what creates order, which I believe is basically correct, the reformers thought that order could be spontaneously created if the existing rigid
structure was destroyed. It is understandable that the people living in the West may not have realized this characteristic of Russian society; but why were the Russians themselves unable to understand this characteristic of the "society of sand"? In the past the Russians had an instinctive fear of chaos. The Russian people supported the Communist Party because they believed that it was the only power that could create order in Russia. The Russian people supported the Stalinist system of control by a terrorist regime because they had an instinctive fear of chaos and disorder. However, during the postwar years, Russian society had been stabilized. During these years of stability, the Russian people I believe began to take for granted the framework supporting the stability of Russian society. They lost a clear understanding of what it was that supported and maintained order in Russian society. And as a result, I think the people came to believe that once the Communist Party regime was destroyed, a new order would spontaneously be created. The Russians came to have that illusion.

**Priorities in a "Society of Sand"**

Russian society is now faced with three basic problems. One is to ensure social stability. Second is economic reform, further increasing the efficiency of their economy. The third is democratization of politics, which includes enhancing human rights. These three challenges are all very important challenges, and in principle, I don't think we can assign priorities among them. If the conditions were in place for simultaneously pursuing these three challenges, I believe that the Russian people should seek to pursue all three together. However, in the Russian Federation as well as in the republics of the former Soviet Union, I don't think the conditions for pursuing these three challenges at the same time are to be found. Therefore, there is no choice but to assign priorities. Roughly speaking, I believe securing stability should be first, economic reform second, and democratization of politics third. Of course, ensuring stability should not be a goal in itself. It should be a stability that will ensure economic reform and democratization.

I give third priority to democratization of politics, but this is not because democratization has low priority. It is because we wish to realize democratization that we should not put democratization as the first priority. If democratization were upheld as the first priority, because of the characteristics of Russia as a "society of sand," it will lead to chaos and disorder. We tend to fall prey to the temptation to give high priority to democratization, and that is what is leading to chaos and disorder in the society of sand in Russia.

**Framework is Needed, Cement is Needed**

How should we deal with this society of sand? I believe some kind of framework is necessary in Russia. It should not be a rigid framework, like in the days of dictatorship, but rather a soft and flexible framework, in which individuals to a certain extent can move around and express themselves.

Some kind of cement is also necessary. The Russian Orthodox religion and Communist ideology can no longer play the role of cement. Unfortunately, democracy, rather than playing the role of a cement, will probably play the opposite role. So, after all, nationalism probably is the only element that will be able to play the role of a cement.

I am talking here not of ethnic nationalism, but rather the type of nationalism that is based on the idea of the state. This is close to the idea of ideology of Bismarck, when he united Germany in 1871. In present-day Russia, nationalism is the only element that can play the role of a cement.

The kind of flexible framework that I am talking about can be referred to as some kind of an authoritarian framework. Unless there is that kind of strong leadership, the society of sand will not be able to create any kind of shape. To what extent can the Western countries tolerate a form of authoritarianism, and nationalism? I think the most important challenge for us in the West is to be able to reach some kind of consensus as to what extent our countries can tolerate authoritarianism and nationalism in Russia.

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ECONOMIC AND POLITICAL REFORM

While I will be talking principally about Russia, you should keep in mind that, especially in the economic sphere, whatever can be said about the situation in Russia, it is worse in all of the other republics, with the possible exception of Kazakhstan.

Getting Perspective
Let me set the stage by quickly running down some points of perspective that are important to my own thought process in trying to sort out this complex situation:

- In dealing with Russia and working there, you should keep in mind that the minute you think you understand something, you are going to find out you were wrong. We are dealing with a situation without precedent in virtually all respects. It is an effort at simultaneous, broad-based, if not radical, political and economic reform. There are very, very few cases where we have seen that even attempted, much less seen it succeed. Whether we like it or not, that's where we are.

- When Western leaders speak to the Russian people about democracy and a market economy, they don't have any meaningful insight as to what we are talking about, nor the slightest vision of what those things can mean over time. That shouldn't surprise us, but I think we all tend to forget it at times. (If I handed out pieces of paper in this room and asked each of you to write down for me the definition of a market economy, I think you'd be very surprised at the diversity of your answers.)

- Another point of perspective in dealing with Russia that we in the West have not grasped is that success means thinking small before you think big.

- With the possible exception of the so-called Liberal Democratic Party and Mr. Zhirinovsky, much of the political struggle that we have witnessed in recent months and years is much more a matter of raw power than it is struggle about the classic "isms." That is not, of course, to suggest that ideological elements are fully absent, but more than anything else, I see a power struggle in classical political terms.

- We have all listened to the leaders in the West celebrate the end of the Cold War. I hope that celebration is not premature. Even if it is not, we are a long, long way from the point where stability in this area, broadly defined, is assured. The potential trouble spots are many. One that troubles me a great deal in the short run is the southern republics and the areas to the south of them.

- I still think that the cumulative process of reform, with its dimensions far from certain, is irreversible; but I am a little less confident of that than I was a year or so ago. Even the legendary patience of the Russian people probably has a limit. In that context, it's very important to recognize that economic progress is crucial. Indeed, if we are going to be able to forestall some of the very dire potential developments that were touched on by other speakers, it seems to me that can only happen in a context in which there is at least some progress on the economic side.

The Political Setting
Before turning to the economic situation, let me add a few points of emphasis of my own with regard to the political setting:

- The political process, as we imagine such a process, is not yet working. That process, in our minds, typically involves building coalitions and consensus. That is not something we are seeing in Russian politics.

- We have to understand that, in part because of the vestiges of the past, the nuts and bolts of a political process don't work either. The administrative skills to make political
decisions work, when they are agreed upon, are not there. And the task orientation associated with making that process work is not there either. Indeed, that may have been the biggest failing of the aggressive reformers in the first two years of their efforts.

- The regional problems and the relationships between the regions and the center are far more complex than many of us appreciate.
- When we think about inter-republic problems, we cannot lose sight of a couple of other things. One is the nature of the artificial, forced economic interdependencies that exist among those republics — a fact that is a direct outgrowth of the Stalin era. He built it that way; and he built it that way for a reason. On top of that, as has already been mentioned, in all of those republics there are large enclaves of Russian nationals, and in some there are still elements of the Russian Army.
- Mr. Yeltsin is perhaps less influential today than he was a year or two ago. But, in my judgment, he is still essential. He still represents a core of stability, and without that core of stability, I fear there will be none. It is my distinct impression that he is working better and more effectively with the Prime Minister. I also sense some efforts behind the curtains to build something of a centrist coalition that might be able to exercise constructive influence in the political vacuum that I described.
- The threat of nationalism is real. In my judgment it is not imminent but it surely cannot be ignored.
- The last point of political perspective is: don’t forget that the presidential election is only two short years away.

The Economic Situation

On the economic side, what I am going to say sounds contradictory. At one and the same time, it is both better and worse than the impressions most of us gain from reading the Western press.

- It is worse because the threat of hyperinflation is greater than at any time since the coup, although I still don’t think that result is probable.
- It is worse because the macro-economic policy outlook and leadership is less clear than it has been in the past, but again not hopeless.
- It is worse because the inter-republic trade in goods is still collapsing, and with it we are seeing this enormous build-up in inter-republic debt and payment arrearages, which has the potential to wreak economic and financial havoc and also to severely complicate the political tensions between the republics.
- It is worse because the gap between the haves and the have-nots in the society has widened appreciably.
- It is worse because crime and corruption, if anything, are worse.
- It is worse because the inter-company debt problems and payment arrearages within the Russian Federation are worse.
- It is worse because the problem of what to do with the colossal state-owned industries has yet to even be seriously considered.

Some things, however, are better than we think:
- The availability of all kinds of goods is sharply higher than it was two or three years ago, even if the prices, regrettably, are also higher.
- We are seeing a significant surge of creative entrepreneurial activity at the micro level of the economy. The farther away from Moscow and St. Petersburg you go, the more of that you see. Indeed, I would be prepared to guess that the scope of this micro-level economic activity is great enough that it’s possible the GDP, if we could measure it, is no longer declining.
- Foreign investment (together with its managerial and technological transfers),
while small to be sure, is probably larger than we think.

- There is a very substantial income transfer occurring by virtue of the very large number of expatriate workers from the West who are now in Russia. The U.S. embassy in Moscow estimates that there are a hundred thousand such expatriate workers in Russia. If on average each one of those results in a transfer of only $25,000 into the Russian economy, that's $2.5 billion. If the average is $50,000, which isn't unreasonable given the living allowances, the total is $5 billion. That's big money.

- In small but nevertheless significant steps, we are now seeing signs of progressive reforms in the banking and financial system.

- Last but not least, and contrary to popular belief, there is a broad-based recognition of what needs to be done. I don't know how many of you have taken the trouble to read the full 110-page text of the Presidential message that was delivered to the Parliament earlier this year. What you see, compared to the press reports, is a completely different situation. There is a broad-based comprehensive menu for change and reform. Close to my heart, there is even a sentence that pledges—of course this may not happen—far-reaching reform of the central bank, with the aim of the creation of a Russian federal reserve system!

**Economic Priorities**

So, the economic situation is on the one hand worse, but on the other hand better. What are the priorities on the economic side? Some of these are very easy to identify:

1. figure out the ways to contain and gradually reduce inflation;
2. the legislative framework relating to business law and so on;
3. the crime problem;
4. reform of the central bank and the banking system;
5. find the mechanisms to clean up the inter-company and inter-republic debts;
6. the emergence, if only on a small scale, of some kind of a social safety net;
7. to build on the progress that is being made on the micro level of the economy, I would love to see the development of enterprise zones throughout the Russian Federation, sponsored jointly by the federal government and the regional government; and
8. tax reform.

**Priorities for the Trilateral Countries**

The priorities for the West are fairly simple, at one level: (1) First and foremost, don't quit now. Part of not quitting now means working to better understand the context in which this whole situation is evolving; not expecting that the process of change can ever be a straight line; and not overreacting when something goes wrong, even if that something injures our sense of values and morality. Patience is the name of the game. (2) A major part of the emphasis of Western efforts should be re-focused at the micro level, consistent with my dictate to think small in order to be able to think big. (3) We should put a great deal more emphasis on the human capital side (not to the exclusion of the financial capital side). That's where the thing is going to be won or lost. (4) We need a much greater level of coordination of assistance and aid programs across the G-7, and that is going to require some political statesmanship on the part of the ministers and the heads of government within the G-7.

Last but certainly not least, I think we all must recognize that this endeavor really should be viewed as a venture for mankind, because that's what it is. You don't have to be a rocket scientist to begin to grasp the implications of it all turning sour.

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Change in President Clinton's Washington

Today I'd like to talk about how the Clinton administration is different from those of Ronald Reagan and, especially, George Bush. I'll talk about how the changes affect the role of the United States in the world. I'll close by discussing a few facts of life about governing America, with a final comment on Whitewater.

An Agent and Symbol of Change

The American people acknowledged and appreciated George Bush as the last President of the Cold War. But after the Berlin Wall crumbled in 1989, and the coup by hard-line Communists against Gorbachev failed in 1991, Americans knew the Cold War was over. Our preoccupation with foreign affairs—and constant worry about superpower confrontation—gave way to domestic concerns, especially jobs and the economy, which took a back seat during the Bush years. Americans were eager for change, a new agenda and a new leader.

Eventually they found Bill Clinton. Most Americans didn't immediately embrace Clinton as a commanding figure or a natural leader—an Eisenhower, Franklin Roosevelt or even a JFK. Many voters came to Clinton slowly and with real questions about his character and experience. But Clinton promised new directions—and he connected on an emotional level with people worried about their jobs and their futures. After a bruising three-way campaign, and an election in which he received less than half the popular vote, Clinton entered office as an agent and symbol of change. He said the word change 11 times in his inaugural address.

Make no mistake about it: Clinton is different from his predecessors in several fundamental ways.

First, Clinton represents real generational change. Clinton is young, only 47. He had no experience of the Great Depression. He was born after the Second World War. The contrast between Bush, a World War II hero, and Clinton, a Vietnam war protester, could not be more dramatic. On the other hand, Clinton is the first American President to have grown up in the age of television, the first to be at home with computers, and the first to be molded by the sexual, feminist and civil-rights revolutions. Also, he is the first since JFK to have lived overseas for as long as two years.

A second fundamental change Clinton brought to Washington is Hillary. The Clintons are in every way a team. Elect Bill Clinton and you get them both—without apology or excuse. Hillary is tough, vocal, opinionated and forceful—about people, policies and political strategy. She has real power. She decides what she'll be involved in, and the extent of her participation. The health care issue is very much her responsibility. However, unlike the President—and the rest of official Washington—Hillary is officially accountable to no one. This concerns me, although I admire her.

A third change brought about by Clinton is the most important: President Clinton believes in government activism to solve the nation's economic and social problems. Reagan's goal was to diminish the role of government. Bush never had a vision of how government could address domestic ills. His chief of staff once said Congress might as well go home for two years, because Bush had no major initiatives that required its...
attention. Clinton, on the contrary, believes—passionately—that government can be used to help solve the country's domestic problems. He has changed the national agenda to focus on these domestic issues. And because both the White House and Congress are now controlled by the Democrats, discussion is taking place about a host of domestic policies that had no chance of being implemented under the Republicans. One administration official pointed out: The debate in Washington has shifted from "whether" to "how"—and that is a tremendous change.

The Clinton Agenda

The Clintons arrived in Washington with an agenda so strongly felt it's truly a mission. I find something almost evangelical about their administration. To put this agenda in its simplest terms, Clinton wants a good education, a good job and good health care for all Americans, and a more liberal social environment. Putting this agenda into effect is requiring action on three fronts.

First, Clinton's ambitious plans immediately came up against harsh economic realities. The fiscal policies of the Reagan and Bush years had left the government in dire straits. Clinton's first priority had to be putting the country's economic house in order, starting with the federal budget deficit. Clinton deserves great credit for a meaningful deficit reduction program. Although it wasn't as much as he wanted—and the deficit is expected to rise again in 1996—this will be the first time since Truman that the U.S. will have deficit reduction three years in a row.

In addition, Clinton is benefiting from a general upturn in the economy, rising employment and growing corporate profits. American businesses are now reaping dividends from the massive restructurings and downsizing of the past few years. And Clinton generally has been supportive of business.

The net result is a more solid foundation on which to build the administration, and credibility for Clinton in domestic and international financial markets—at least until recent weeks when confidence has eroded.

The second front on which Clinton is moving is in social policy and programs. Here Clinton's ambitions are immense—at least equal to Lyndon Johnson's Great Society. And his knowledge of the issues—to the smallest detail—is extraordinary. Clinton is very smart.

The biggest issue is health care, which the Clintons have put first on the national agenda. It has to be said that Hillary Clinton's health care team, charged with formulating the administration's plan, has been a case study in process failure. Five hundred people worked for a year to produce a document that's undigestible. Few Americans understand the Clinton plan and how it would affect them, and public support for the plan is diminishing. Yet Clinton has established the parameters of the debate, and some form of health care will probably pass, because the public expects and wants action on this issue. Clearly, the President's ability to steer health care through Congress will be a defining test of his presidency.

Still, health care is only one of many problems the Clintons are eager to attack. They've also targeted welfare reform. An education bill has already passed. Training programs are on the way. National service is another signature Clinton goal. These initiatives are in their infancy. Because of financial constraints, most of the Clinton agenda is being introduced as pilot programs that can be expanded later as funds become available—and if the programs prove successful. Clinton is pragmatic. If one program doesn't work, he'll move on to another. Clinton has said if he stumbles, it's only because he's moving forward.

The third front Clinton is attacking is the country's social environment. Here Clinton wants to redress 12 years of Republican conservatism. He's had mixed success so far.

The issue of gays in the military proved explosive and threw the administration into
turmoil in its first months. On the other hand, the administration has won victories on abortion rights and fetal tissue research. The first major federal gun control legislation in 25 years has passed. And Clinton is committed to placing more women and minorities in government and the courts. At the same time, Clinton has coopted a traditional Republican issue: crime. Crime ranks number one on the public’s list of concerns. The President is determined that no one will be “tougher on crime” than he. Clinton supports the death penalty and a controversial “three-strikes-and-you’re-out” proposal that would imprison for life people who commit three violent crimes. A major crime package will pass Congress this year.

Clinton's willingness to tackle critical issues, and his success on the economic front, have created a profound change in public attitudes. For the first time in memory, polls show that Americans believe Democrats can run the country better than Republicans, including handling the economy, reducing the deficit, dealing with crime and helping the middle class. Only in regard to taxes and foreign affairs do Republicans still come out on top.

**International Relations**

That brings me to international relations. President Clinton will be a pivotal figure in American foreign policy despite the fact—indeed, because of the fact—he doesn’t focus on it. Clinton doesn’t bring the same easy confidence, interest or passion to traditional international relations. He’s more like a student mastering material for a test, rather than the hands-on expert he is on domestic issues. In fact, Clinton tends to view foreign policy through the prism of domestic policy—even as an extension of domestic affairs. This reflects another profound change taking place.

Since World War II, the core of American foreign policy has been national security. With the Cold War over, that’s no longer the case. Clinton wants to replace national security at the heart of U.S. policy with economics and what he sees as the “real” foreign policy issues of the ’90s: trade and technology. Clinton is a president for whom NAFTA is more important than NATO. Clinton believes vigorous international trade is the only route to sustained economic growth and jobs. He has said: no longer can any country resolve its unemployment problems within its own borders. That’s an extraordinary statement for an American president to make, but an accurate one.

For this reason, Clinton has fought hard for trade agreements, and stood up to organized labor to get them passed, a truly courageous act for a Democratic president. And he’s scored some important successes. Although he waited until the last moment to lead the charge, Clinton’s victory in passing NAFTA is of great importance, as is the recent GATT agreement. Through these measures, Clinton established himself as a defender of free trade and an internationalist. He also strengthened his credentials as a new Democrat by standing up to the traditional forces of protectionism in the Democratic party.

At the same time, however, U.S. relations with Asia are a cause for concern. Clinton recognizes that Asia is the most dynamic and fastest changing part of the world—and that it’s of fundamental importance to the United States. But at the moment, the U.S. is not keeping up with changes in Asia very well. The administration is in the unusual position of having created strained relations with both China and Japan simultaneously.

Clinton’s populist, hard-nosed stand toward Japan resonates well with the American public. And his intention, no doubt, is to solidify the long-term strategic interests of the two countries. It’s imperative that Japan find ways to reduce its enormous trade surplus with the U.S. However, the President’s confrontational stance and insistence on objective criteria in measuring progress may not
be the most productive position at this time, when Japan has been undergoing a severe recession and adjusting to progressive, new political leadership—and now, of course, must deal with the current upheaval.

U.S.-Chinese relations are also tense. President Clinton has been criticized for explicitly linking human rights and most-favored-nation trading status for China. I believe these issues must in the long-run be separated. We need to redefine the choices to encourage both free trade and human rights. We need to avoid the yearly fight with China. We also need to recognize that our ability to influence internal events in China is limited, although we must maintain strong support for human rights. That's what our country has always stood for.

The situation in Korea is especially dangerous and sensitive right now. The administration needs to be particularly skillful if it is to prevent North Korea from having nuclear weapons, while avoiding an armed confrontation.

This is a more traditional foreign policy challenge. The world needs U.S. leadership to help resolve these regional crises and establish a more stable international order. However, this leadership hasn't been as strong under Clinton as it should be.

One reason is the problems are so difficult. President Clinton also did not come into office with any particular national security agenda or strategy of his own. He believed the U.S. would be free of serious challenges to national security for the next decade. He also recognizes there is less desire for the United States to be the world's policeman. The American people, understandably, are not willing to support the kind of international engagements that were justified by the Cold War.

In the major instance where Clinton supported a U.S. ground force—Somalia—the objectives became over-ambitious, perhaps because of government inattention. What had begun under Bush as a successful mission to feed starving people changed, under Clinton, to the manhunt for Aieded and to the goal of nation-building with U.N. involvement. Somalia became an example of how multilateralism was supposed to work in the New World Order. That aspect of the mission failed, and the U.S. has removed its troops. President Clinton didn't want to take the political risks, or expend the political capital needed to generate support for sustained U.S. intervention. Nor has he wanted to deflect attention and resources from his domestic agenda.

The truth is, the administration hasn't yet worked out new definitions of U.S. national interest in places like Somalia—and Bosnia—that would justify the use of American power. And in the absence of American power, the administration hasn't developed a viable alternative to prevent or defuse crisis points, where concepts like multilateralism have failed.

Finally, the administration hasn't yet succeeded in devising a new, post-cold-war arrangement that would prevent the major Powers from being dragged into crises and conflicts among themselves, although the administration's Russia policy has been consistent so far.

In short, when it comes to foreign policy in the traditional sense, the administration tends to worry more about what it shouldn't do, rather than what it should. And it tends to manage by crisis, rather than by strategy. This isn't usually a formula for long-term effectiveness.

Basic Facts of Life about Governing America

President Clinton, like most presidents, would prefer to be judged by his ambitions. But history judges presidents by their achievements. In both foreign and domestic affairs, the Clinton administration hasn't been as effective as it hoped. Part of the reason is that change is extraordinarily difficult to bring about. While the desire for change was
Clinton's friend in the election, people's natural fear of change is his enemy in power. The administration's failures also have a lot to do with some basic facts of life about governing in our country.

Good Management
Regardless of party, policy or agenda, to be effective, the government must be well managed. But almost from day one, the Clinton administration has been racked by blunders.

This stems from inexperience and, to a lesser degree, youth. More harmful is the President's personal style, which isn't simply informal, but undisciplined in a way that saps people's energy. Decision-making is over-centralized. Nothing moves without Clinton's involvement. The appointments process is contributing to turmoil as well. After more than a year, some 130 top positions remain vacant.

Most important, the Clintons have not replaced their campaign mentality—and operating style—with a governing mentality and operating style. As a result, the administration is making decisions on the run. It's preoccupied with spin control. And sometimes it takes an excessively adversarial stance toward its opponents, which is unproductive, rather than a conciliatory approach that gets things done.

Working with Congress
That brings up a second fact of life: presidents must work closely with Congress to get their programs passed. Clinton came into office with very narrow political support. Balancing his broad policy agenda on that narrow base is proving to be exceedingly difficult. Despite Democratic control of Congress, Clinton must build a different coalition for virtually every program. For example, only 78 House members (out of 435) voted with him on both NAFTA and the budget.

This has forced the President himself to change. Clinton campaigned against "business as usual" in Washington, and he started out by trying to ignore his Republican opponents. But he's discovered he has to operate the old-fashioned way. The budget and NAFTA got done because the President cut deals, made promises and expended political capital on both sides of the aisle. The difference is, the Clintons are their own political capital. They promised to hold seminars and town meetings with legislators who voted with them.

The Press
The final, unchanging fact of life in Washington is the press. Clinton at first thought he could bypass the traditional media and take his message directly to the people through the new media—town meetings, television talk shows and talk radio. It worked during the campaign, and Clinton thought it would work in Washington. He found out differently, and it's been a hard lesson.

Former presidents and government officials say there is no way to prepare for the intensity of Washington press coverage and criticism. At the same time, it's through the press—especially the printed press—that policy options are introduced, debated and often resolved in our society.

Clinton only now is beginning to manage press relations with some skill. The administration has learned the art of the successful leak. And they're strengthening ties with reporters. But press relations will remain stormy; that's the inevitable consequence of an adversarial free press in our kind of democracy.

Whitewater Affair
The Clintons' troubles with the press and Congress, and their management style, all have come home to roost in the Whitewater affair. This murky brew is a jumble of ingredients that is exceedingly difficult to sort out. The key issues are whether an Arkansas savings-and-loan owned by a Clinton associate received special treatment while

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Clinton was governor, and whether some of its funds were improperly diverted to Clinton's campaigns. Also involved are possible White House efforts to hinder investigation of the affair.

It's still too early to know whether Whitewater is a true tragedy in the making, or whether it will eventually be deemed less than critical. The press has been criticized with some justification for piling on and blowing some stories out of proportion.

This much is certain: Whitewater won't simply go away; the outstanding questions must be resolved. It's taking a toll on the White House, diverting attention, time and resources from the President's agenda. And it's affecting Clinton's public standing and may affect his ability to lead. Assuming no criminal acts are involved, as I do, this is most unfortunate.

* * *

Our country needs to address critical problems. And despite President Clinton's faults—what leader is perfect?—he has qualities that can serve him and the American people well. President Clinton learns from his mistakes. He has almost superhuman resilience. He has a clear and convincing vision for the future of the United States. He has the ability to inspire people to tackle problems. And I believe he has the intelligence to learn to manage foreign policy well. His ultimate success will depend on many factors, including some he can't control. But if his achievements come close to his ambitions, he could still be a very great President indeed.

Katharine Graham is Chairman of the Executive Committee of the Washington Post Company.
The Future Course of European Integration

I want to address four issues: first, the raison d'être of the European Union in the future; second, its institutional framework; third, the method of progress; and fourth, the influence of enlargement.

The Raison d'Être of European Integration
The raison d'être of European integration is to a certain extent a new subject in European politics. So far, the existence and the meaning of that integration have more or less been accepted without deeper discussion. There had never been in Germany, for instance, a discussion about the advantages or disadvantages of participation in European integration. Everybody accepted it. Sometimes there was grumbling by the Finance Minister about Germany's financial contribution, but nobody really took that seriously. For the first time, we are discussing: Is it good to be a member of the European Union or not?

This debate was caused by the Maastricht Treaty. Commentators and critics often used to say, why are the politicians not courageous enough to take a really important step to move Europe ahead? For once, with the Maastricht Treaty, the politicians did that—and the shock was considerable. People started to discuss: Is the Union democratic? Is it good? Shall we give up our national currencies?

We had two main reasons for the existence of the European Community. First, all the European nations that came out of the Second World War did not want to get into another war of that kind. They wanted to build a fundamentally solid basis for peace among themselves. The second reason came about after the separation of the world into East and West was beginning to show quite clearly. Apart from the military defense that was organized in NATO, we felt there should also be an economic working together. At that time, people believed that communism had a possibility of being more effective than capitalism. That, as we all know, was an illusion. But when this illusion disappeared, this did away with the second reason for the European Union.

We need another convincing argument. If you look at the discussions in Great Britain, if you look at the decision of the German Constitutional Court about Maastricht, you can feel that there is a change of mood and of argumentation.

To my mind we have two major lines of argument to use. The first is an economic one. The foundation of the European Economic Community was an effort to reinforce the international competitiveness of the European economy. The globalization of the world economy is calling for a globalization of politics as well, but the globalization of politics will not be as easily done. Therefore, we have to start with regional cooperation. One of the big advantages of Europe is that we have started earlier than others. We have developed a sense of economic partnership (the single market is showing that there is an ability to work together economically). That is the only real basis for our remaining competitive in the global economy. We have all the disadvantages of traditional industrial states, and we have to overcome that. We have to spend much more money and much more political energy on training our people to be as effective as a newly industrialized country. Regional cooperation is one of the main prerequisites to remaining competitive.

One aspect of European integration which
was not foreseen in the beginning is the in-built competition of the systems in the Union. Not only enterprises are competing. Systems—the Spanish, the French, the German, the British system—are competing with each other. We have seen that in our discussions on telecommunications. It never would have been possible to reach the degree of progress we did if everybody was not convinced that he had to compete with his neighbor. So we were able to liberalize mobile telephone systems. We were able to take a decision on stationary telephone systems. We were able to start—as our Japanese and American partners have—the so-called information society.

That is, to my mind, the best argument for Europe: In economics, without Europe, the nation-states would not have the same chance to survive.

The second argument is much more philosophical, or more political. If you want to be competitive in a global system, you have to develop some values in social life which normally are not existing in a nation-state. The key value is tolerance, the capacity of living and working together with other people who belong to a different culture. The European Union for its citizens is a school of tolerance, something which is preparing them for participating in the global system.

These two reasons, to my mind, could be the future *raison d'être* of European integration.

**What Institutional Framework?**

What should be the institutional framework for this integration? There are two sub-questions here. First, do we have to have one cohesive structure or can we use more flexible methods, like the “Europe of different speeds” or “Europe à la carte”? I personally believe that we can use the two more flexible methods only as a transitional possibility without creating the danger that we are not directing the whole effort toward a cohesive structure. I accept that sometimes we have to do that for political reasons. The opting out of Great Britain from the social policy of the Union is an example of

“Europe à la carte.” To my mind, it is not a good development, but for political reasons we had to accept it for the time being. It is less dangerous to have a “Europe at different speeds,” because even if you are progressing at different speeds, there is no opting out. In the European Economic and Monetary Union, for instance, we had to accept different speeds, because the criteria that were set up cannot be met by everybody on the same schedule. For some time we will have a two-class Europe—members that belong to the club and members that do not.

So in practice we are being flexible, but in principle we should stick to one cohesive structure. That, in politics, is necessary, especially in the very complicated structure of Europe. One of the biggest problems of integration so far is that we have difficulty explaining the different methods that we are using. People sometimes do not understand that.

The second sub-question concerning the institutional framework is: Do we have to use an existing model or are we free to create something totally unique, something that has not already been done in history? Although future integration does not have to follow directly an existing model, I do believe that we have to choose among certain options.

We have three general options. The first is a centralized state. This, of course, is a vision which is pursued neither by political parties nor by the Commission. So, the centralist option is not a practical one. It is just a ghost which is described from time to time in order to frighten people.

The second model is that of independent sovereign states forming an association: a confederation. This may be the dream of some of the member-states, but we have already gone much further than that. Even the Rome Treaty passed beyond the idea of a confederation. It already had features of the third model, the federal model.

I know that “federal” for some of our friends in Europe is a four-letter word. I personally believe that there is a misunderstanding about
what a federal structure really means. Everybody has already accepted that the Rome Treaty gave trade policy and competition policy exclusively to the European Community. Trade policy is an exclusive privilege of the Union. Competition policy in general is already imbedded in the Rome Treaty, and we have enlarged that. The Commission is acting in the most important areas of merger activities, not member-states.

The key issue in a federation is the division of competences. Some are going to the federal level; some are remaining on a national level. The single market is exactly in the line of that federal system, and Economic and Monetary Union is the line of that thinking. The second important element of a federation is majority voting. A loose association of sovereign states does not accept majority voting, because majority voting is the expression of a legitimate authority which is beyond national sovereignty. Whenever we are working by majority voting, we are using a principle of a federal structure.

So, we cannot say we are not living in a federal structure already. Of course, the German Constitutional Court was right when it said that member states should remain states. They should have their own parliaments with their own rights, and their parliaments have to play a role in the construction of the Union. That is fully acceptable.

So, I am pleading for the model of a federal structure. It is already existing and we have just to deepen it.

**Constitution or Pragmatic Approach?**

Should we now work out a constitution and adopt it by votes in member-states? Or should we pursue a pragmatic approach, with all the successes we have had in the past? If you belong to the Latin tradition, you have a tendency to want a constitution as a clear-cut basis for all political decisions. My fear is such a constitution may go less far than we could go with a pragmatic approach. Openly discussing and agreeing on, for instance, the division of powers between the federal and the national level would require a lot of political understanding on the part of national politicians, with whom European politicians are now in a fight about these competences. So we risk, in order to have a compromise on a constitution, reaching less than we could reach pursuing a pragmatic approach.

Our pragmatic approach so far has had good results. We have reached a higher degree of cohesion than everybody else in the world in these sorts of undertakings. Economic and Monetary Union would be another major step ahead, and there is a spillover effect from one area into other areas.

**Enlargement**

What is the influence of enlargement on all that? We have had that debate when we started to discuss the possibility of taking members of the EFTA into the Union. That was the famous debate on widening or deepening. The compromise we found is a productive one. We concluded that we cannot reject new members, because that would affect the political meaning of the Union. The Union is not meant as a club of the rich Europeans; it is meant as something which must be open to European democracies, which also have the economic capacity to compete with other economies. To say we have to deepen our own institutional structure first would have created the misunderstanding that we want to keep the others out.

But we do not want to touch the so-called acquis communautaire—that is to say, what we have accomplished up to now—when taking in new members. This is a very good compromise. That this compromise is already difficult enough you have seen in the debate about the blocking minority: to go up from 23 to 27 was a major problem in Great Britain. But maintaining the acquis communautaire is something essential for the Union and for the new applicants. The current applicants have no difficulty matching...
the average economic capacity and efficiency of the Union. It would be a success for the whole of Europe if they joined.

* * *

Let me conclude with one remark which is born of my long experience as a European politician. I am doing that now for more than 30 years, and I have lived with all the ups and downs. It is a mistake to underestimate what is going on in Europe. We do have an actual capacity for cooperation, a great asset with which we can balance the disadvantages that we may have in terms of economic and political efficiency compared to other parts of the world. Even if there are doubts about Economic and Monetary Union, that is a change of quality of our cooperation that will come about before the end of the decade. It will make Europe a valuable and competitive partner in the global system. Europe's capacity to play a positive and vital role in a global system depends on such regional cooperation. The national member-state is not able to do that in Europe. Therefore, with European integration we are preparing ourselves for that global cooperation, and that is in the interest of all of you.

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SECTION 7
THE G-7 PROCESS

Hisashi Owada’s speech to the Tokyo meeting drew on a paper he prepared for the special issue (April-June 1994) of The International Spectator—published by the Institute for International Affairs (IZI) in Rome—linked to Italy’s hosting of the 1994 G-7 Summit. Two parts of his paper are presented below.

HISASHI OWADA

The Role of the G-7 and Its Future

Basic Rationale of the G-7 Summit

The international community is undergoing great structural changes. The collapse of the Soviet Union in December 1991 symbolized the end of the bipolar structure based on confrontation between the United States and the Soviet Union. This means the disappearance of the basic framework which has formed international relations since the end of World War II. However, this structure has yet to be replaced by a new concrete framework for peace and stability. Furthermore, there is no assurance that the realization of such a framework will be a simple task. Does this mean that the validity of the summit, which was created as a device for policy coordination among the countries of the West in the era of bipolar confrontation between the East and West should be called into question? The answer to this question should be a categorical “no”.

The integration of the international community has generated a need to deal with global issues that affect all nations, notably the macroeconomic management of the world economy but including in addition such major issues as the refugee problem, environmental problems, combating AIDS and other lethal diseases, and coping with transnational crimes like international terrorism and drug smuggling. In the economic sphere in particular, it has become impossible for the economy of any one nation to operate detached from the overall perspectives of global economic management. In all these sectors, interdependence among the nations of the world is growing stronger and deeper.

In this new environment, the nature of the new international order that will replace the old bipolar order cannot be a unipolar. Nor will it be a multipolar world based on a geopolitical balance of power among nations. It can be only a world order of international cooperation among the major nations that have the will and the capacity to play a large role in forming and maintaining such an order.

Within such a system, cooperation among the advanced industrial democracies within the trilateral structure of East Asia, Europe and North America is being called upon to play the most crucial role. The combined economies of Japan, the United States and Europe account for more than 70% of the world GNP. Furthermore, the triad of Japan, the United States and Europe has pursued the welfare and prosperity of humanity based on the common values of freedom, democracy, the rule of law and respect for human rights. Now that the Cold War has come to an end and the importance of building a world based on these universal values is strongly recognized, it is crucial that these core nations cooperate vigorously to strengthen the new international order.

Herein lies the basic rationale and the intrinsic validity of the G-7 Summit within the order based on pax consortis in an age of interdependence.

Composition and Structure of the Summit

If the validity of the summit essentially lies in its character as a forum for policy coordination on a voluntary basis among countries pursuing common policies based on shared values, the question of membership and composition becomes a crucial issue to the extent that the composition of the club will determine the basic character of the forum.

From this perspective, the difference between...

IT IS CRUCIAL THAT THESE CORE NATIONS COOPERATE VIGOROUSLY TO STRENGTHEN THE NEW INTERNATIONAL ORDER.
different fora for policy coordination in the post-Cold War era of pax consors should be clearly registered in our mind. In particular, it is important to keep in mind the essential difference in purpose and in function between the United Nations and G-7 summity, both of which can serve extremely useful purposes in the present setting, although in radically different ways. The United Nations has a membership comprising in principle all the members of the international community, representing different interests, policies, creeds and ideologies. It is a forum for policy coordination and policy decision to bring about the harmonization of these differences through debates and decision-taking. Its principal organ, especially in the field of maintenance of international peace and security, is the Security Council, endowed with a strong executive power to act as the political directorate of the international community. Essentially all the major powers with the willingness and the capacity to carry out this function should be represented on a global basis, so that the Security Council can truly act in the name of the international community.

By contrast, the G-7 summit is not and should not be a worldwide forum of a similar character. Its raison d'être lies elsewhere than that of the United Nations. In order to perform its proper functions, the summit does not have to aim at universality in representation, at all major powers of the world irrespective of the differences in policy goals and value preferences. The G-7 summit is expected to carry out quite different functions from those assigned to the United Nations.

Hence it would be wrong to argue that Russia, or for that matter China, would be automatically qualified and should be considered for membership in the G-7 summit, simply on the grounds that Russia or China, as prominent powers of the world, should not be excluded from the pulpit of the world political directorate.

Conversely, the integrity and homogeneity of the forum could be jeopardized by the inclusion of elements which represent different value preferences and different policy goals. The forum might be rendered totally ineffective for achieving the purposes for which it was established.

Another problem to be carefully looked into in relation to the composition and structure of the summit is the problem of what some regard as dual representation on the part of the countries of the European Union. France, Germany, Italy and the United Kingdom are represented both by their own heads of State or Government and by the European Community, which in turn is represented both by the President of the Commission and by the President of the Council.

It might be argued that this anomaly is not so material, given the fact that the G-7 summit is not a decision-making body where such a dual representation would bring about an inequity. However, even in a deliberative body for policy coordination the texture of the membership counts as being determinative of the general sense of the conference. I recall one of the participants from the United States in the summit once remarked that the problem with the summit is that "there is sometimes a tendency in which the tail wags the dog instead of the dog wagging the tail, because of the European domination of the scene in number."

Organization of the Summit

Another complaint about the summit that one hears increasingly frequently is the problem of "bureaucratization" of the summit process. The personal representatives of the summiters have come to be nicknamed "sherpas" because they lead the way to the summit throughout its preparatory process. As a result, the actual summit is reduced to little more than a ritual to endorse the lengthy work of the sherpas in the form of a Declaration written in officialese as the final outcome of elaborate negotiations among the bureaucrats in advance of the summit.

To cope with this trend, it has been suggested by one of the summiters that the preparation of the Declaration may not be necessary and that meetings of the sherpas should be reduced to the minimum, leaving the greatest latitude for freewheeling discussion among the summiters. This suggestion is based on a misunderstanding of the process and is dangerous in its implications.

The basic point about an excessive bureau-
Special Significance of G-7 Summit Process for Japan

There is no assurance that the international community, as a result of the end of the Cold War, is moving in the direction of a more peaceful, democratic and stable order. In fact, paradoxical as it may seem, the end of the Cold War, having brought about the disappearance of a structure of confrontation based on the clash of ideologies, has in its place brought to the surface a plethora of national and religious conflicts hitherto contained within the bipolar regime, as well as moves to seek regional hegemony.

From the perspective of Japan, these structural changes acquire an added special significance. Japan by now has become an important partner in this setting, able and willing to share the burden of maintaining the new emerging international order through playing a constructive role in this game of collective engagement. However, when it comes to the concrete application of this philosophy, it is essential that fora exist in which this political will can be put into practice. Unfortunately, it has been a fact of international life that this willingness on the part of Japan to play a constructive role could not be effectively put to the test of practical application, because of the lack of an institutional mechanism for implementation.

It is true that, in the sphere of economic policy coordination, the G-7 Finance Ministers effect a policy coordination on a macroeconomic—fiscal and monetary—level. However, it is doubtful whether sufficient policy coordination has been carried out in a comprehensive way, comprising both the macroeconomic factors in the fiscal and monetary areas and the microeconomic factors in the areas of trade, investment and employment. An approach featuring a much greater degree of integration is needed now, both in terms of the scope of the fields to be covered as relevant to the problem and in terms of the players involved in the process of coordination.

When it comes to the sphere of policy coordination in the political arena, the present situation requires even more urgent attention. Japan is unfortunately outside most of the institutional machinery in existence for policy coordination among the major industrialized democracies—such as the NATO, the WEU, the European Union (especially its EPC) or the Council of Europe. She has more recently been admitted into the circle of the CSCE to a limited extent, but her participation in this institution has had only a marginal significance. The CSCE has not been sufficiently effective as a forum for genuine policy coordination. In addition, Japan's participation has been accepted only in the form of a special guest status—a factor which puts a severe limitation upon the capacity of Japan to have an impact upon the policy process within the CSCE.

Under these circumstances, it is easy to see that the summit process has acquired a special significance to Japan as a continuous process for policy coordination on major world issues of common interest.
summit as a process for genuine policy coordination should be revived and improved.

Nevertheless, a word of caution is necessary against some of the more radical proposals. It has been suggested that the summiters should be left entirely free to engage in a “fireside chat” without any prior preparation, as was the case in Rambouillet, that what is important in the summit process is the development of personal rapport among the leaders of the industrialized world, that therefore the less preparation by the sherpas the better it would be; etc.

This extremist view is based on some misunderstanding of history, on a somewhat naive understanding of the many complex issues afflicting the present-day world, and on an oversimplified grasp of the summit process. First, it is not true that the 1975 Rambouillet summit, which may have retained some of the flavor of a “fireside chat” of the “Library Group” of previous years, was conducted without much preparation. It was a most elaborately prepared summit. Second, and more important, many of the problems that the summiters are expected to deal with, particularly in the economic field, are complex in nature, to say nothing of accomplishing meaningful policy coordination on them. They have to undergo a careful and structured analysis before being presented to the high table of the summiters for substantive policy coordination and decision. To have a fireside chat to promote personal rapport among themselves is one thing; to promote policy coordination in a substantive sense in order to move things ahead is quite another. There is nothing wrong about the former approach to the summit, except that to hold a summit just for that purpose would be too expensive an undertaking and not commendable from the viewpoint of cost-effectiveness. The occasion of the summit will certainly provide an opportunity to promote the former, but that cannot be the central purpose of the summit. In order to pursue the latter purpose as the central theme of the summit, it will be advisable as well as inevitable to engage in an elaborate, though not necessarily lengthy, process of discussion over substance at the level of sherpas, with a view to sorting out the problems, digesting the relevant factors and offering a policy direction for coordination among the leaders. If we are to be serious about the summit process as one of the few precious processes for viable policy coordination in a world in which pax consorsit is based on genuine cooperation among the major industrialized democracies is the order of the day, we must pursue a more structured approach to many vital issues through the summit process, while avoiding a bureaucratic straitjacket of spending much of the time in preparing a document which does not come to much in substance.

**Institutionalization of the Process**

Another problem, closely linked to the problem of bureaucratization but not identical, is the problem of institutionalization of the summit as a system.

The first summit at Rambouillet was more a product of convenience and the wisdom of the moment than the result of a long process of deliberation. It was not even designed as a process to be continued. After the success of the initial round, however, the summit gained momentum as a continuing process and a degree of international recognition for the useful results it achieved in particular at Rambouillet, in Bonn in 1978, and in Tokyo in 1979.

As already argued, the collapse of the Cold War structure of the international system, of bilateral confrontation between two camps based on pax americana and pax sovietica, requires us to have a new look into the problem of international order and the mechanism to maintain this order. In this new setting, a kind of pax consorsit is inevitable; in fact this is the only viable international order in this period of transition, however imperfect and fragile this order may be. The G-7 summit is the only viable process which can provide the essential machinery needed to maintain this pax consorsit. It therefore needs to be reinforced as even more relevant, rather than discarded as outdated and ineffective. If we need this process as a framework for collective engagement in the management of international economic and political order, we have to devise con-
crete means to reinforce it by making it a forum for genuine policy coordination, and not reduce its effectiveness by making it less structured and turning it into a mere salon for a fireside chat among the leaders.

It is not my intention to suggest a further institutionalization of the G-7 process in any formal sense. Its formal institutionalization through the creation of a permanent secretariat and other institutional arrangements could go in the direction of making it more bureaucratic and less flexible, to the detriment of the cause which the G-7 process is meant to promote. What is required might be called "informal institutionalization" of G-7 summity through making it a more continuous process of consultation rather than a festive event that takes place once a year.

In this regard, two concrete proposals are offered. First, in the economic field, it is highly advisable to try to establish a much closer link between the summit as a process and the work of the OECD. After all, the OECD's primary task is to act as a center of policy coordination—macroeconomic and microeconomic—among the industrialized democracies. There already exists a fairly close link between the OECD and the G-7 summit in that each year the Communiqué of the OECD Ministerial Meeting offers a model for reference in preparing the Economic Declaration at the Summit. However, this link can be widened to cover a broader field of common interests and deepened to engage the OECD in research and analysis of the fundamental issues facing the summit.

Second, in the political field, it is highly desirable to intensify the practice of using the G-7 framework for a continuous process of political consultation on major issues and trends. This practice started in the early part of the '90s, with constructive results already, especially on China in preparation for the 1990 Houston summit and on Russia in preparation for the 1991 London summit. However, this practice has met with strong reservations from some quarters, who argue that this new practice creates the danger of turning the G-7 mechanism into the political directorate of the world. This criticism is not justified, even if based on a genuine concern. If the criticism comes from a political concern that too close consultation among the G-7 countries as a continuing process could jeopardize the freedom of action on political issues of each of the G-7 partners, such a concern should only be described as anachronistic in the present setting where collective engagement, and not collective abstention or freedom to veto, should be the rule of the game.

Intensifying cooperation on a voluntary basis, built upon a commonly accepted consensus of views based on shared interests, will be essential for the preservation of our common values and for the maintenance of an international order based upon such common values.

* * *

It is clear that we are at a turning point in the 20-year experience of the G-7 summits. The suggestion for reform is not only understandable but positively welcome. It will be important to assess the validity and the utility of the summit in the context of evolving new realities of the international system. If an order based on the concept of pax consorsis is the only viable alternative to the disruptive disorder of disintegration, then this requires us to think harder about the mechanism to put that philosophy into practice, so that states may not go in the direction of pursuing their own narrowly defined self-interests to the detriment of common interests of the international community. What we should guard against is straying into a negative-sum game at a time when we should be searching for an effective framework for playing a positive-sum game.

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...A MORE CONTINUOUS PROCESS OF CONSULTATION RATHER THAN A FESTIVE EVENT... ONCE A YEAR.
RENA TOM RUGGIERO

The Post-Uruguay Round Trade Agenda

"FREE TRADE AS AN IDEAL IS absolutely. There either are barriers that need to be removed, or there are not. Reality is not so simple." This famous statement by David Ricardo is the best way of illustrating the great challenge which lies ahead of us in dealing with the agenda of world trade problems in the wake of the Uruguay Round. The positive outcome of the Uruguay Round, in a world dominated by so many contradictions and conflicts, is an act of great political wisdom, in which both industrialized nations and the developing countries have shared. It is now important to focus on a new agenda.

1. The first point, inevitably, must be the prompt ratification of the Uruguay Round agreements, which will be signed in Marrakesh in three days.

2. The second point on the agenda concerns the creation of the World Trade Organization by January 1, 1995.

We are at the end of an important chapter in the history of the world trading system, a chapter started in Geneva in October 1947 with the conclusion of the first multilateral round of trade negotiations and the birth of GATT. As Richard Gardner reminded us, in Sterling-Dollar Diplomacy, the achievements of GATT have been remarkable in spite of the fact that its legal status has remained uncertain. Take the dismantling of tariffs: at the end of eight rounds of negotiations, between 1947 in Geneva and April 1994 in Marrakesh, the tariffs of industrialized countries have fallen from an average of 40% to around 3%. According to GATT statistics, the volume of world trade rose by 67% in the '70s and 49% in the '80s, compared to a growth in world production of 48% and 34% respectively.

The dispute settlement mechanism has grown much stronger and the creation of WTO will unify the existing set of rules. Unilateralism should become obsolete. Trade in services (the most dynamic sector in the trade system, accounting for 20% of world trade) and the trade aspects of intellectual property and of foreign direct investment have been brought under the umbrella of the multilateral system. But, as Peter Sutherland pointed out in a speech given recently in Davos, one of the major successes achieved, especially by the Uruguay Round, is the change of attitude of many developing countries. Many of these countries have now become great supporters of multilateralism and in the latest negotiations, although to varying degrees, they made a considerable contribution to trade liberalization.

It is very significant that after almost 50 years and in what is a very different world, we are today about to complete the Bretton Woods institutional design with the founding of WTO. The meaning is clear: although the world changes, the principles which have guided our reconstruction and development after the Second World War are still relevant. This is why, going back to the ideals and objectives which shaped the debate on the creation of the great post-war international economic institutions, we must celebrate the creation of WTO as a major political and institutional event. We must also give the new institution the universality of character envisaged by the founding fathers through a rapid enlargement of membership to China, Russia and other countries which are now moving towards a market economy. Today, there are 20 or more requests for GATT membership on Director-General Sutherland's desk.
The new WTO should also make coordination easier between Bretton Woods institutions on an equal footing. In an increasingly open and global market, coordination of economic, monetary and trade policies is a prerequisite for the smooth running of the market. The experience of European construction demonstrates that. A more balanced process of coordination between economic, monetary and trade policies should also recognize the major role of trade liberalization for economic growth and, thus, for job creation. Merchandise trade now accounts for 30% of world GDP compared with 18.5% in 1960. With the inclusion of services, the figure rises to 40% against a 1960 level of 20%.

3. The third point on the agenda concerns the relationship between trade and the environment.

A document will be adopted at Marrakesh by the representatives of the signatory states of the Uruguay Round providing for an ad hoc committee under the auspices of WTO, with a well-defined initial mandate. The objective is to make sure that the rules of international trade and those of environmental protection will be compatible and mutually supportive. Agreement on this subject is a very positive point on the road to Marrakesh.

4. Trade-related labor standards are the fourth point on the agenda.

This very delicate subject sometimes comes up in relation to the problem of unemployment in industrialized countries. At the heart of the problem is the combination of an increasingly interdependent world economy and the growing diversity of the countries which play the biggest parts in world trade. We are moving fast from a trade system characterized by a limited number of homogeneous partners toward global competition in a heterogeneous environment. The most important new players in world trade are mainly in the Asia-Pacific region, which has the highest growth rates in the world and the greatest prospect of trade expansion. The new market-oriented countries of Latin America and Eastern Europe will also add their contribution to the definition of a global market economy. This is why we are now in a transitional phase where the relationship between trade and labor standards calls for clarification.

The problem of human rights must be distinguished from that of “social dumping.” The first involves the production of goods in inhumane conditions, in prisons, or in violation of basic human and social rights. The problem is not new and it has already been dealt with in some international institutions: in the UN, as in last year’s world Conference on Human Rights, in Vienna; in the International Labour Organization (ILO); and in GATT (Article XX). There is also a social clause in one of the three complementary NAFTA agreements. In all the bilateral agreements of the European Union, there is a clause on the respect of fundamental human rights which forms an essential condition to those agreements.

The problem of human rights cannot, therefore, be ignored in the preparatory work for the creation of WTO. The quest for multilateral consensus on this subject and the definition of objective criteria are essential in order to avoid unilateral measures and the impression that trade actions could be used for protectionist purposes. Should this be the case, the moral power of our policy would be affected and so would our ability to defend human rights.

“Social dumping” is quite a different matter, involving the not always proven belief that, to increase their competitiveness, some developing nations deliberately maintain artificially low wages and insufficient social protection. Today it is widely recognized, especially in the industrialized nations, that the development of intellectual power, management skills, professional training and a high level of education are more important than low wages. Competition between the most advanced economies is based on these criteria, which have the greatest influence on companies pro-
duc ing high-tech products when deciding where to locate. In fact, in 1990, more than 80% of total foreign investment went to industrialized countries. The amount going to developing countries decreased from 35% at the beginning of the ‘80s to 17% in 1990.

Also, the advantage of low wages is often canceled out by other diseconomies in the developing countries. Wages in the Indonesian clothing industry are 75% lower than those in Europe, but the overall cost of the product at the factory gate is only 15% lower. There are significant differences in labor costs even between the major industrialized economies. A few weeks ago, The Economist calculated that, taking into account social security, the cost of a German worker is today twice that of an American one.

But the low wage level in some developing countries is felt as a real problem in several labor-intensive sectors. In fact, in the industrialized nations, the relationship between economic growth, productivity gains and job creation has changed because of the current level of interdependence of economies and the globalization of markets. An objective discussion of the problem in its different aspects is, therefore, crucial in the course of the preparatory work for WTO and it is in everyone’s interest—industrialized and developing nations alike.

As the Detroit G-7 Summit showed, we do not have all the answers to solve the problem of unemployment. But on two points, which do not provide an answer to the problem, there must be consensus. On the first, I quote Laura Tyson: “Societies where the going wage is $1 an hour and workers can be hired and fired at will certainly have flexible labor markets. But that is no solution.” The second point is clear too: the appropriate response to different wage and social protection levels is not protectionism. As the economic history of the past fifty years has shown, increasing liberalization favors economic growth and harmonization towards higher wages and better social protection in various countries. Closing borders not only makes living conditions worse in developing countries, but also reduces the chances of growth and development in industrialized nations.

5. In an increasingly integrated and diversified world economy there is a real need to broaden and strengthen international rules of competition.

The foundation of WTO brings to a close a phase characterized mainly by the liberalization of import controls, and marks the start of a new phase characterized mainly by the need to establish some new rules to help the development of global competition in a heterogeneous environment.

Technological advances, such as the rapid expansion of telecommunications, make traditional trade barriers increasingly obsolete. Alliances and co-operation agreements between companies on an international level take ever more sophisticated forms, with capital investment playing second fiddle to the acquisition of complementary knowledge. The financial market already operates on a truly worldwide scale. The daily volume of transactions on the exchange market amounts to some 900 billion dollars, three times the 1986 figure, whilst the yearly turnover of cross-border equity transactions has now reached the 1400 billion dollar mark, or 7% of world GDP, compared with 120 billion dollars in 1980. As a point of reference, the total volume of reserves in the industrialized nations, excluding gold, amounted to 550 billion dollars in 1992, or just 60% of the daily turnover on foreign exchange markets. The turnover of some private companies now exceeds the GDP of some medium-sized developing countries.

And yet GATT is concerned only with government policies and not with business, even if restrictive competitive practices, enacted by companies, can impinge upon free trade and often on freedom of investment too. The adoption of some international rules of competition which fix “minimum standards” would thus facilitate the extension and the homoge-
nization of laws and conduct concerning companies and their governments. Just think of the delicate areas of anti-trust laws and laws concerning mergers. In WTO it will be necessary to ensure that multilateral trade policy and competition policies are co-ordinated so that the aims of both are mutually supportive.

We are at the beginning and not at the end of a difficult debate on this subject, but what counts is that there is wide agreement on the need to progress in this direction, in the general interest.

6. Regional arrangements are not officially on the post-Uruguay Round agenda, but are important to bear in mind.

Perhaps the major change in the trade system, in the last two decades, has been the spread of regionalism. Article XXIV of GATT does, of course, consider it compatible with the multilateral system when, along with internal trade liberalization, it favors the development of world trade too. This is how it has been up until now. Toyo Gyohten’s report on regionalism to the Triangular Commission in 1992 is still valid.

But it is difficult to ignore that the possible further development of the two existing major regional trading areas—the European Union towards the Pacific via Russia and North America south towards Latin America and west via APEC—could make most-favored-nation treatment the exception rather than the basic rule. The importance of regionalism as a preferential system tends to decline due to the low level of tariffs, now around 3% in the industrialized nations. However, what continues to grow with geographic expansion is the political and negotiating power of trading regions.

A strong multilateral institutional system is, therefore, more necessary than ever so that regional systems as well as subregional and bilateral agreements can remain part of a transitional phase towards the truly integrated world market and not become permanent and predominant protagonists in the definition and interpretation of the rules of the game.

The creation of the World Trade Organization is an opportunity to recall all those who, with unparalleled idealism and pragmatism, set down the basis of the multilateral system with which we now have been living for some fifty years. “If goods cannot cross borders, soldiers will cross them,” the American Secretary of State Cordell Hull was in the habit of saying. In his memoirs, he added: “The basic approach to the problem of peace is the ordering of the world’s economic life so that the masses of people can work and live in reasonable comfort. Nations cannot produce on a level to sustain their people in well-being unless they have reasonable opportunities to trade with one another. And this cannot happen in a world of...economic barriers, political hostility, and recurring wars. The principles underlying the trade agreements programme are therefore an indispensable cornerstone for the edifice of peace.”

These words are still valid today. We face an unprecedented prospect of growth and development in the global market economy coming from so many new actors in Asia, Eastern Europe and Latin America. But we must not forget that free trade is an essential factor of peace, of progress and of freedom.

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The World Bank

GIVEN THAT THIS IS the World Bank's 50th anniversary, there is a good deal of discussion going on inside and outside the Bank on our future role. In preparing for this presentation, I asked myself the simple but provocative question: if we were starting anew in 1994, what kind of institution would we want to create to promote development? I found much in today's Bank to replicate; with other areas ripe for change.

The Development Challenge
Let's begin with some quick facts. In many ways, the past 50 years have seen more progress in improving the human condition than any comparable period in history. In the developing countries, life expectancy has increased by 50 percent; infant mortality has been halved; per capita incomes have more than doubled. The pace of this progress has been extraordinary.

The Bank has been part of this success story. Over 50 years, the Bank has supported more than 5000 projects in over 140 countries, lending more than 300 billion dollars for development purposes. In the process, the Bank has helped to support, for example, the spectacular economic growth of the East Asian nations, the Green Revolution in India, the overcoming of the debt crisis in Latin America, the defeat of Riverblindness in West Africa, and the provision of financing for agriculture, infrastructure, education and health which has raised living standards throughout the developing world.

Increasingly the Bank has played an important advisory role on economy-wide policies in our borrowing countries. We have also helped to push forward the frontiers of knowledge—and merge the fruits of development research with practical operations in the field. In fact, after 50 years of experience, the Bank is essentially a knowledge-based institution. That knowledge is cumulative, based on lessons learned: successes and failures. In the post-Cold War era, we need that knowledge and experience as much as ever before—and perhaps more than ever before.

First, because a tremendous development challenge remains. Yes, more people have been lifted out of poverty over the past 25 years than in any previous generation. But—largely due to population growth—there are also more people in poverty today than at any time in history.

There are environmental issues which must be urgently addressed: not only "global" problems such as ozone depletion and biodiversity loss, but "local" problems of inadequate sanitation, dirty water, and soil erosion—which affect literally billions of people in the developing countries.

Then, of course, there is the multifaceted challenge of transition in the former Soviet Union; a very different kind of transition in the Occupied Territories; yet another in South Africa—and the list goes on.

At the same time, the context within which these development challenges must be met has changed—and is changing:

- the political context presents a welcome trend toward democracy and openness, an increased emphasis on human rights and good governance, and increasing participation in political and economic decision-making—by NGOs, local communities, environmental groups and the media.

- the economic context is also changing: the trend toward market systems, the globalization of capital, the renewed support for trade liberalization, and the increasing power of the developing countries in the global economy.

After 50 years, we know our development objectives. Our compass is steady: to promote sustainable growth and reduce poverty by working with governments to make wise investments in their physical and human infrastruc-
tecture and adopt policies which create an enabling environment for private markets to thrive. But now, some of the ways in which we address those objectives have to change.

What's Working?

Three fundamental aspects of the Bank have evolved and benefited from the test of time:

1. Purpose

The Bank's basic purpose—to promote sustainable economic growth as the principal means of improving people's lives—is a powerful guiding principle. Increasingly over the decades, the Bank has been a pillar of the liberal international economic order and, by learning from experience, has become one of the strongest institutional supporters of the linkage between economic growth, open markets, outward-oriented policies—and improvement in human welfare. This emphasis has varied according to country circumstances. But the overall 'market-friendly' thrust of our work is certainly now a major theme—from Argentina to China and, more recently, Russia and the 14 other states of the former Soviet Union.

This conceptual thrust has gained tremendous momentum from the practical "revolution" in economic management which has taken place all over the world. There is now widespread recognition that the past reliance on government to invest in the productive sectors, protect domestic producers against competition, allocate capital, and control prices is simply not the best way to promote economic growth nor to improve people's living standards. Broadly, governments have recognized that these past practices are inconsistent with the requirements of today's increasingly competitive and integrated global economy—and with the requirements of the 21st century.

The potential inherent in this global shift toward "market-friendly" approaches is enormous. Now, therefore, is surely not the time to move the goal posts of the Bank's basic mission. On the contrary, the Bank can now play an even more important role—financial, technical, and advisory—in helping our borrowing countries to establish the enabling environment in which private-public synergies can be maximized, sustainable economic expansion promoted, jobs created—and progress made in reducing poverty.

2. Financial Structure

The second aspect of the Bank which has benefited from experience is its financial structure. This is the "magic of the Bank":

- The "magic" of an IBRD which basically finances itself by selling its bonds in the world's financial centers while also being the world's largest lender for education, health, and tropical forestry conservation in the developing world.

- The "magic" of transforming the IBRD's total paid-in shareholder capital of about $10 billion into a volume of loans nearing $250 billion.

- And the "magic" of lending to over 140 countries for almost 50 years, without loss and with a very strong record on arrears.

Of course, it's not magic at all. It's the product of 50 years of sustained consensus by governments and Bank management regarding the need for prudent—even conservative—financial policies on creditworthiness, loan charges, liquidity, provisioning, profits, balance sheet management, and so on. The result is an AAA institution which accomplishes massive leveraging of government funds while garnering highly efficiently priced resources in large volume for the purpose of development. The financial structure of the IBRD certainly ain't broke—and so we don't need to worry about fixing it!

...THE OVERALL "MARKET-FRIENDLY" THRUST OF OUR WORK... HAS GAINED TREMENDOUS MOMENTUM...

1Our IDA affiliate makes concessional credits to the low-income nations. The contributions which governments make to it every three years allow it to play an indispensable role as the centerpiece of the international effort to aid the world's poorest countries. Another affiliate, IFC, has become the largest single external source of equity and loan financing for private enterprises in the developing countries (with more than $2 billion in commitments last year). Our other, more recently established affiliate, MIGA, is coming into its own as a risk-insurer for investors in the developing world.
3. Governance Structure

Third, we should not flirt with fundamental changes in the Bank’s governance structure. Again, this is something quite unique which carries a high rate of return in terms of the Bank’s ability to respond quickly and flexibly to different challenges in different countries. The Bank is not the UN—neither extreme of the General Assembly or the Security Council. The Bank is also not the EBRD—we do not have a political mandate to promote democracy. In fact, the Bank is explicitly prohibited by its original Articles of Agreement from linking its work to political criteria.

These arrangements continue to serve the global community well. Indeed, at a time when other international organizations (e.g., NATO) are painfully wrestling with membership issues, the Bank has proven to have the flexibility to absorb major new states—and take on major new challenges in a credible way. The Bank’s system of “weighted voting” among its members is not idealistic; it is wonderfully pragmatic. Moreover, the Bank’s actual practice of basing decisions on “consensus” among its member countries has allowed it to be apolitical and neutral in its approach to economic and development issues. Considering that we have 177 member countries, this is no small achievement. It means that the Bank has been able to take its empirically founded advice to governments of every political complexion—and to support ideas and programs which are best for development.

The Bank’s political “independence” may sometimes be a frustration for some of our member countries. On the other hand when there is a global consensus on the need for a task which does not fall squarely within the Bank’s operating structure (e.g., early technical assistance to the former Soviet Union), a way can usually be found to get things done. In short: the governance structure is not only an essential moderating force for insulating the Bank from political pressures, but it also helps to ensure a flexible response capacity. Why change it?

What Needs to Change?

Changes in a few key areas might usefully be examined: the Bank’s relationships with private sector financing; the need to pay increased attention to sustainability issues; and the need to forge stronger partnerships and recognize comparative advantages in the development effort.

1. Private-Sector Financing Relationships

The role of private capital in development has been picking up a lot of steam over the past two years. While there is a great deal of attention in the financial press to external portfolio flows to the so-called emerging markets, from a development point of view key attention is merited to domestic capital market development and flows by foreign direct investors. Governments facing severe budgetary restraints recognize not only that the private sector has the volume of resources to finance traditionally public-sector activities, but also that the private sector can often improve the quality of those services.

Attracting these private flows is a key element in the success of long-term development efforts. Whither, therefore, the IBRD? The answer, I think, is clear. The Bank’s most important role is to work with our borrowers to create economies that are competitive in the global marketplace and to design policies which can attract the private sector financing they need. This is a role which we have been playing through our policy-based lending at both the macroeconomic and sectoral level.

However, we should also not overlook the more prosaic, but very important role of Bank financing to “catalyze” (as the expression goes) private financial support for priority projects and programs. It’s here that we all realize it’s time to look carefully at how we might be able to enhance our assistance through evolving loan structures and approaches to supporting private flows and domestic capital market development.

The Bank has begun experimenting in its support for the private sector. But we know
that this is a long-term effort. And we should be open to the ideas of those private market players whom we aim to support.

2. Sustainability
Sustainability is the second broad issue which will require change from the Bank—and from all of us concerned with development. We have become increasingly aware of the connection between lasting development and environmental protection. We must do more to foster the synergy between economic growth and natural resource management.

Change is underway. Lending for environmental purposes is now the fastest-growing segment of our portfolio—$2 billion last year (double what it was in the previous year and five times what it was five years ago). Even countries in the midst of economic crisis—like those in the former Soviet Union—have asked for the Bank's help to clean up their environment. At the same time, countries which have had success in restructuring their economies—such as Chile, Indonesia, and Mexico—are asking us to help them give increased priority to the environment. We're currently assisting over 40 countries with environmental management projects—from pollution control in Beijing to land management in Uganda.

We strongly believe, however, that true "sustainability" goes beyond "green" issues. It must also include:

- **Investment in people**: The Bank's experience shows, for example, that no country has been able to take off economically with a less than 50 percent literacy rate. The Bank's support for education, health, and family planning has increased five-fold over the last decade.
- **Real ownership of and participation in development projects and programs by the people affected by them.**
- **Proper follow-through and implementation**. The operation and maintenance of a project and the service it provides to people is, ultimately, more important than its inception. It may not be as exciting to fill the pothole as it is to cut the opening-day ribbon, but it's absolutely fundamental. Bank President Preston commissioned a major review of the implementation of all the projects we support—and specific steps have been taken to ensure that as much priority is given to the performance of current loans as to new loans.

3. Partnership
The demand for the Bank's services is greater than ever before. Many of our new members face unprecedented problems—the 15 new states of the former Soviet Union, for example. We have been asked to help with a broad array of new issues: clean-up of the Aral and Baltic Seas; the buy-back of commercial debt in Africa; analysis of nuclear power issues in Eastern Europe and Central Asia; the transition to peace in the Occupied Territories. We are also now helping our client countries to undertake new and important tasks such as poverty assessments, private-sector assessments, and environmental assessments. In addition, we are often expected to lead the aid coordination process—which entailed the Bank chairing 46 "aid group" meetings last year alone. In summary, expectations of the Bank—from our own membership—have increased.

Against this background, we ought to give thoughtful attention to outside suggestions regarding cooperation with our partner organizations—regional development banks, the UN agencies, bilateral donors, and NGOs—on a more efficient division of labor in tackling development issues. This is not a new effort but we should remain open to ideas that promise a better sorting out of respective tasks, more effective coordination on

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This change in the composition of our lending is also reflected in our advice and help in designing environmental action plans in our borrowing countries. It's reflected in our help to set up and fund the Global Environment Facility. And it's reflected in our skills mix—five years ago we had only a handful of environmental specialists. today we are at 200, and counting.
the ground—and, yes, less arrogance on the Bank’s part.

Increasingly, therefore, the Bank is in a “partnership” mode. But “partnership” must meet the test of efficiency. If the bureaucracies explode and the meetings proliferate with no real improvement in development outcomes, we will only contribute to the growing cynicism within all our polities about “official” approaches to anything.

Conclusion: Re-Inventing the Bank?
If the Bank had not been created in 1944, would we need to invent it in 1994? What kind of institution would we want it to be? What characteristics would we be looking for?

- **Global.** We would want an institution that is global in its reach and could both draw on and respond to the differentiated development universe which faces us today. Indeed, if we take the notion of an increasingly integrated global economy seriously, it could be argued that, more than ever before, the “world” needs a “world bank”; an institution that sees development in the context of a global economy committed to the liberal principles of markets and growing international trade.

- **Self-Financing.** Given resource constraints, we’d also want this new institution to be self-financing—by some “magic” able to cover its administrative costs and operations without much recourse to taxpayers.

- **Knowledge-Based.** With official resources being scarce, good ideas take on even greater importance. We would want this institution to be knowledge-based—able to undertake the research that generates breakthroughs and, even more important, able to apply development experience across regions and countries with impartiality and rigor.

Does any of this sound familiar? We would also, however, wish this institution to have the support and enthusiasm of not only its shareholder governments, but also the publics that they represent. Today, the Bank has the former, but not the latter. We will have to change in order to turn that around. We have simply not done a good enough job of communicating what we are all about and, even more importantly, what the nature of the development challenge which faces the world is all about. We’ve taken several steps recently to open our information policies and communication efforts. But we have a long way to go—and we could use a little help from our friends.

Working on a global scale on issues which affect the well-being of billions of people is not always intellectually “tidy.” A major problem for the Bank is that the “whole” is not always perceived as being greater than the sum of our various “parts.” The 50th anniversary offers an opportunity to begin to change that perception—and to mobilize the support necessary to meet the challenges of the next 50 years.

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International Monetary System Challenges

Just about 19 years ago, the international monetary system shifted to a floating rate regime for major currencies, not necessarily because of major countries' deliberate decision but more exactly because of their inability to adjust their own exchange parities.

Floating Rate Regime Problems
The performance of this exchange rate regime has not been as bad as its opponents had warned. International trade has continued to expand. Without the flexibility of this regime, drastic events such as the two oil crises may not have been coped with. Without this regime, the quick reduction of the large current account surplus of Japan during the late '80s may not have been possible.

However, the floating rate regime has not achieved what some of its proponents had advocated. Even under this regime, exchange rate changes are affecting the economies of individual countries, particularly their prices, interest rates and incomes, so that the economic management of individual countries cannot be conducted without due consideration to the economies of other countries, more than before.

Though techniques to cover and diversify greater exchange risks have been invented and improved, both the volatility and the misalignment of exchange rates are the two major problems of the current exchange regime. Because of these two problems, it is difficult to make long-term plans for industrial and financial activities. The fact that there are some who can gain enormous profits from exchange transactions within a minute seems to discourage those who are trying to improve productivity through steady but time-consuming efforts. International imbalances intensified by misaligned exchange rates tend to strengthen protectionist pressures for restriction of the freedom of trade and investment.

What should we do to address these problems? It is an old but new important question. Of course, greater exchange rate stability cannot be obtained or sustained without proper functioning of the balance-of-payments adjustment process. How can we improve such an adjustment process?

Currently in Western Europe, a great experiment to attain greater exchange rate stability is being tried through the European Monetary System, as steps are taken toward European Monetary Union, though with occasional or frequent turmoil and setbacks.

Globally, the situation is less encouraging. These days the authorities of the major currency countries repeatedly state that if each country can put its house in order, better international balances and greater exchange stability will be eventually attained. They may be right in theory and in the long run, but there are a number of serious problems in reality. Under this approach, sufficient international consideration is not likely to be given when each country formulates its own economic policies, despite increasing global interdependence of national economies. Without effective international surveillance, individual countries' policy formulation tends to be delayed and/or insufficient until or unless market forces react violently. This approach can be considered as one of the expressions of the arrogance of the big economic powers in the international community; they prefer bilateral or G-7 exercises to multilateral fora such as the IMF or GATT.

Modest Suggestions
I would like to make a number of modest suggestions, though some of them have already been raised by others.

First is reestablishment of the authority... Volatility and... Misalignment... are the two major problems...
of the IMF and other relevant international organizations. I am not proposing the enlargement of international bureaucracy, though I am suggesting the recruitment of the best and brightest by these organizations. I would like to urge major currency countries to listen more willingly to these institutions’ prescriptions, which must reflect the views and concerns of smaller, developing and reforming countries.

Of course, in this increasingly interdependent world, no single country, however large and powerful, can dominate the world economy, but in the area of currencies it is still true that a few national currencies backed by large economies and financial markets are bound to play an important role. This fact is the basis of the growing importance of the G-7 exercise. However, in view of the global importance of exchange rate stability and the increasingly domestic-oriented approach of major currency countries, including my own, I would like to see a more active role of the IMF or its Managing Director in monitoring and promoting international cooperation among major currency countries in connection with exchange rate problems. These problems are concerns not only of these major currency countries, but also of the entire world.

Second is the issue of desirable rates versus undesirable rates. In connection with exchange rate stability there have been a number of proposals to contain exchange rate fluctuations within the narrow range of “desirable rates,” such as target zones. But what are “desirable rates”? One option is the currently prevailing rates. It is easy to start a new scheme from there, but current rates are not always at desirable levels.

Another option is non-current rates, but it is extremely difficult not only to lead market rates to such desirable levels but also to choose such desirable rates. Domestic purchasing power parities could be one possible guide, but in view of the large difference existing between the external and internal values of some important currencies (including my own), if we adopt purchasing power parities (say 170 yen per U.S. dollar in case of the Japanese yen), international imbalances are bound to increase rather than decrease. Another possibility is the use of so-called equilibrium rates, under which current account imbalances are supposed to be contained within the range of easily manageable magnitudes. In view of the large international imbalances existing at present, even if we could calculate such rates fairly correctly, such rates would be at levels some countries cannot accept for their domestic economies.

After all, it is not only impossible but also unwise to rely too much upon exchange rates alone in order to attain better international balances, and it is also impossible to contain exchange rate fluctuations within too narrow margins in view of the enormous amount of funds transacted in exchange markets and the limited effectiveness of official intervention in exchange markets. Therefore, it might be more realistic to leave exchange rate movements usually and primarily to markets, but to strengthen international cooperation of major currency countries not only in exchange market intervention but in macroeconomic policies, once exchange rates move excessively in an undesirable direction or to undesirable levels.

What is “undesirable” is arguable, but it can be defined as the direction or the level which is most likely to increase the already existing too large imbalances. As a matter of fact, we have made similar cooperative efforts at the time of a too weak U.S. dollar in November 1978, a too weak yen in March 1980, a too strong dollar in September 1985 and a too shaky dollar in February 1987; and it may not be too difficult to follow these precedents.

Of course, I am not saying that until or unless exchange rates reach such undesirable ranges, we need not cooperate. Domestic as well as international imbalances are not
created overnight. If we allow the boom to reach the size of a tall mountain of inflation, we may be forced to face later the painful downfall into a deep valley of recession. Therefore, constant international efforts for a smooth adjustment process are extremely important. I am seriously concerned with the domestic orientation of most of the major currency countries. I think it is a reflection of their weak domestic political leadership, mixed with their superficially nationalistic arrogance. It is one of the important tasks of our Trilateral Commission to resist such trends by building reasonable public opinion within our countries.

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SECTION 9
STRUCTURAL CHALLENGES IN TRILATERAL ECONOMIES

C. FRED BERGSTEN

The Central Problem: U.S., Europe, Japan

Each of the Trilateral areas has one major overriding structural problem, each with very large social consequences and very large international consequences. In fact, these domestic structural problems carry the main risks for future international conflict among the Trilateral areas. At the same time, they may offer the potential for beneficial cooperation in helping each other improve our economic situations.

The United States: Flat Wages
The overriding U.S. structural economic problem is that there has been no increase in the average real wage in the United States for 20 years. Indeed, the wages of production workers in the United States are now 10-20 percent lower than they were two decades ago. These wage cuts have been offset to some extent by increases in non-wage compensation. But it is safe to say that American wages have been flat for the last two decades.

That is particularly stunning for the United States, where the "American Dream" has suggested we can count on a doubling of real incomes every generation. It’s also stunning for a country that remains, in many senses, the world’s economic leader to be unable to get its real incomes up for such an extended period.

To some extent this is, of course, the flip side of the so-called amazing job creation

...American wages have been flat for the last two decades.
machine in the United States. The United States has created 40 million new jobs over the last 20 years, and most of our remaining unemployment is of a short-term duration. The United States has done so in large part, however, through three very controversial social choices, all of which differ substantially from the choices made in other countries.

First, we have simply decided to price our labor very competitively. By holding wages down, we have increased the number of jobs. We were unable to get both job increases and wage increases. Second, we failed to create a substantial social safety net in the United States. Our unemployment insurance programs are weak: millions of workers have no health insurance. So, when workers in the United States are laid off, they have to find new jobs. Third, we let our companies lay workers off virtually at will. It happens in every recession. More recently it has happened as firms try to rationalize and improve their position for long-run global competition.

This jobs pattern in the United States is juxtaposed with the globalization of the American economy, which is, in essence, the other big trend in America over the last 20 years. The share of trade in the American economy is now as large as the share of trade in the Japanese economy or the share of trade in the economy of the European Community as a group. The key question here is whether there is linkage between these two trends, whether globalization of the American economy has been a significant factor in holding wages down. It's a familiar question to economists, under the heading of "factor price equalization." More pragmatically, it is the issue that lay beneath the NAFTA debate. The underlying fear in that debate was of low-wage competition further depressing the American wage and job quality outlook. Obviously, if that's a problem with Mexico, it's an even bigger potential problem as we consider expanding trade further with Asia.

There has not yet been enough analysis of the linkage. Has globalization depressed American wages over this two-decade period? Of the two major studies to date, one says it has been a factor, the other says it has not.

Europe: No Net Private-Sector Job Creation

The key structural economic problem in Europe is the opposite of the U.S. problem: Europe has created no private-sector jobs in the last 20 years. (Europe has created a few million jobs in the public sector.) Unemployment in Europe, which was 2-3 percent 20 years ago, is now at 9-10 percent and still rising. And much of that European unemployment is long-term in nature. A stunning 4 percent of the total European labor force has been out of work for more than a year. The flip side in Europe is that over this same 20-year period, real wages, far from being flat like in the United States, have risen by something like 60 percent. The Europeans, in essence, have secured the quality of jobs, while being unable to raise the quantity of jobs. They have then transferred part of the higher incomes through government transfer programs to the unemployed, and that in turn has reduced the pressure on unemployed workers to get new jobs. In addition the European systems have made it hard for companies to lay off workers. That in turn creates a disincentive to hire new workers, adding to the unemployment difficulties. So Europe has made a fundamentally different social choice from the United States.

That has also led to big problems in Europe, most notably perhaps, a loss of competitiveness. Recent studies in Germany (including by the German government) suggest that wage levels in that country have become overpriced by something like 25 percent in terms of the country's ability to compete in world markets, suggesting that Germany, over the next decade or
so, might have to repeat the experience of the United States over the last decade or so. A related aspect, of course, has been the sharp increase in government spending, transfer programs, and budget deficits in Europe—and a growing view that these programs simply cannot be afforded.

The international risk is that the structural situation in Europe will push policy in a protectionist direction, in order to try to create more jobs and to protect the higher wage levels that have emerged. We know that the European position was a very close call in the Uruguay Round. We know that, by most counts, a majority of European Community countries are now leaning in a protectionist direction. That of course raises big problems for trade policy and the outlook for the world economy.

A policy risk now facing the world trading system is that the United States and Europe, from their different standpoints, might team up to oppose so-called social dumping by other countries. It would be alright to put international labor standards on the trade agenda if the goal was to defend internationally agreed rules, as in the ILO. But we know that in both big regions there are significant temptations to provide a new rationale for protection.

A common—not necessarily joint, but constructive—solution might be available. In essence, what both areas need is to improve their underlying productivity and competitiveness through worker training, improved education programs, and better incentives for private investment—to create high-wage and high-employment societies, rather than having to choose between one or the other as our two areas have done over the last two decades.

Japan: “Rich Country, Poor People”

In Japan, one finds a very different problem. Over the last two decades, at least until lately, Japan has been able to increase both jobs and income (though there is a good deal of hidden unemployment in Japan, which means that the numbers are not quite as different as the raw figures suggest). In Japan, this increase in both jobs and income levels has come at the price of the real standard of living of the individual citizen. At current market exchange rates, per capita income in Japan is $30,000, compared with per capita income in the United States of $23,000. Thus, at market exchange rates, the average Japanese appears to be 30 percent better off than the average American.

Of course, every serious study of real standards of living in the two countries suggests that the real standard of living in the United States is at least one-third higher than it is in Japan. In short, there is an enormous gap between national wealth in Japan and the real standard of living of the individual Japanese citizen. The Nikkei Keizai Shim bun had a wonderful editorial a couple years ago headed “Rich Country, Poor People,” which catches very nicely this dichotomy that I am suggesting.

This suggests that reduction or elimination of the gap between the national wealth and the individual’s real standard of living should be a cardinal objective of policy in Japan. One would think that would be an objective of the so-called political revolution now going on in Japan. One would think that a Japanese political figure or party or coalition which could find a way to do that might come out of the current power struggle in office for quite a long time.

The outcome will clearly have a very big effect on Japan’s international position, because the narrowing or elimination of this gap could only occur via steps that would harmonize Japan’s position with the rest of the world. An example is expansion of domestic demand—which could come through stimulating better housing, reducing commuting time, and increasing leisure opportunities, all of which increase the real standard of living of Japanese individuals. Likewise, liberalization and deregulation of
Restoring Europe’s Competitiveness

Declining competitiveness lies at the heart of Europe’s current difficulties. Without competitiveness, there can be no sustained growth, and no permanent generation of new employment opportunities. This phenomenon has now been correctly diagnosed and accepted almost universally by politicians, business organizations and trade unions throughout Europe. I would like to talk to you about a new UNICE study, which will give you an idea about how European business people see the competitive position of Europe in relation to other developed industrial economies and, more importantly, their recommendations to reverse Europe’s declining competitiveness.

Causes

In relation to others in the Trilateral relationship, Western Europe is today a high-cost, slow-growth, low-productivity area, marked by high levels of mostly non-productive government spending. Almost half our average national wealth is taken up by the public sector, whose relatively strong presence in large sections of industrial production and in the provision of services is a typically European phenomenon. In short, we are not competitive enough, despite the very significant adjustments which have already taken place in view of the completion of the EU’s Single Market.

There is no single cause of the decline in European competitiveness. In my view, there are three principal causes.

Firstly, European costs have risen faster than in other regions and are now higher than in Japan and the United States. Whether we take labor or energy costs, interest pay-
mements or the burden of taxation. Europe and European companies in particular, have suffered adversely in almost every single area, in recent years.

Secondly, despite similar rates of productivity growth in the last decade, absolute levels of European productivity are still significantly lower than in the economies of our major competitors. Arguably, the most important of the causes of this lower level of productivity, is that labor flexibility is much lower in Europe than in Japan or the United States.

Thirdly, the macro-economic environment has been less stable, less predictable and less favorable for business in Europe than in other countries. For example, European companies have had to manage with higher inflation, a larger public sector, greater budget deficits, higher interest rates and more volatile exchange rates—inside the European Union as well as outside.

Solutions
Just as there was no single cause of the decline in European competitiveness, there is no single group who can provide the solutions. Rather, a wide range of solutions must be found—and these must be found primarily from within Europe itself: by Member States, by the European Union, by the social partners at all levels, by trade unions, by firms and by individuals. The key to reversing the decline in European competitiveness lies in making our economic and social systems more adaptable, and therefore better able to adjust to rapidly changing conditions in the outside world. Our external environment will, in the future, become even more challenging, as new competitors, many from Central and Eastern Europe, enter ever more global markets.

Restoring competitiveness will require bold action in six principal areas:
• to ensure greater labor-market flexibility;
• to increase the effectiveness of technology and innovation;
• to improve the level of inter-firm competition;
• to reduce the role of the State and make it more efficient; and
• to stabilize the business environment through appropriate macro-economic policies.

1. Labor-Market Flexibility
More flexible labor markets will improve incentives for employers to generate new jobs and for employees to accept new jobs. Europe must, for example, find a way of reducing the costs of recruitment and redundancy, and it must find a way to reduce non-wage costs, which in Europe are more than double the level in Japan and the United States.

The recent G-7 meeting on employment, in Detroit, was a useful opportunity to compare and contrast policy experience in different countries. Broadly speaking, in Europe we have a problem of quantity, not enough job creation and too high non-wage costs. In the United States, there appears to be a problem of quality of employment: one is often told there are too many low-grade, “cheap” jobs and insufficient social and welfare provisions. Japan is said to suffer from a mix of both problems, depending on the sector and whether the business is export-oriented or not.

2. Education and Training
Human resources together with R&D and innovation are the strongest determinants of Europe’s comparative advantage, and are powerful engines of sustainable growth. To improve the quality of human resources in Europe, it is important to encourage input from business to the curriculum in schools; and to encourage employers and employees to undertake continuous on-the-job training.

The key... lies in making our economic and social systems more adaptable.
3. **Technology and Innovation**
Continuous adaptation requires the introduction of new products and processes, the improvement of existing products, the extension of products to new markets, and the withdrawal of products. There is however no magic formula we can use to achieve this. There is no correct level of expenditure on R&D; it varies between sectors, over time and between firms. But, firms must take account of global benchmarks when planning their R&D activities. What is equally important, however, is that we use the existing level of expenditure more effectively.

4. **Inter-Firm Competition**
Competitiveness and growth rely on a flexible, modern and efficient industrial sector. Continuous, rapid re-structuring from low growth to high growth sectors, and from declining industries to emerging industries requires: (a) an environment conducive to the entry of new business; (b) incentives for innovation and re-structuring; and (c) the timely exit of declining industries to free resources for emerging firms.

5. **Role of the State**
Governments need to reduce the size of the public sector, the scale of public sector deficits, and the level of taxation. Three ways of achieving this are through: (a) the transfer from the public sector to the private sector of responsibility for many activities associated with “consumption”; (b) the reduction in unnecessary regulations and administrative burdens; and (c) the improvement in the efficiency of those activities that remain in the public sector, particularly through the greater use of market- and user-oriented decision-making structures.

6. **Appropriate Macro-Economic Policies**
Finally, competitiveness also depends upon a stable and predictable macro-economic environment in which firms can prosper, with steady growth in consumer demand. Macro-economic policy must be co-ordinated more effectively on an international basis, so as to achieve greater exchange rate stability and reduce economic imbalances between major trading blocs. Inflationary pressures must be kept under control. And public sector deficits must be reduced, to facilitate a reduction in interest rates and an increase in investment.

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This vision of how Europe should move forward is not easy for politicians to support, especially as we move towards elections, not just for the European Parliament, but also at national and regional level in several Member States. There are many who would prefer to take the politically easier path of short-term measures of the “throw-money-at-the-problem” variety. Such policies have been tried too often before, and are one of the causes of our current problems. Europe’s decline will not be halted unless we have the political courage, and the resolve, to tackle these problems at their roots, instead of dealing only with the symptoms.

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De-Regulation in Japan

De-regulation is the most important aspect of structural change in Japan. I hope I am wrong, but I have a hunch that at least the tempo of de-regulation may be slowed by the government change of this week.

Largely, de-regulation has been supported by the fact that de-regulation means a low-cost or no-cost Keynesian prescription. If you remove the regulatory straitjacket from the private sector, the private sector will expand investment and create employment. Domestic demand will be expanded without government increasing its expenditures.1

De-regulation is also necessary to fight corruption. Bad parts of the bureaucracy and corrupt politicians have been sitting on regulations and asking for monopoly rent. Removal of these regulations would lead to elimination of a hot-bed for corruption.

Easier access for new market entrants, domestic or foreign, is another healthy aspect of de-regulation, which will lead to more imports and reduction of the trade surplus of this country. Also de-regulation will lead to saving of administrative and compliance costs, and lead to lower prices.

Whether we are able to do de-regulation and expansion of domestic demand is dependent on the future of the Hosokawa government and the succeeding government, and the strength of these governments in passing the budget and organizing their thoughts and strategy on de-regulation. There are favorable conditions for that, although not too strong. First and foremost, the Socialist Party has changed in the past year.2 As Seizaburo Sato eloquently explained this morning, the Socialist Party has changed its views about rice, the consumption tax, nuclear power, Korea, Japan-U.S. security—on almost all fronts. So it has become easy for the politicians to take realistic measures which will make this market function better.

The remaining task for the political parties is to confront the forces which oppose de-regulation. There was a good question in this morning’s session about business’ vested interests in keeping regulations. Certainly there are business people who like regulations. These are largely in the areas where the regulatory levels have been high—such as the licensing business and the distribution sector. The construction business is another example. (The number of construction companies in this country has been going up in the past four decades continuously.) If we increase the transparency in the market and reduce market rigidities, certainly the price levels in these areas will go down. And our quality of life will become much better.

As we do de-regulation, the next question...

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1 Of course, the present economy will require a certain amount of Keynesian stimulus. But I personally feel a great sympathy towards the people who have been very prudent or hesitant in demanding domestic expansion through Keynesian measures, probably because we share a deep distrust of politicians. The government has borrowed from the nation as much as Y200 trillion (which is nearly $2 trillion) in government bonds. In addition, the government has borrowed nearly Y200 trillion in short-term money from the nation in the form of postal savings account deposits. The government has also borrowed through special accounts (such as the forestry special account) and liabilities of the former National Railways (amounting to Y26 trillion) left in the hands of the government. The government has altogether more than Y4 trillion of debt to repay.

Over the past four decades, we have been using Keynesian stimulus even when we had 5 percent growth or 6 percent growth, largely for political convenience. People from abroad advise us about the wisdom of taking a Keynesian prescription. We are not ignorant about this wisdom, but we have good reason to be very prudent.

2 Over the past three decades, the combined strength of the Socialist Party and the Communist Party has been going down. In the 1950s and 60s, in the Tokyo metropolitan area and other urban areas, their share had been enormously large, and that gave rise to the concern on the part of the business about a possible regime change in this country. That, of course, was the reason why the business community has supported the LDP.
emerges: what is the norm to be taken up as the target of our efforts? It is not too clear yet. There is no Euro-American system to serve as a norm. Europe is not one system. When we discuss convergence and systemic harmonization, we have to deal with the "capitalism versus capitalism" question. Are we seeking to realize pure capitalism on earth? Is that the target of all our efforts? Or are we going beyond that and making efforts to create a somewhat more humane capitalism on earth? That is the question which I think we should address in the future. I say this largely because I see champions of society in our three regions in this room. We have to think deeply about the impact of our policies towards the people who are not sitting in this room. And we have to find the way in which we will not rejoice in the increase of productivity at the cost of people who are put onto the street.

Finally, I would like to add two factual comments about competitiveness and about employment, issues taken up by the other panelists. First, an increase in competitiveness does not necessarily mean an increase in employment. Basically, changes in international competitiveness are dependent on relative productivity increases and exchange rate changes. Second, an increasing current account balance is not correlated with a decreasing unemployment rate. The two charts presented here—one for most OECD countries and the other for Japan in particular—have arrows moving in a multitude of directions. In the Japanese case, it is more typical for an increasing current account surplus to be associated with an increasing unemployment rate (and a decreasing current account surplus to be associated with a decreasing unemployment rate).

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