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The Commission’s ongoing interest in the management of a globalizing international economy and the associated challenges for emerging and Tri lateral countries was evident throughout the meeting. This publication begins with the remarks of the World Bank’s James Wolfensohn and the IMF’s Stanley Fischer, who opened the two parts of the session on “The International Community and the World Economy.” Among emerging economies, the prospects for Brazil and its neighbors after the January collapse of the real were at the center of the session led by André Lara Resende and Domingo Cavallo (Section 8). The challenges for East Asia with the financial crisis of the region easing somewhat were a large part of the context for the remarks of Tommy Koh, Jasuf Wanandi, and Yuan Ming (Section 7). One theme in the East Asia session was the importance of continuing reform. As Tommy Koh put it, “My fear is not that East Asia will not recover; my fear is that it will recover too soon. If it recovers too soon, the momentum for reform will fade.” Andrey Kokoshin and Serhiy Holovaty spoke of the reform process in Russia and Ukraine, respectively (Sections 9 and 10). The changing world economy also presents deep challenges to Tri lateral countries, addressed in the remarks of John Sweeney, Yoito Kobayashi, and Edmond Alphandéry (Section 3).

The Washington meeting took place just before the collapse of the Kosovo negotiations in France and the beginning of the NATO bombing campaign. The unfolding crisis in Kosovo dominated the discussion with Javier Solana, Secretary-General of NATO, who also spoke of the upcoming NATO Summit and the formal entry into NATO of Poland, Hungary, and the Czech Republic only a few days before. Kosovo came up most poignantly in the remarks of UN High Commissioner for Refugees Sadako Ogata, already struggling with great human insecurity on the ground. Mrs. Ogata, with Rudolf Scharping and John Deutch, opened the session on “Security Challenges in a New Era” (Section 4).

As the host region, the United States (Section 5) and Canada (Section 6) were given special attention in the Washington meeting. Canadian Industry Minister John Manley set out an impressive range of initiatives for “connecting Canadians” to the Internet. Lee Hamilton and Chuck Hagel led the session on “Congress and U.S. International Leadership.” Treasury’s Larry Summers and the State Department’s Thomas Pickering spoke to the meeting. The values which Tri lateral countries share relate not only to foreign policy and international interests but also to the successful functioning of our democratic societies. Among the basic societal challenges for the United States are those of its larger central cities. Just after the Washington meeting a number of members participated in a program with this focus in Baltimore, led by Tri lateral member and Baltimore Mayor Kurt Schmoke.

The essays by Robert Zoellick, Hisashi Owada, and Peter Sutherland which framed the whole Washington meeting will be published separately under the overall title 21st Century Strategies of Tri lateral Countries: In Concert or Conflict?. Brief excerpts of these individual essays are presented here (Section 2).
James Wolfensohn opened the first half of the session on "The International Community and the World Economy." Stanley Fischer opened the second half, dealing with the international financial system. We also present the brief comments after Stanley Fischer’s presentation by Toyoo Gyohten, Niels Thygesen, and Jim Leach.

James Wolfensohn

Underlying Human, Social, and Structural Problems Must Also Be Addressed

Later in the morning you will hear from important people on the international financial scene who will tell you about the new financial architecture. I am going to set out for you some issues that I think are important and which relate to the financial and economic issues but do not often get the central attention, given the new "architecture" or the sort of headlines about the size of packages to Korea, Thailand, Indonesia, Russia, and Brazil.

You will hear later about some of the causes of the Asian crisis; you will hear about some of the steps that might be taken to ensure that such crises don’t occur in the future; and if they do occur, steps that can be taken quickly to deal with them. You will learn that in the new international order we must have transparency, we must have rules that are understood, we must have similar accounting practices, and we must caution countries against being reliant on short-term flows. You will learn of the need for better integration in the international financial community—linkages between the BIS, the IMF, the World Bank, and other international institutions, such as the regional banks. From all this will emerge a dream and vision of a new financial order.

All these issues are, of course, extraordinarily important. But thus far, you have not heard a word about people. You have not heard a word about the underlying social and structural problems. I would like to take a few minutes to talk about these problems which, I think, are fundamental both to the management of economies and certainly to the resolution of the sort of crises with which we have been confronted.

People, Stability, Peace, the Environment: Fundamental for Any Architecture

What is the basis of some of these issues? We have a world of 5.8 billion people; 4.8 billion of them live in either transition or developing economies; 3 billion of them live on under two dollars a day; 1.3 billion live under a dollar a day. Approximately 2 billion of them do not have access to any form of power; 1.3 billion do not have access to clean water; 3 billion do not have access to sanitation. Hundreds of thousands of kids are not in school and too many are street children. We look forward in the next 25 years to adding another 2 billion people to the world. The probability is that we will have not 4.8 billion people in development, but 6.5 billion people in development.

There is an environmental crisis. We are losing forests at the rate of an acre a second and have been doing so for 20 or 30 years. Our environment is not in great shape. Witness the debate about carbon emissions. You can argue the science, but the impact on weather patterns and on the environment is probably clear to most of you. By the middle of the next century we will need double the food that we have now with the same amount of land, and will have increased pressure on water, so that water for our children will be the sort of issue that oil was some years ago.
These are not trivial issues. They are not readily apparent on a daily basis. They are slowly evolving issues. They are not headlines.

The gap between rich and poor—between countries and within countries—is not diminishing, it is increasing. We are doing a lousy job in terms of the emancipation and the education of women. We have made a major effort to get girls into school, which is critical to deal with the issues of gender and absolutely central to the whole issue of development. Many greater people than I have said, "If you educate a man, you educate a man; if you educate a woman, you educate a family and a nation."

The simple fact is that these issues will affect everyone in the Trilateral countries. The developing and transitional world is now 18 percent of the world's GDP; in another 25 years it will be 30 percent. It is the fastest growing sector of the world. It is the fastest growing market for those of you in business. But you will not have a fast-growing market if we do not have stability. And as we have seen from instability in Korea, Thailand, Indonesia, Brazil, Russia, Pakistan, and many other countries, the linkage through financial markets today is not slow—it's instant, as is the linkage through trade affecting stability. Kofi Annan told me the other day that we have about 35 wars going on at the present time.

According to the statistics, the GDP growth rate next year is going to drop to 1.9 percent in the developing and transitional world, with variations between areas. But at the base there is a fundamental problem that relates to people, stability, peace, and the environment. It is fundamental to any architecture that we might construct. If you do not have the base right, we can build using our architecture but the building will fall.

I say this having grown up in the world of many of you. I say it as somebody who has come from the private sector. But I have now been to 85 countries and I can tell you that the issues that I see every day in villages, slums, dense urban populations, and rural areas without services are such that we are looking at a world which is gradually getting worse and worse and worse. This is not hopeless, but it is inevitable if we do nothing about it. Most importantly, it is an issue for your children. This is not our issue. Most of us can retire happily without confronting this issue, but our children will not be able to do that. If we are to be responsible we need to do something now and we can only do it if we do it collectively.

The Other Side of the Balance Sheet
Let me address some of the issues that I think one needs to think about alongside fiscal and monetary policy, financial architecture, and the global monetary system. Let me give you the other side of the balance sheet.

You have to deal with governance, with the ability of countries to govern themselves and to have adequate and clean governance. We have to confront corruption and recognize that corruption is an issue not just for the developing countries, but for us too. After an enormous amount of work we have just signed an OECD convention to criminalize corrupt practices. In some developed countries bribery is still deductible for tax purposes. It is difficult to convince somebody in a developing country that bribery does not help their economy when we are bribing them and getting a subsidy from our governments.

The second thing we have to support in these countries is a legal system. You have to protect property rights. You have to protect contracts. You have to protect weak people. With a legal system you need a justice system that works. In too many of the countries that I go to the justice system is corrupt. If you do not have a justice system that can administer justice, having a set of laws is not an enormous help.

You need a financial supervisory system that works at the level of banking, but also beyond banking. It needs to go to capital markets. It needs to go to corporations. It needs commonly accepted accounting principles and supervisory bodies. In many of the countries we are talking about—including Korea, Thailand, and Indonesia—we have neither a deep group
of supervisors nor, in banks and corporations, people used to being supervised. So a transition into a system that works internationally, in many cases, is a huge cultural change.

And we need a social system that works. We have to deal with people that are out of work and people that are poor. The issue of the child is an enormous and growing issue of significant proportions. We have to deal with the disabled. We have to deal with all the things that most of us expect in a social system. It does not have to be our sort of social system—it can be a familial system, it can be a tribal system—but you must have a social system that works.

In the countries of those 4.8 billion people, that basic structure is very, very spotty. In some cases it is exemplary; in other cases it is a disaster. And so one cannot just talk of architecture without looking at the sands on which you are building.

With regard to equity and development, in the long term the issue of education and knowledge is key: I was recently in the Côte d’Ivoire looking at cocoa and coffee, which make up 45 percent of that country’s exports. The farmers, 2.5 million of them, have sold their cocoa and coffee, typically, to monopolistic intermediaries who get their licenses from the government. If the production cost is 500 and the selling price is 1,000, they get 500 and the intermediaries get 500. That’s not terribly good for income distribution. So we decided to break the monopoly as a condition of some of our lending. Then we discovered that the farmers had no idea of the price. In a village in Côte d’Ivoire just a few weeks ago, I went into a meeting and in a little room were two computers, with an Ivoirian sitting in front of each. The first Ivoirian showed me how they now weigh in the cocoa and the coffee and give a receipt. The second is linked through the internet to a service supported by the World Bank, which gives prices in Chicago, Paris, and London. I went back to talk with the chiefs after I had seen this and they didn’t stop talking about hedging and foreign exchange, how Chicago is ahead of Paris or Paris is ahead of London. And yet most of these people are illiterate.

So, the impact of education and knowledge is quite remarkable. Education and knowledge are central; as is health; as is the issue of communication—physical and telephonic and electronic; and power; and water; and sewage; and rural development; and urban development; and the capacity of the private sector.

This is an agenda which is rarely talked about. It is implicit in your decision-making about investment. It is as important for investment decision-making as fiscal and monetary policy. It is the basis of security. It stops physical violence and crime. It creates an environment in which you can have stable growth. And yet too little attention is given to this agenda. You cannot have discussions of finance without thinking of the other side of the balance sheet, yet it happens all the time.

**The Importance of the Private Sector Has Risen Dramatically**

Dealing with those issues is not just the work of the do-gooder organizations. It is not just an issue for governments, which lack capacity in many cases, or for the World Bank or the regional banks.

The Bank started over 50 years ago. We and the Fund, the Bretton Woods twins, were established to try to bring stability after World War II. The Bank subsequently mutated into a development institution, adding IDA and the IFC and MIGA for the private sector. We have been joined by regional banks and bilateral aid programs, and we all constantly fall over each other, even though we do try to cooperate better.

There are two other major changes in the background for ODA. First, you no longer have a Cold War. You no longer have to provide funding to developing countries because some others might if we did not. That changed the dynamic.

The other thing that has changed is, of course, globalization. With globalization has come the development of overseas investment. In 1987, the level of overseas investment going to developing countries was just over $20 billion a year; in 1997 it was $300 billion. In 1987, ODA was over $40 billion, twice the...
size of private-sector flows; ten years later, official assistance at $40 billion is one-sixth or one-seventh of the size, in 1997, of private-sector investment flows.

So the importance of the private sector has changed dramatically. There is a need for social responsibility and participation by the private sector. There is no free ride in the development of markets from 18 percent to 30 percent of the world’s GDP unless there is socially responsible behavior and partnership. There are dozens of things that the private sector can do. And you now have dynamic public groups in civil society, from small villages to international NGOs with whom you can engage.

* * *

To put in place this whole mosaic of the financial and the structural and the social and the human, you have the governments of the countries themselves. You have the multilaterals and the bilaterals. You have the private sector and you have civil society. It is crucial for the four to come together in a way that can allow us to face the issues that are before us.

If we do not come together we are going to lose the battle. With the pace of development today, with the population added every day at the rate of ten thousand an hour, we have a problem and an opportunity facing us that can only be met if we change our thinking. We need to take a new view of our responsibility. It is a joint responsibility among the governments of the countries, the people of the countries, multilateral and bilateral institutions, civil society, and the private sector.

And the only thing I can say to you in closing is that if we do not come together, in 25 years when our children will be sitting here, the issues are going to be deeper, more difficult, and more intractable than they are today.

James D. Wolfensohn is President of the World Bank Group.

Stanley Fischer

Ten Tentative Conclusions from the Past Three Years

I want to give a list of ten tentative conclusions about the problems we deal with in the IMF and in the international system that I have drawn over the past three years. Some of them touch on the global financial architecture, but they are much more reflections on what we have learned and what we have yet to learn, than about architecture, on which I could speak on another occasion.

1. It is very difficult to predict an economic crisis. The most sophisticated statistical work has success rates of about 25–30 percent in predicting crises. But the fundamental problem with predicting crises is you have to worry about both mistakes: predicting crises that might not otherwise happen but for the prediction itself and not predicting crises that do happen. We often do well in saying there are elements of vulnerability, but the timing and likelihood of crisis are different matters. It is not always impossible to predict crises—in the Thai case it was clear that it was going to happen; similarly, the probabilities in the Russian case were very high.

2. It is hard to get a country to take action even when you do see a crisis coming. Crises occur in large part because the government hasn’t done a variety of things it should have done earlier. They are probably just as well informed as you about the underlying situation, but possibly more optimistic, possibly less willing to look the facts in the eye, possibly unable to do anything about it. There is a crisis today in Ecuador which we have seen coming for at least a year. The President had no support in
the Congress; he simply couldn’t do anything. There was nothing that anybody on the outside could do to prevent that crisis.

The issues of whether the IMF should go public in these cases are very difficult. We have tended to speak out a bit more loudly lately, but we have always to be cautious, and to remember that forecasts are inexact and that our own forecasts can affect the outcome.

3. It is hard to have a program implemented when the government you are dealing with is divided and weak, and, accordingly, it is difficult to decide whether to help. You cannot know how fully the program will be carried out. The consequences of not helping are very serious, but the consequences of helping, providing aid and having the program fail, are also very serious. It is not an easy choice. In some cases I believe it could be very useful to have more bilateral assistance from those who have political reasons for wanting to help, rather than rely entirely on the international institutions.

At the same time, we all need to be a little modest. I reflect on the fact that the richest country in the world, the only superpower, has taken a very long time to get its poverty problems under control. It has a lot more money than the IMF and the World Bank combined, even relative to the scale of the economies with which we deal. It is reasonable to ask, “What is the rate of return that should be expected on dollars provided by the IMF to a country?” It could be presumably a little bit above the rate of return in the New York stock market. Well, even taking the last few years of, say 20 percent real stock market gains doesn’t change the universe because the amounts of money we are moving are not very large relative to the economies to which we lend.

4. I am struck by how little understanding there is of the IMF’s system of internal governance and accountability to our member governments. When I read the newspapers I get the impression Michel Camdessus makes the decisions about whom to help and how much money to give, and goes off and gets it all done. In fact, there is nothing that the management of the IMF does that does not have the support of its executive board, which sits in permanent session. The 24 Board members represent 182 countries; the 8 largest members have one-country constituencies; other members are grouped into self-chosen multi-country constituencies. The U.S. controls 17.5 percent of the votes. Important decisions typically require an 85 percent majority. Very little happens without the support of the G-7. We—the management of the IMF—hardly ever lose votes in the board of the IMF for a very simple reason: We don’t take things to the board until we have an understanding with our shareholders that they will support what is being proposed. The staff has a lot of expertise and therefore provides a lot of independent input, but, in the end, we are accountable to our member governments—and that accountability is exercised every single day.

5. Keynesianism is alive. In the mid-80s there was growing support for the view that fiscal contraction was expansionary. This conclusion was based on the fact that in Ireland and Denmark budget deficit cutting had very positive impacts on economic growth; and somehow this conclusion was generalized, the argument being that by tightening the budget you increase confidence in the economy and then there is more investment, etc. Well, we have seen in Asia that Keynesianism is alive in two regards. First, the budget cuts that took place in Thailand in the IMF program in July 1997, when we thought Asia was booming, were probably too large. Subsequently, all programs in Asia have switched to fiscal expansion on a very large scale. Second, the liquidity trap, which was thought of as a Keynesian curiosity, is indeed happening in Japan where interest rates are zero. The authorities have to figure out how to act in this environment and the questions are all Keynesian questions now.

6. The strategy of going fast on bank restructuring and corporate debt restructuring is much better than regulatory forbearance. I don’t doubt that within
a couple of years the banking systems and the corporate debt structures in Korea, Thailand, and Indonesia will be in far better shape than they would have been if these countries had waited to restructure. Indeed, they probably wouldn't have done these things had they not been forced to undertake them in the heat of the crisis. At least in those cases, without trying to propose a general rule, I believe that rapid action on these profound structural problems is the right way to go and that waiting until the macro situation is right is the wrong way to go.

7. Exchange rate systems. The major crises we have had in the last couple of years have all involved a fixed or a crawling peg exchange rate. Although Thailand, Indonesia, and Korea were not really fixed, they were assumed to be fixed. Brazil and Russia were formerly crawling pegs. From these experiences, the conclusion has been drawn by many that pegged exchange rates cannot be maintained and that we need to move to almost universal floating exchange rates. There is no question that pegged exchange rate systems are crisis prone and that crisis is more likely to be avoided if the rate is to float. Quite a few countries would undoubtedly have had a crisis if they had had a pegged rate system—in particular, South Africa, Turkey, and Mexico. But let me register three reservations:

- **First**, if a country, for historical reasons, has a pegged rate that it is able and willing to defend and has enshrined, for instance, in the law, in a way that makes it even more credible, as have Argentina and Hong Kong, that may well be a good way of maintaining a peg. These are the two extreme versions of exchange rate systems: either float or peg them very, very hard.

- **Second**, I am not sure that this particular period of enthusiasm for pure unvarnished floating rate systems is going to last. Views in the economics profession fluctuate. This is one of those problems that doesn’t have a good solution. And we have seen, for example, in the case of the two largest economies, the United States and Japan, the exchange rate move from 80 yen to the dollar in 1995 to 147 yen to the dollar two years later. It's not clear that small developing countries can put up with movements like that. I doubt we have the final answer. Whether we go to a system with broad bands, which seemed to work in Europe, or something else, I think we will probably move on from the pure floating regime, but not right now.

- **Third**, I do believe that if the Euro succeeds—and there is no reason to think it won't succeed—we will see fewer and fewer national currencies. The Argentine dollarization move and the quiet Mexican dollarization campaign now under way are likely to make progress in the years ahead. One’s views on exchange rate systems are affected a little by whether you're a young optimist or a more mature skeptic. When you're young and optimistic you're very impressed by all the good things that could happen if you're free to let your exchange rate move. But, when you've watched what countries do with their floating exchange rates over long periods, you become much more concerned about the damage they can do by having their own exchange rate to manipulate.

8. **Globalization is here to stay**. The most extraordinary result of this crisis is that after all the noise, after all the statements about how the universe could not put up with this, how countries could not withstand this type of system, how we would have something else, that essentially only one country has tried to move away from integration into the global system—namely, Malaysia—and now even it is coming back from that position and seeking to reintegrate.

That is certainly not to say that the current system cannot be improved. What happened to several emerging market countries in the last few years is extremely undesirable, and we must be able to do better. But even in these circumstances, countries have simply not withdrawn from the international system in the way that the pessimists predicted. There have been some changes in national policies with regard to capital flows, and there should
be such changes. There are more countries now that do put some controls on international capital flows. Only a week ago, Thailand, which has remained open, imposed some controls on what could be done with offshore contracts. But those changes do not represent a major withdrawal. Rather they're something which will make the system work better.

The fundamental fact is that globalization will strengthen and will deepen. No country in Latin America and only one country in Asia has sought to withdraw from it. It is an extraordinary outcome of the debate which most people thought would go the other way.

9. Of all the difficult issues in dealing with the international financial architecture, the need to involve the private sector in the solution of international crises is probably the most difficult. We are struggling with this now in the IMF in a variety of programs. We are currently engaged with the Brazilian government in an effort to get the international banks to commit to keeping their credit and trade and interbank credit lines at the levels they were at the end of February. The effort is going well, but it is a very delicate exercise. I was told by a banker the other day as the discussion heated up, "We are not willing to let the IMF make our portfolio decisions." That's an appropriate view. The banker's obligation is to maximize shareholder returns, not to satisfy the international institutions, and that is a balance that we have to solve by getting them to see that it is in their individual interest to stay in if the others stay in.

10. The IMF is here to stay. When I was in the World Bank a decade ago, I thought it would not be a good idea to merge the Fund and the Bank, for two fundamental reasons. One is that these agencies are immensely powerful relative to the countries they deal with, and putting them together would make them even more powerful. We and the Bank exert control on each other by occasionally disagreeing and that's a control mechanism that we'd lose if we unified. And the second reason, and I am far more aware of this now than I am in the management of the IMF, is that it is very hard to control an agency of 2,700 people, which is the size of our institution. I am not sure it is possible to control an agency of 10,000 people, which is Jim Wolfensohn's agency. However, I am quite sure that 12,700 would be beyond the control of mere mortals, even with a permanent board in residence representing 182 countries riding herd on us. So merger is not a good idea and we shouldn't go that way. What we should do is redefine our separate responsibilities, minimize the overlap, and cooperate when we overlap. We are doing that pretty well, as we go our mutually supportive ways. So, the IMF is here to stay. And we will make it work better.

Stanley Fischer is First Deputy Managing Director of the International Monetary Fund.

LOYOO GYOHTEN

Two Lessons of the East Asian Financial Crisis

The East Asian financial crisis has left us with many lessons to learn. Two lessons are particularly relevant to the improvement of the international financial architecture. First, we need to have an emergency financing mechanism to cope with the onset of a financial crisis. Second, we need to have greater stability of exchange rates between major trading currencies.

Regional Emergency Financing Mechanism in East Asia

The East Asian crisis was triggered by the sharp reversal of short-term capital flows. At first, affected countries tried to counter the movement by intervening in the market. However, their reserves were soon depleted and their resistance was given up.
What followed was a sharp depreciation of the currency—the magnitude of which exceeded by far the necessary level of adjustment—and also the acute shortage of foreign exchange liquidity. As a result, the external debt service burden mounted sharply, and defaults became prevalent. Industries couldn't finance imports of necessary materials, parts, and components, exporters couldn't get the letter-of-credit facility. In other words, the vital parts of the countries' economies suffered serious damage and the crisis left a lasting scar on the balance sheets of banks and business firms of those affected countries.

In order to prevent the recurrence of such traumatic developments, it is desirable to create a mechanism which provides quick and ample financing to the country suffering the first blow of a financial crisis. Financing should be used for the purpose of preventing the excessive depreciation of the currency and of keeping the trade-related industries going. In my view, certain mechanisms could be established as the IMF's regional vehicle. In order to ensure the high degree of maneuverability which is the key for the success of this kind of operation, the vehicle should be accorded the minimum necessary autonomy, backed by regional contributors and regional voting rights. East Asia will be the fitting place to establish such a new facility. With the much increased recognition of the need for closer regional cooperation and $600 billion of official reserves held within the region, the conditions to support such an enterprise seem to be favorable. And I believe Japan is willing to play a leading role.

Greater Exchange Rate Stability Between Major Trading Currencies

The second lesson is the importance of exchange rate stability. It is now a common view that the so-called dollar-peg system was a major culprit of the East Asian financial crisis. Well, certainly it is true that affected countries ignored the fundamental disequilibrium that had emerged in their economies and failed to adjust their currencies' exchange rates accordingly. In that sense, the rigidity of exchange rate policies was responsible for the crisis. However, more important was the fact that the dollar itself fluctuated violently vis-à-vis the yen, which is another important trading currency for the affected economies. The ten-year weakening of the dollar between 1985 and 1995 brought about a windfall trade surplus for the affected countries. Then the sharp reversal started in 1995 erased their excessive price advantage and weakened their current account position, which in turn undermined market confidence and prepared a feeding ground for a crisis. In other words, it was not the dollar-peg system, per se, which is to blame. It was the unheeded fundamental disequilibrium in the countries' economies and the wild fluctuation of the dollar-yen exchange rate.

It is hardly possible to explain or justify such wild fluctuation by the relative situation of American and Japanese economies during the period. In my view, it was a product of the combination of the enormous amount of volatile capital and the herd mentality of market participants which can be triggered by capricious flow of information.

I am not advocating the return to a fixed exchange rate or even a rigid kind of stability. Exchange rates should change over time, reflecting such fundamentals as balance of payments, inflation, or interest rates. What I am arguing is that unwanted volatility, which tends to create a prolonged misalignment, destroys the reasonable predictability of exchange rates and thereby distorts trade and investment decisions. I think it is indisputable that the wild fluctuation of the dollar-yen exchange rate since 1985 has produced a serious distortion not only for the Japanese economy, but also for East Asian...
economies as well. If the dollar-yen exchange rate had remained reasonably stable, I suspect the severity of the East Asian crisis could have been mitigated considerably.

Now, having said that, how to achieve exchange rate stability is clearly a different subject. I have no time to go into the argument now, however, if there is a broad agreement about the desirability of exchange rate stability then we should explore how to find a way. In my view, the first and most important step to be taken is a joint public commitment by countries concerned to recognize the importance of cooperation and exchange rate stability. Then, we will be able to discuss practical means to agree upon the mutually acceptable range of stability and various instruments to be used to achieve the goals. On this issue, also, Japan is willing and anxious to cooperate with other major currency countries.

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NIELS THYGESEN

Aspects of Improving the International Financial System

In competitions on architecture, normally the builder gives a number of technical specifications on which bids are then submitted. In the international financial system, there is no well-defined builder. And there are disagreements about the whole nature of the structure. What emphasis should be placed on national improvements of policy, what parts belong properly to the international sphere, and what should the involvement be of private institutions—rating agencies, banks and investors? Let me try to focus on some technical specifics.

Improve Transparency

The first, and least controversial, is to improve transparency. This relates to public authorities, not least central banks—some of the unpleasant surprises in the Asian crisis were that the foreign exchange reserves that markets assumed were there were not really usable. Obviously, here there has to be full disclosure. Transparency also needs to improve for private financial transactions and asset-liability positions. More has been known here, in fact, than has generally been admitted. And finally, most importantly, non-financial corporations also have to submit fuller information. All of this is not that controversial and these are national tasks, although they need the help of an international framework.

Stanley Fischer touched on the question of whether the Fund should go more public in publishing Article 4 country reports, and I understand there are now discussions on this issue. The arguments seem on balance in favor, though some confidential discussions about vulnerabilities may still have to be kept out. The public service function of an international institution such as the Fund would be well-served by mandatory publication. If it is voluntary, those that have good reports would publish; others would be more reluctant, but there would at least be pressure on them to follow the same route.
More National Policy Norms?
A more controversial innovation is the introduction of more rules and norms for monetary, fiscal, and financial policy. Now, to a European, more rules about policy is not a strange concept. A useful checklist on the basis of norms of fiscal policy—i.e., some appropriate balance over the longer term and sustainability of debt positions—will improve transparency further. When we go into monetary and financial issues it is no longer so clear the turf of only one institution. There will have to be more collaboration between the IMF and particularly the Basle Committee on Banking Supervision. The Global Stability Forum recently adopted by the Group of 7, meeting for the first time in April, will no doubt help to formulate the kind of rules that will then subsequently have to be mentioned by the International Monetary Fund.

International Lender-of-Last-Resort Facility?
Once these rules have been discussed, maybe the system can move on to the grander issues of architecture—for example, the idea of a conditional credit facility and the international lender-of-last-resort facility, which Stanley Fischer has elucidated in a paper circulated to us.* The initial U.S. proposal of September last year was that countries that met norms of good policy behavior would become eligible for a credit line to protect them against the kind of contagion we have seen in Asia and Brazil. Some have seen the package for Brazil last fall as an early experiment, but the package for Brazil was basically still a traditional package, large and front-loaded and with plenty of conditions. The policy norms had certainly not been met a priori. There wasn’t yet a catalytic role mobilizing private creditors. The package was, however, catalytic in mobilizing the World Bank and the Inter-American Development Bank for some smaller amounts.

Now, a priori, the idea of having a lender-of-last-resort facility does sound appealing. If private market participants were to perceive that the IMF could mobilize very significant resources to come to the defense of currencies, or a banking system under attack, then the probability of that attack would surely be reduced.

But the resources are not there. Let us look at some European experiences. In principle, there was unlimited support for currencies in the European Monetary System. The constraint was a short repayment period: around three months, countries had a short breathing space, and the adjustment burden was still largely on the debtors. If there are strong pressures on countries to behave in accordance to the norms that I referred to before on fiscal, monetary, and financial policy, then maybe such a system could work. But I remind you that even in Europe, where the rules were to a large extent put into place for a number of years, at one point the creditors said “no” and the system did have a breakdown.

What about the problem of moral hazard? The problem of moral hazard really implies that both debtors and their creditors sometimes become excessively bold in continuing the build-up of loans. If clear policy norms were established, the moral hazard problem might be reduced to manageable proportions in relation to debtor countries and private creditors. But since it will take a very long time to build up the norms, there is a problem here also for the foreseeable future.

Regional Currency Arrangements, Greater Stability Between Major Currencies

The crisis in several Asian countries was particularly vicious because of the interaction of currency and banking crises. Such crises are very hard to predict, though it is not impossible to show that they become more probable in certain circumstances. An important contribution to the international financial architecture could, therefore, be that regional cooperation on currency arrangements be strengthened. There may have been insufficient attention to convertibility plans (or currency boards) where countries are ready to give up also their monetary policy and have sound financial systems. There are successful examples outside Argentina and Hong Kong in some smaller European countries. Might it not be worthwhile to build on some of these successes (and on the unusually low inflation observed), instead of throwing in the towel and saying floating is the only resort? When is the IMF going to discuss not only exit strategies from fixed exchange rates, but also entry conditions into fixed exchange rates?

And that, of course, brings us to the relationships between the major currencies: the dollar, the euro, and the yen. Yesterday we had a discussion of whether it was advisable to use trade-weighted pegs for the exchange rate strategy of a country. Even that may not be sufficient to assure confidence because in a financially unstable world with the three major currencies fluctuating, there will still be strong incentives to attack such an arrangement. So greater stability between the major currencies remains a central task for the IMF and for the international financial architecture, because it is a prerequisite for sound exchange rate policies in the rest of the world.

Niels Thygesen is Danske Bank Professor of International Economics at the University of Copenhagen. In June 1998 he was nominated by the Executive Board of the IMF as an external evaluator of the effectiveness of IMF surveillance.

JIM LEACH

Maintaining Perspective on the Modest Roles of International Institutions

The case for change in the international institutional framework may be compelling, as the world changes, but care has to be taken not to be mesmerized by the lure of the language of change. Reform of the architecture of the "global economic order" is such an attractive term that it itself may be intoxicating. In this context I find it difficult to do anything except to urge a certain degree of caution.

In the United States, as the world has observed, there is a tension between isolationism and internationalism, between the willingness to play a role in global affairs and, at the same time; a predilection to go it alone. The irony is that if one assumes that we have moved from a world dominated by international politics to one dominated by international economics, as many observers suggest, the U.S., despite misgivings, reluctance, and rhetoric, may be more internationalist today than it has been at any time since World War II. After all, open U.S. markets are more important than American political harrumphing. It may be true that too many in the Congress harumph about the UN and the IMF and the World Bank, and that many around the
world harrumph about our harrumphing. But we're doing more than a little to stabilize international politics by keeping our markets relatively open. This is not to say that it isn't an embarrassment to be in arrears at the UN, I consider it very much one. It's not to say that we shouldn't support the IMF and World Bank; indeed I wrote the law that replenished the IMF. But we would make a mistake to give too much attention to international institutions, and thereby too little to the two "T"s—trade and transparency—and the one dilemma—corruption.

On trade and transparency issues, as Chairman of the House Committee with jurisdiction over banking, I would just like to make three quick points. (1) Everyone notes the issue of protectionism in trade and most people have concluded it's rather counterproductive for most societies. But there has been far too little attention to the issue of protectionism in finance. Any country that protects its financial system from foreign competition is in my judgment operating in the most singularly counterproductive way. (2) I would suggest that one of the great lessons in the United States that Americans haven't followed, and that virtually no foreigner knows, is that while the big are getting bigger in finance through mergers, in community after community in America, market share is being won by smaller locally controlled institutions. The role of the small in finance has been underestimated, and I think in countries such as Russia, the case for smaller institutions is rather large. (3) Finally Stanley Fischer talked about the obvious dilemma in deciding whether or not to redistribute any money to a divided and weak government. Interestingly, one could argue that is the United States today. On the other hand, the United States has extraordinarily strong institutions. Intriguingly leadership has been unbelievably strong in countries like Mexico, but institutions strike me as weak. Likewise, a number of the Russian leaders, are more than a bit impressive, but the institutions are colossally weak. So the issue is not just leadership, it's the institutions that go with them. What does that mean for the IMF? I think there is a case in countries like Russia for the IMF, if it can't distribute monies through governments that reach the people, to contract with institutions like the World Bank to try to distribute money in more helpful ways—or to distribute money in a colossally different way than has ever been considered before, that is to avoid central governments and perhaps move to provinces, for example, areas on the other side of the Urals.

In conclusion, let me just say that from an international perspective its indisputable that government money is of declining significance relative to other resources. Nevertheless, it's key not to deny the role of government money, but to use our wit in how it's used. And here the IMF and World Bank in my judgment deserve to be supported, but we also have to be very careful in realizing that their roles have to be kept in a fairly modest perspective.

Jim Leach is a Member of the U.S. House of Representatives and Chairman of the House Banking and Financial Services Committee.
SECTION 2
21ST CENTURY STRATEGIES OF TRILATERAL COUNTRIES

This section presents excerpts of the essays prepared for the Washington meeting by Robert Zoellick, Hisashi Owada, and Peter Sutherland, to be published separately in a volume entitled 21st Century Strategies of the Trilateral Countries: In Concert or Conflict?

ROBERT B. ZOELLICK

The United States

The Cold War alliances and institutions protected their members from outside threats, but also enabled them to manage and even transcend conflicts with one another. The genius of the Western political community created after World War II was its combination of shared commitment and independence, to be managed with flexibility and creativity. The Trilateral countries recognized that they would benefit from common action, but they also acknowledged that they would have disagreements and even sustained disputes....

In his recent biography of Dean Acheson, James Chace maintains that this post-war construction reflected a unique American realist tradition. Acheson knew the United States has had difficulty maintaining and manipulating the grand designs that appeal to hard-nosed realists as well as to liberal idealists. He appreciated that U.S. foreign policy has always been subject to pulls in various directions—by righteous zeal and rational legalisms, a penchant for both unilateralism and universalism, and a great energy that surges and ebbs depending on public opinion and the quality of national leadership.

To manage these contending forces, Chace asserts that Acheson combined strategy with practical workmanship. Acheson developed a set of core objectives for the world the United States hoped to foster, and he navigated towards them through pragmatic adjustments to events.... Acheson committed the United States to alliances and international institutions to anchor these policies in a more lasting fashion—at home as well as abroad. In combination, his policies conveyed an overall sense of direction and established priorities for the use of U.S. power and influence.

During the 1990s, the United States and the world have been waiting for the successors of the Cold War leaders to use U.S. power, prestige, and principles to transform the successes of the Cold War into a new agenda. The United States has needed to define its purposes and plans—to guide allies and friends, to warn enemies, and most important for a democracy, to cultivate the support of the U.S. public. Without a strategy, U.S. officials risk racing from crisis to crisis, each a new distraction, patching over problems until the paste cracks again. Scattershot responses dissipate the United States’ effectiveness as a coalition leader and may erode the existing structures of influence.

Looking ahead, the United States has four strategic objectives that would preserve and expand the political community it sponsored after World War II.

First, the United States needs to overhaul the ties with its two primary overseas partners, Western Europe and Japan, to better meet a new generation of challenges. Although the networks among the Trilateral countries are extensive and rich in content, it would be a mistake to take these ties for granted. Competition and conflict could lead to acrimony and even alienation....

Ongoing, healthy U.S. partnerships with Europe and Japan will go a long way toward ensuring security in two regions—the transatlantic area and the Asia-Pacific—where instability has bred threats to the United States. These partnerships will also enhance the ability of the Trilateral countries to address the
uncertainties of China’s and Russia’s futures. And Europe and Japan are the two partners the United States is most likely to turn to for collective action, whether to deal with transnational topics like the environment or whatever the problem.

Second, North America, the European Union, and Japan need to reach out to the next group of potential partners in this political community. The candidates are those nations that are building open market economies, creating middle classes, and developing representative democracies with respect for individual liberties. In varying degrees, moving at different paces, countries in Central and Eastern Europe, Latin America, and East Asia offer an opportunity to enlarge today’s democratic political community. Yet over the past year, the countries in these regions have struggled with enormous economic and political stress. Much is at stake in their success.

Third, at the edges of this democratic community are the three great challenges of Eurasia—China, Russia, and India—each in the midst of a massive transformation. China and Russia are experiencing staggering internal turmoil while they also are trying to redefine their places in the world. Our aim should be to offer a path to integrate China and Russia peacefully into this community if we can, while being prepared to shield against them if we cannot.

India, the world’s largest democracy, presents a different challenge. To grow and prosper, India will need to adjust to the global economy. To achieve stable security, India will need to lower the risk of conflict with its neighbors. Both tasks will be easier if India can develop a cooperative partnership with the Trilateral countries.

Fourth, the United States and the other Trilateral countries need to link these regions together within a global economic system of finance, trade, and information. That economic system needs to secure the benefits from integration, competition, and efficiency, while also coping with the inevitable stresses of capitalism on a global scale.

These four objectives offer a sense of direction for U.S. engagement with the world. They point to a future global architecture that should help the United States to promote security and economic interests it has in common with others, while also advancing representative government and freedom—political principles that the United States values. In the spirit of Acheson’s New World realism, these objectives might be attained through pragmatic adjustments to changing conditions and world events.

Robert B. Zoellick, former U.S. Undersecretary of State and Executive Vice President of Fannie Mae, is working on a book on U.S. foreign policy in the 20th Century.
Pax Consortis in an Age of Interdependence: The Challenge for Japan

The integration of the international community has generated the need to deal with global issues that affect all nations. In this new environment, an attempt to replace the old bipolar order by a unipolar order, as being claimed by some people, cannot solve the problems. Nor can a multipolar world based on a traditional balance of power.

The problems can only be dealt with adequately through a mechanism of management based on shared responsibility among the major players in the system that have the will and the capacity to play such a role.

With regard to this order based on what might be called pax consortis, however, it must be said that this might look like an ideal order on paper, but in practice it will be the most difficult order to maintain.

First, pax consortis means an order whose viability depends upon positive cooperation through sharing the burden of maintaining the order among the major players in the system. To put it in another way, the order cannot be sustained as an effective order unless there is political will to maintain it on the part of each one of the major players.

Second, by contrast, it is an order in which paradoxically it is quite easy to be a free rider at the cost of other members of the system. This is so because there are such a number of players who jointly share the burden for sustaining the order that each one of the players may be tempted to make its own share of contribution as small as possible. In addition, the situation can be aggravated when the system consists of a number of members whose power relationship is not quite in equilibrium, since in such a case the temptation is greater for each member to try to minimize its share for responsibility for the management of the order.

Third, the most essential prerequisite for the proper functioning of this order is the identification of common objectives to pursue, based on shared values and common interests, followed by a strong political commitment to work for the achievement of these objectives. This clearly is not easy to come about at the present juncture. When there is a clear and present danger to such shared values which are vital to the order from an external source, it is comparatively easy to forge a strong political commitment, as the experience of East-West confrontation has demonstrated. Under less compelling circumstances, the order has a built-in fragility in this regard.

It will be easy to see from what has been stated that in order to make this order truly viable, it is essential to create a community framework in which we can agree on identifiable, common shared values as the foundation of this order and to make this framework workable for defending and promoting such common values. It is precisely here that trilateralism as a movement has to exert its efforts in order to create such a community framework for pursuing common shared values as the foundation of such an order.

Within such a community based on common shared values, the advanced industrial democracies in the trilateral regions of East Asia, Europe, and North America can play a particularly crucial role.

* * *

The demise of the Cold War has affected the situations in each of the trilateral regions in such a way that a satisfactory maintenance and advancement of trilateral relations as a process can be put into question. In the case of Japan, it will hardly be an exaggeration to say that this new development has shaken the societal structure of the postwar Japan to a much larger extent than it has affected the other regions of the trilateral partners.

It is often said that modern Japan has gone
through “the opening of the country” twice in the past, one in the middle of the 19th century when Commodore Perry came to the shore of Japan, and the other in the middle of the present century, when Japan had to restart the process of integrating itself into the outside world after the shattering defeat in the Second World War. However, it would seem fair to say that each time the process was incomplete as a social revolution, to the extent that it was always an attempt for a quick-fix to graft new ideologies and new institutions to the old socio-cultural substructure of traditional Japanese society.

Now, the impact of the third wave of “opening of the country” is hitting Japanese society in the form of globalization in political, economic, and social processes. These processes inevitably shake the political, economic, and social culture of Japanese society in its more traditional aspects in a much more radical manner than the country has experienced on the two previous occasions. In this sense, it is fair to say that the country is going through the process of a major societal transformation which will probably take a decade to complete.

What is significant to our purpose for trilateral cooperation, however, is the impact of this process of societal transformation upon the external behavior of Japan in the immediate future. It is disconcerting to note in this context that presumably reflecting the mood of the nation under stress with all these painful developments, a visible shift would seem to be taking place in the nation’s outlook towards the world. What was once a growing trend towards the sense of willingness to search for an appropriate role for Japan in the world, which marked the Japan in the ‘80s and the early ‘90s, is now being replaced by an overly pessimistic outlook for its own future, which forms a hotbed for an attitude of inward-lookingness, only buttressed by occasional outbursts of nationalistic emotions as a defensive reaction....

**Hisashi Owada, former Japanese Vice Minister for Foreign Affairs and Ambassador to the United Nations, is President of the Japan Institute of International Affairs.**

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**Peter D. Sutherland**

**Europe’s Global Role Dependent on Successful Internal Reform**

The issues raised in some quarters in the United States on the pace of EU enlargement, linked to the debate on NATO expansion, demonstrate to many Europeans a fundamental lack of understanding about the essential nature of the integration process being undertaken here. It is often put to Europeans that there is no real reason why the accession negotiations with the first wave of Central and Eastern European states cannot be rapidly concluded. With Poland, the Czech Republic, Hungary, Estonia, Slovenia and Cyprus champing at the bit to join, and indeed becoming disillusioned with the demands being made of them, European politicians are often criticized for procrastination. They are also sometimes accused of creating conditions and attitudes in the countries in the next potential wave (and even in Russia) that may damage the course of democratization and economic liberalization over time.

Let us be clear—nobody in Europe is happy with the pace of the institutional reform process that is necessary to accommodate enlargement. Equally, however, it is readily apparent that substantial changes are required before any enlargement can take place. This is no trivial matter. As the EU is much more than a Common Market, and is in fact constructed on a supranational basis, European politicians bent on further deepening are constantly touching the nerve ends of national sovereignty in a manner that would not even be contemplated in the United States in the context of say, Nafta. The
negotiation of necessarily reduced voting rights in the Council of Ministers and changes in representation in the Commission are issues that go to the heart of the democratic system as the EU can adopt legislation that overrides national laws. In addition there is the complication of the reallocation of scarce resources following enlargement. The requirement in some Member States to submit necessary treaty amendments to a referendum underlines the fundamental nature of debate that is taking place on the basis of the Commission's document "Agenda 2000".

Eurobarometer polls provide some evidence of changing opinions in Europe about the integration process and the EU's external relations which further complicate the debate. There has been a clear decline in support for the EU as an entity virtually everywhere and the level of generalized support is now below 50 percent (with the United Kingdom at 35 percent). This statistic of course does not imply that a majority in any one Member State is for withdrawal from the European Union, but it is a matter of considerable concern nonetheless. Ironically the assessment of the support for European policy development suggests a wish for greater integration. For example current opinions on policy issues show that 73 percent of EU citizens support a common defense and security policy. Whilst 63 percent of Europeans agree with the principle of subsidiarity (which is based on the notion that the EU should only be responsible for matters that cannot be effectively handled by national, regional, or local governments), a similar percentage believe that the EU should have a common foreign policy.

The reality is that progress in developing a common foreign and defense policy is likely to be slow and hesitant notwithstanding the apparent understanding of the electorate of the need for progress in this field. Whilst the many, particularly in the United States, who prematurely wrote off the Euro should recognize that the momentum of integration, whatever its problems, is not to be underestimated, the difficulty in making progress in these areas is truly formidable. It would be helped most by an early and effective institutional reform establishing a greater degree of democratic control of policy than exists today.

The other positive element that may provide some momentum, notwithstanding current bickering about the ECB and diminishing value of the Euro, is the fact that the Euro has been successfully launched. It is of course crucial that EMU is seen now to work. Whilst nobody takes too seriously Martin Feldstein's view that a collapse into war is a plausible outcome of Economic and Monetary Union, there is a clear need to demonstrate rapidly that it is working efficiently and is making a positive difference to the prospects of growth generation.

So in summary the EU's global role, alongside its Trilateral partners, is highly dependent on successfully accomplishing internal reform. Successful internal reform will create more efficient decision-making procedures. It will also establish a significant external dynamic by bringing in new Member States, building confidence in the EU's institutions and policies, and bringing the EU closer to its citizens. By contrast, a failure to achieve internal reform will seriously hold back the EU's global role; enlargement would be put on hold, energies would be diverted to internal issues, confidence would evaporate and the EU would lose credibility and support among its citizens. The contradiction is that the EU needs time whilst, at the same time, the issues are urgent.

The only answer can be found in a dynamic leadership that is not yet evident in the Member States. The governments of Europe will need a visionary leadership that is prepared to confront the conflict between the realities of our time and the illusions of continuing independent power that still hang...
over the chancelleries of the larger European Member States. The issue of a common foreign and security policy is now firmly on the agenda. The successful launch of the Euro shows that the momentum of integration is not be be underestimated, however formidable the challenge is. Equally however, while Helmut Kohl, François Mitterrand and Jacques Delors provided real leadership on the EMU project, it is not apparent that there is anything approaching a similar coalition of strong committed integrationists available today.

_Peter D. Sutherland, former Director-General of WTO/GATT, is based in London as Co-Chairman of BP Amoco and also Chairman and Managing Director of Goldman Sachs International._

**SECTION 3**

**TRILATERAL ECONOMIES IN A TURBULENT GLOBAL ECONOMY**

**JOHN Sweeney**

The Global Economy: The Need to Act

Let me express my appreciation for the kind invitation to share with you the perspectives of the AFL-CIO, representing over 40 million members of working families across this country.

Let me also take a moment to recognize one of your distinguished members, a friend and colleague, Jay Mazur, the president of UNITE!, the international union of textile employees. You have chosen well. Jay is a remarkable leader who serves as the chairman of our AFL-CIO Executive Council International Committee. His union has launched path-breaking organizing drives across borders, and invented the most creative initiatives to fight against sweatshops at home and abroad. When the history of the struggle for workers’ rights is written, Jay Mazur’s name will be writ large.

Jay’s work and that struggle provides the context for what I want to talk about today. I’ve been asked to speak briefly about workers’ perspectives on the global economy. I’ve had a chance to review the fine paper presented, _21st Century Strategies of the Trilateral Countries_, to frame this meeting. Let me suggest, with all due respect, that the situation we face is much more perilous than the paper suggests. The global crisis is more acute. The divisions are deeper. The need for leadership—and the leadership vacuum—is more stark.

Bosnia, Iraq, NATO’s future, proliferation,
etc.—all these are serious questions. But the future relations of the Trilateral countries, and their relations with the rest of the world, will largely be determined by the response to the current global economic catastrophe. The question is whether we can ensure that the new global economy works for working people. Because, as President Clinton has warned, if it does not, then it cannot long be sustained.

These are strong words. They are meant to be. Let me set out a series of propositions to make my case and then elaborate briefly on each in turn:

- First, the global economic crisis is more than a financial crisis—it is a human tragedy of staggering dimension.
- Second, the crisis marks the end of business as usual. The so-called Washington consensus is not even the consensus in Washington anymore.
- Third, attempts to continue down the old path will not work—and already are fueling a growing and destructive reaction.
- Fourth, we must now create rules that can save the global market from its own excesses. Workers' rights and environmental and consumer protections must be at the center of that process—along with a renewed emphasis on demand-led, bottom-up growth.
- Finally, this debate cannot and will not be limited to the comfortable suites of the few. It is already being joined on the streets, in union halls, on computer screens across the world.

Let me elaborate on each of these propositions in turn.

**A Monumental Human Tragedy**

First, President Clinton has said that we face the worst global financial crisis since the Great Depression. That is true—but this is far more than a financial crisis. It is a monumental human tragedy. Much has been said about the "moral hazard" of bailing out speculators when their bets go bad. But too little is reported on the immoral hazard of enforcing austerity on working people to cover those bad bets. Now, in Asia, millions of working men and women who thought they were part of a rising middle class have found themselves thrust back into poverty overnight. In Russia, workers are not being paid for months at a time. One of the world's industrial nations is being reduced to barter. Life expectancy is falling; disease and hunger are spreading; desperation is rising.

The Wall Street Journal reported on Monday that the Mexican economy is humming, exports soaring, 100,000 new manufacturing jobs in the last year. Yet, Mexican workers have suffered a 40 percent reduction in purchasing power over the past five years. Absolute poverty—measured as people making less than $2 a day—has increased dramatically. And this is when the economy is working. It will soon get worse when Mexico is hit by the aftershocks of Brazil's recession.

The Trilateral nations have suffered less, but we are not immune. The Japanese find themselves trapped in a cycle in which prescriptions dictated by the old orthodoxies fail one after the other. In Europe, unemployment has taken a terrible toll on an entire generation of young men and women.

In the US, of course, these are the best of times: unemployment low; wages rising; the stock market soaring. But don't be fooled. Working people are laboring longer and harder for less reward than they did two decades ago. One in five children is raised in poverty. The trade deficit has soared to record levels. Last year witnessed the highest announced layoffs of the 1990s. And no one knows how long we can survive as an island of calm in a sea of trouble.

**The End of Business as Usual**

This global crisis marks the end of business as usual. We should be very clear about this. Some suggest that now that Asia seems to have survived the worst, the global system is headed back to health. That is a profound misjudgment. Not only is the contagion still spreading, but its full political and economic effects...
have yet to be felt. Across the world, the magic of the marketplace has been dispelled. In its place, there is a renewed awareness of the cruelty of markets, the manias of speculators, the terrible price of instability.

For over two decades, corporations and banks forged this new global economic order. They set the pace; they made the rules. Workers, consumers, environmentalists were not invited to the table. We were told to bite our tongues and bide our time, and we would eventually enjoy the rewards of faster growth and greater prosperity. Well, after twenty-five years, the results are in. As Joseph Stiglitz, the chief economist of the World Bank reports, countries large and small have been whip-lashed by financial crises of ever greater frequency and severity. And in both industrial and developing countries, the result has been slower growth with growing inequality within and between nations.

The so-called Washington consensus—the systematic dismantling of controls over capital, currencies, and corporations—has been shattered. Democratic peoples will not support it. Authoritarian regimes will fear to impose it.

In the United States, at the height of the current recovery, a majority of Americans—even a majority of Republicans—are skeptical about the benefits of trade. In Washington itself, a coalition of unions, consumers, and environmentalists—backed by the vast majority of the American people—blocked fast-track trade authority for the president, not once but twice. The Washington consensus is not even the consensus in Washington anymore.

One would hope that this reality is finally sinking in. President Clinton has called for a new dialogue on trade, saying it is vital to put a "human face on the global economy." British Prime Minister Tony Blair called for a new Bretton Woods, presumably a bold initiative to rewrite the global rules. French Prime Minister Lionel Jospin summarized that "we have learned three things: capitalism remains unstable, the economy is political, and the global economy calls for regulation."

Yet, inertia still seems to be the rule of the day. In the wake of the global crisis, there has been much hand-wringing, but little change. The IMF admits that it made things worse in Asia, and then proceeds to enforce the same brutal austerity on Brazil. Central bankers worry aloud about global deflation, yet the new European Central Bank continues to fight the old war against inflation even as Germany lurches toward recession. Fed Chair Alan Greenspan warns about the dangers of the U.S. trade deficit, yet the Treasury and IMF prescriptions give countries no other hope but to export their way to recovery.

The Treasury Secretary announces we need a new "global architecture," yet seems to debunk anything that goes beyond patching the leaks in the roof and washing the windows.

**We Need Another Way**

We need to go another way. Already, countries are acting on their own. Throughout Asia—for example, in Malaysia, and even in Hong Kong—governments are intervening to protect their people from the speculative gales. The European nations, focused on their own unity, have clearly chosen to limit their exposure. The US administration has to act—belatedly—on the distress caused by a flood of cheap imports. Financial leaders in the Trilateral countries raise cautions about the dangers of protectionism. But such warnings ring hollow if there is no collective response to the current crisis.

Here the leadership vacuum is most apparent. The Trilateral nations should be taking the lead—coordinating immediate steps to stem the crisis, and initiating bold efforts for fundamental reform.

In the short term, we need immediate steps to stimulate growth. Japan should be applauded for its bolder efforts, and encouraged to do more. The European Central Bank should lower interest rates immediately to boost growth in Europe. The United States should be wary about making long-term commitments to fiscal austerity in a world struggling...
against deflation.

The Tri lateral nations should also push a coordinated effort to relieve and restructure the debt burdens that trap developing nations in austerity, force cuts in health and education, and foster a beggar-thy-neighbor competition for export markets.

And at home, we must use our trade laws to blunt the destabilizing flood of imports unleashed by enforced devaluations.

Rewriting the Rules of the Global Economy

In the longer term, we need a new internationalism—a rewriting of the rules of the global economy to make it work for working people. This will require bold new ideas, new initiatives, and new institutions. Controls must be devised to limit capital speculation; to make currencies more, not less stable; to make corporations more, not less accountable. Global arrangements for trade and investment must leave nations free to follow different paths to prosperity. The Tri lateral countries should take the initiative now to call for a new Bretton Woods to begin rewriting the rules of the global economy.

In this country, Treasury Secretary Rubin is right when he warns that we cannot continue to serve as the buyer of last resort. Our trade deficit is unsustainable economically and indefensible politically. Some of the most efficient steel companies and workers in the world find themselves submerged under a flood of low-priced steel from countries whose currencies have collapsed. Workers lose their jobs; families lose their hopes and often their homes; communities are disrupted. Their action is fierce and utterly understandable. It is not an adequate answer, as Steelworker President George Becker has stated, to give workers a “pat on the head and put them at the front of the unemployment line.” If the U.S. economy slows, as most observers believe it will, demands for protection and nationalist fears and anger will build rapidly.

Reform can sensibly begin by addressing the glaring contradictions of the current policy. Consider our policy towards China. Already the radical right in our country is campaigning to isolate China for its human rights abuses, its repression of religious freedom, its military buildup.

The AFL-CIO supports engagement with China. We think it foolish to pretend we can isolate a nation of 1.1 billion people. But current U.S. policy is indefensible. Last year, the Congress labored to change the terms of the trade debate over China from “most favored nation” to “normal trading relations.” Some pollster must have thought it was easier to sell the latter than the former.

Better get a new pollster. How can you call “normal trading relations” a $60 billion trade deficit with a nation that controls access to its market, targets its trade, suppresses independent labor organizing, and trashes its environment? We currently sell to the Chinese about as much as we sell seven million Australians. Our trade deficit with China helps destabilize its neighbors whose systems are more democratic and more open. The $60 billion trade deficit with China directly subsidizes the race to the bottom that undermines support for the global economy. I can tell you one thing. We will either gain greater balance in our trade with China—and with the world—or we will feed a xenophobic populism that may make Pat Buchanan look like Woodrow Wilson.

At the same time, the Tri lateral nations should be seeking to ensure that the global economy works to lift standards up rather than drive them down. At the AFL-CIO, we will continue to fight to make core labor rights, environmental and consumer protections central to trade agreements, to the conditions enforced by financial institutions, to the standards required for preferred access to our markets.

Some argue that child labor is a necessity for poor countries and attempts to ban it a form of Western chauvinism. Or that enforcing internationally recognized, core labor rights—the right to organize, to bargain collectively, to strike—is protectionism.

...WE NEED A REWRITING OF THE RULES OF THE GLOBAL ECONOMY TO MAKE IT WORK FOR WORKING PEOPLE.
Here is the simple truth. No society benefits from exploiting its children rather than educating them. No society benefits from impoverishing its workers rather than empowering them. And no culture or creed condones slave labor, sweatshop labor, or imprisonment of workers seeking to organize trade unions.

Labor rights are a core human right, vital to the development of a robust civil society central to democracy. But they are also economic necessities. As former UAW president Walter Reuther said, "You can't build an automobile economy on bicycle wages." Today too many workers are making goods that they cannot afford to buy. Empowering workers is central to creating a prosperous economy.

This Debate Cannot Be Contained
One final point. This debate cannot be contained among the accredited few in these upholstered suites. The negotiators of the Multilateral Agreement on Investment found that out. They thought they could write what they called the "constitution of the global economy" in closed meetings in line quarters in Paris. They discovered to their dismay that their constitution was being debated and rejected across the world in union halls, on computer screens, and on the streets by workers, consumers, environmentalists, and human rights activists.

Some years ago, the Trilateral Commission gained notoriety for Samuel Huntington’s essay complaining about the “excess of democracy” during the Cold War. But, it is the “deficit of democracy” in the global economy that must be redressed. Trade accords cannot be negotiated in the closed precincts of trade representatives and corporate lobbyists, ratified on a fast track, and enforced in a secret tribunal. The Trilateral nations alone cannot impose the new order. Others now demand a place at the table. And their interests, concerns, and values can no longer be easily ignored, or quietly deferred.

I don’t pretend that any of this is easy. Simply finding ways to limit destabilizing speculation in currencies and short-term capital flows would tax even the brilliance of Paul Volcker. But we have faced similar challenges before. In this country, at the beginning of the century, the great corporations and trusts forged a national market and an industrial economy. The transition generated booms and busts, displaced workers and farmers, sparked upheaval and protest. Progressives of the era joined to organize unions, extend democracy, and develop new rules that would make the economy work for people—food and drug standards, anti-trust regulation, fair labor standards, a ban on child labor—and eventually, labor rights, a social welfare net, consumer and environmental protections. These reforms did not come easily. They were not granted by the generosity of those Roosevelt called the “malefactors of great wealth.” They required organizing by citizens and workers, a crusading press, and bold leadership.

Now we face the same challenge once again—only this time on a global level. I do not claim to have the answers, merely the first of the questions. In this country, it took many decades—and two world wars and a Great Depression—to elaborate protections that saved the industrial economy from itself. Now at the beginning of the 21st century, the global economy poses the same challenge. Let us hope that we need not relive the horrors of the past to unlock its promise for the future.

John Sweeney is the President of the American Federation of Labor—Congress of Industrial Organizations (AFL–CIO).
YOTARO KOBAYASHI

Revitalizing the Japanese Economy

I would like to talk about two phases of revitalization of the Japanese economy. The short term, in the sense of the next several years, is probably the most important phase in the eyes of most people because of its connection to the global economy. The second phase of revitalization is somewhat longer term, without which the Japanese economy will be in danger of repeating what it has done in the past, doing a disservice to its own economy and the rest of the world.

Short Term: Greater Effort by Private Sector, Strengthening of Safety Net
Let’s begin with the short term. Today the newspaper reported the Japanese government’s announcement that the Japanese economy had negative growth in the fourth quarter of calendar year 1998, making the rate for calendar year 1998 -2.8 percent. Although I share with many of my Japanese colleagues the view that the first quarter of calendar 1999 will be better than the previous quarter, I have no doubt that fiscal 1998 will have negative growth for the second year in a row.

Let’s review what Prime Minister Obuchi’s government has done since he came into power. Last year, on July 30, he was elected prime minister with the lowest popularity rating of any prime minister in recent history. A week later, on August 7, he promised to rebuild the economy in one or two years. Very few believed him, including most newspapers and television. On August 11, the yen depreciated to ¥147.64 per U.S. dollar, the weakest in eight years. Later that month, the government announced plans to inject public money, which had been discussed for some time, into the Long-Term Credit Bank of Japan. On September 18, LDP and opposition parties agreed to revise financial bills. Three days later Mr. Obuchi met with Mr. Clinton, and Mr. Clinton urged him to stabilize Japan’s financial system. On October 2, the Nikkei stock index fell below 13,000—the lowest in 12 years—and then six days later the yen appreciated sharply to ¥111.45 to the dollar in London. The Diet passed financial recapitalization bills to deal with failing or failed banks. On November 16, the government announced a ¥24 trillion economic stimulus package. On December 12, the government announced the nationalization of Nippon Credit Bank. Immediately after the turn of the year, on January 14, Prime Minister Obuchi surprised everybody by forming a coalition cabinet with Ichiro Ozawa’s Liberal Party. And on February 19, the Lower House passed the fiscal 1999 budget plan. Today the stock market is about 15,000.

My personal view is more optimistic than before, but cautiously optimistic. The new minister for economic planning, Taichi Sakaiya, contends that he sees the beginning of a move of the economy. Some people say that contention is not backed by the numbers. But my personal experience is that there are more positive signs than before in various parts of the economy. The number of bankruptcies is down (some experts offer concrete negative reasons why, but still, the number is down). Inventory adjustments are not finished, but have been going on quite nicely. Sales of electronic consumer goods at large consumer electronic stores are up. However, corporate profits are down, wages are down, and equipment investment (which traditionally moves with the economy) is still down. So, the current picture is encouraging, but still far from totally reassuring. We have to keep watching.

Where does the Japanese economy go from here? What has to be done to continue this improving tone into the balance of this year and hopefully to 2000 and 2001? Certainly, the most important thing that has to happen, particularly this year, is a much greater effort by the private sector to do a couple of things. One is the continued effort to do a much bet-

...MY PERSONAL EXPERIENCE IS THAT THERE ARE MORE POSITIVE SIGNS THAN BEFORE IN VARIOUS PARTS OF THE ECONOMY.
On government fiscal and monetary measures, there are not very many things left to be done. Already, of course, there is a growing concern about the long-term fiscal health of the Japanese economy, simply because of what has been done already and how that has impacted long-term interest rates. At the moment, the actions by the central bank seem to be acting positively on the market. An almost zero interest rate, the increase in the money supply, and increased public spending are having a meaningful impact. Again, the numbers still say you have to be cautious, but the information networks in the local areas do tell you that they are benefitting in a very visible way from the huge amount of public spending.

Of course, there is the question of how long it will last. Will it last for the balance of this year or is it going to be necessary to come in with additional money? To come in with additional classical public spending is out of the question. If something like this is going to be necessary, it is going to be in the most selective of areas; there are lots of infrastructure areas that need to be improved. We suf-
fer from the universal and, perhaps, political problem of not being able to allocate those resources to the needy areas. Often, these decisions are political, with some areas receiving redundant resources that are wasted. But we will continue to pursue this further.

Longer Term: Corporate Governance, Guiding Principles, Education

A word or two on three aspects of the longer-term revitalization. One is already beginning—fundamental change and improvement in the area of corporate governance. For instance, Mr. Kojima’s very fine paper points to the huge non-performing loans that have blocked the quick recovery of the economy.* But a basic, more fundamental question is: Why did it happen? Why was the banking situation left unmanaged for so long? It is not just poor management. The question of corporate governance is being looked at very hard by many Japanese companies, resulting in reducing the size of the board, but more importantly, inviting outside board members to inject into the management a new structure and outside views. This is a fundamental change in the way Japanese companies are run. It is going to take a long time before the changes will have a visible effect on the way companies are run, and size itself might grow again, but this is a very, very important beginning.

The second aspect is a question of the guiding principles for the management and the captains of the economy. Next month I will be assuming the presidency of an organization called the Japan Association of Corporate Executives (Keizai Doyukai). Immediately after World War II, when all the former captains of industry had been purged, younger men of aspirations and idealism worked together with the very high hope of establishing a benevolent business society. Their guiding principle was called “modified capitalism.” What did they mean by modified capitalism? This idea is interesting because in Japan today, we are talking about shifting toward the so-called Anglo-American model of capitalism; but in 1945, what had been proposed was modification away from the Anglo-American capitalism that had previously dominated the Japanese economy. Since then, we have over-done the modification or, perhaps, we forgot to modify the whole thing. Japan does not have capitalism, it has socialism. So, it is no wonder people are now calling for shifting back toward the Anglo-American model. Nobody is saying that we have to go all the way, but, if not, what is going to be the mix—70:30, 80:20, 50:50? In Japan, we are getting our minds together to think about and learn from the experiences of America and Europe, but this will take a few more years. Organizations like the Japan Association of Corporate Executives will think very deeply about what the new guiding principles will be for us beyond shifting toward Anglo-American capitalism.

There is one last thing that has to be done. We need to revitalize not only the Japanese economy, but also the Japanese society as a whole. If you look back on what has happened in the last half a century, while we were growing very rapidly economically, areas of education like the liberal arts had been more or less left behind. In the last several years people have come to realize that there is something more fundamental that has to be established in Japan—the sense of common values that we all share. We should not sit still until this long process of rebuilding our education system is done; this process has to run parallel to short-term and mid-term actions reestablishing the guiding principles for business and the economy. When that is done, whether ten or twenty years ahead, that will be when we can really say that the Japanese economy has been revitalized.

* * *

Now, for the short term, we have a mixed bag, but to me it is looking more promising. In 1999, the most important part of maintaining this momentum has to come from the private
sector, and I can tell you that in the Keizai Doyukai and the Keidanren there is a very, very firm commitment on the part of the private sector. The government has done as much as it can do. Now it is our turn.

Yotaro Kobayashi, Japanese Chairman of the Trilateral Commission, is Chairman and Chief Executive Officer of Fuji Xerox.

EDMOND A. PHANDERY

The Euro as Catalyst for European Reform

The advent of the Euro has to be one of the most meaningful developments in trilateral relations between North America, Japan, and Europe at the close of this century. To be sure, the Euro, adopted by 11 countries, doesn't yet concern Europe in its entirety. But its sheer weight and impact make it a key component of the trilateral dialogue—or should I say, "trialogue."

Looking back, it is hard not to be struck by the contrast between the skepticism prevailing among academics and international experts at the mere thought of a supranational currency, and the credibility which the Euro acquired over a period of a few months even before its official launching on January 1, 1999.

Indeed, the world's economic turmoil of 1998 (especially in September and October) could have been expected to cast a shadow over the creation of this new currency. In fact, quite to the contrary, the very prospect of the disappearance of exchange-rate fluctuations within the Euro-zone actually deterred markets from upsetting the European monetary scene. The convergence of interest rates of our central banks became a reality in the most harmonious way. As to the delicate conversion to the Euro on December 31, 1998, it took place without a glitch.

But if the Euro started so successfully, less than three months after its birth questions are now surfacing again. While many had predicted a strong Euro, its value has initially depreciated vis-à-vis the dollar. The jostling over the right "policy mix" between the European Central Bank and various Euro-zone governments has been widely publicized. The multiyear budgetary programs put forth by the
member-states a few weeks ago to meet the requirements of the “Pact for Stability and Growth” have not all been deemed convincing by the European Commission.

However, there is nothing to justify that the initial euphoria should now give way again to doubts. Indeed, we have entered a new era. Roles have been redistributed. On the one hand, European Central Bankers, now fully and independently in charge of monetary policy, read the Maastricht Treaty as giving them the mandate to ensure price stability. On the other hand, governments share among themselves the responsibility for economic policy in the Euro-zone. We are at the beginning of a learning period, of a long process, still filled with many unknowns. This will require on the part of European leaders courage, and a sense of vision and reform—which is precisely what they had to show, too, in order to place the Euro into orbit. That, in and of itself, is promising for the future.

Let me submit to you a few observations about the Euro’s international dimensions before I give you my views on the kind of reforms which the Euro ought logically to promote in Europe.

The Euro’s International Dimensions
The champions of the Euro, especially in France and Germany, whether they belong to the Left or the Right, all share the same culture on international economic relations—a culture based in particular on the virtues of free trade. True, since most of member-countries’ external trade takes place within the so-called Euroland, some have seen in the creation of the Euro a means of reinforcing the supposed “fortress Europe.” Yet such impressions are misleading. For us to yield to the temptation of protectionism is, let’s face it, inconceivable. We simply have too many economic interests and too many jobs which directly depend on our exports. Too many global companies have spread out their resources in accordance with the costs and characteristics of each and every region—and their very existence in Europe now depends on the durability of a free-market economy on a world scale.

In the very logic of the previous “Single Act,” we created the Euro precisely in order to improve the workings of European markets. We created it also because it meant over time a closer European integration. We created it, finally, because we hoped it would quicken and strengthen Europe’s industrial and financial power.

Indeed, this is happening. As Hervé de Carmoy has pointed out, financial concentration is now intensifying within our countries—in Portugal, in Spain, or more recently in France, with the mergers between several large banks—and also on a European scale. That trend is also significant in other sectors which demand large-scale operations to secure the creation of value expected by financial markets, which internal growth can no longer promise everywhere by itself. That is now true in heavy chemistry, insurance, automobiles, pharmaceuticals, aerospace, and even in the multimedia industry. All this enhances our European capacity to be “global players.” In addition, a greater convergence of the rules of the game on such matters as accounting, corporate governance, and the monitoring of financial markets—largely influenced by American practices based on common criteria of transparency and business ethics—contribute to a better understanding among all involved. Such an evolution will improve the quality of exchanges among the main industrialized countries and enhance their growth potential.

This evolution will culminate in a “Millennium Round” of multilateral trade negotiations in search of a balanced partnership and fair trade among the main world economic actors. This Round must integrate all the components of today’s competitiveness—including the essential accelerator of R&D in all its forms, through information and communication technologies—triggered by a Schumpeterian process which we have seen at work over the last eight years in the United States, and which is now emerging as the prerequisite for faster development in Europe.

On the international scene, the Euro, far from being a weapon in some mythical struggle against the dollar, should help the European...
countries better shoulder their global economic and financial responsibilities.

Every day more global, our new world is characterized by gigantic—and growing—capital flows, and by persistent current account payments imbalances. America’s considerable deficit co-exists with a strong dollar, while the Euro-zone’s surplus goes for the time being with a somewhat weakened Euro in spite of its recent rebound. Japan’s economic and monetary evolution raises a number of questions. Thus, on a Trilateral level, too, factors of market instability remain latent. In such a context, to insure the greatest possible stability, we need to ask whether domestic monetary policies geared to stability, as has been the constant philosophy of the G-7. But will that be sufficient?

Last year, we have witnessed the role played by the Federal Reserve System in responding to the deterioration of the international financial climate. How much longer can the European Central Bank and Europe’s political leaders continue to be unwilling to respond to the United States’ call? When it comes to sharing, through a balanced and constructive dialogue, the responsibilities of great powers in the face of potential worldwide turmoil, how could Europe refuse the call of duty? It must be said, however, that to follow this path might entail a redefinition of the missions of the European Central Bank, and perhaps at least a rereading of the rules set forth in the Maastricht Treaty. This is a crucial issue.

There is at least one other essential question: the Euro’s gradual move towards the status of a “reserve currency,” which will inevitably have repercussions on the management of the dollar. As we can see, the emergence of this new European currency profoundly alters the functioning of the financial world. It calls for a deepening of the Trilateral dialogue, which, as Peter Sutherland puts it, will be all the more constructive in so much as “the pooling of sovereignty has fostered a more reliable and accountable Europe within the Trilateral partnership.”

The Euro and Reform in Europe

Let me come now to the heart of the issue. I am convinced that the Euro will lead Europe over time into radical reforms to reduce public and social expenditures, to increase the flexibility of labor markets, to favor productive investments and job creation and thereby reduce unemployment.

To be sure, as we seek to empower the European economy to create jobs as the American economy has done, many obstacles will have to be overcome, which are readily identifiable.

The first difficulty is of a conceptual nature. A number of economists tell us that the Euro-zone is not an ideal monetary zone. In other words, in the event of a shock in a given country which could worsen unemployment, this country lacks cross-border labor mobility, and no longer has the ability to adjust its exchange rate. Under such circumstances, these economists argue, budgetary transfers must be facilitated to help the troubled areas. Some even go as far as to question the wisdom of the “Growth and Stability Pact” which strictly limits budget deficits. Clearly, such an analysis is debatable. Within any country of the Euro-zone, disparities in unemployment from one region to another may be greater than between two different countries in the zone. After all, no single European country—be it France, Germany or Italy—has ever been an “optimal” monetary zone in the past! And yet, no one ever thought of allowing several different currencies on its territory!

Let’s not, however, underestimate the impact of such an approach which, in its pessimistic version, conveys a defensive, downright defeatist vision of the future that spells permanent, intractable unemployment, together with ever more widespread social protection. In such a scenario, since it eliminates the exchange-rate constraint, the Euro could appear as an opportunity, since it discharges governments from enforcing the discipline attached to balance-of-payments disequilibria. Euro-zone trade being primarily intra-EU, it would become much easier to sustain economic activity through
budgetary policies, since they would be conducted simultaneously by member-countries. In such an approach, the temptation would also be strong to harmonize fiscal policies through higher taxes, and thus to extend to all member-countries the most favorable conditions of social protection.

In spite of today’s predominance of social-democratic parties on the European political scene, it is by no means obvious that we will take this path. For at least four reasons:

- First, the facts are before us: The European countries which did best in containing unemployment are not those using budgetary and monetary policies. Rather, they are those which courageously engaged in reforms—especially in order to improve the workings of their labor markets, and to eliminate the systemic “unemployment traps” built into their systems and thus provide a favorable environment to entrepreneurship and innovation.

- Second, our governments’ firm commitments to the Pact for Stability and Growth deter those who might still wish to resort to budgetary growth stimulation. Such a stimulation, unacceptable to member-countries as a whole, would in any case have limited effects in any particular country.

- More decisively, the kind of fiscal competition which already goes on among the states of Europe is only enhanced by the Euro. Indeed, by giving it greater visibility, the Euro intensifies this competition. On such a sensitive subject, it helps indirectly to mobilize public opinion. In some of our nations, the disincentives in the tax system lead the young, educated at great costs in the best of universities, to seek employment in other countries where their prospects look brighter. Faced with the prospects of a heavier tax burden, some companies no longer hesitate to threaten a relocation of their headquarters. When the Financial Times polls the leading Employers’ Associations of Europe about the harmonization of corporate taxes, an overwhelming majority of them react negatively. Clearly, they wish for the continuation and accentuation of fiscal competition which can only benefit over time European firms and citizens at large.

- My last reason for optimism lies with the gradual awareness within political circles. This is illustrated in France by the statements to this effect of President Chirac and Prime Minister Jospin. At the Congress of European Socialist Parties in Milan, on March 2, British Prime Minister Tony Blair welcomed the emergence of a “third way” which reconciles “the culture of entrepreneurship” and a modernized European social model, a third way which “equips people for work by improving education and infrastructure, combines a tough approach to youth crime and far greater emphasis on the duties of parenthood, while enhancing family support to meet the needs of children and to help families, particularly the most vulnerable.” Thus, the prospects for such changes overcome political boundaries as well as the strict confines of Euroland. Furthermore, recent political developments in Germany don’t seem to contradict this desirable evolution.

To be sure, this is only the beginning of this new evolution. We all know the challenges before us: They boil down to nothing short of the modernization of our social protection systems in ways which reconcile greater individual responsibility with better coverage for those most in need of collective solidarity, and at a lower cost. What is at stake is the restructuring of our public sector, and its heightened responsiveness thanks to privatization and the use of the technologies of information; the lifting of obstacles which hamper the fluidity of the labor force; and a true competition, already largely into place, among major infrastructure network operators. All these changes will have to take into account the values of our European social model which are crucial to its cohesion. As Peter Sutherland has underlined rightly, they will not simply duplicate the American Way. But they are...
unavoidable. It was already so before the birth of the Euro; it is even more so today.

It is all the more so since the European economy now tends to slow down, and inflation to disappear. Price increases in Euroland have declined to 0.8 percent per year as of December 1998. Europe might require sooner or later a more accommodating monetary policy. But the best environment to allow for such a move requires precisely such an acceleration of structural reforms.

True, the public declarations of some of today's Euroland leaders do not seem quite to point in this direction. But minds often change faster than some dare imagine. Let us recall the dramatic turnaround we have witnessed in the past, when reality became inescapable.

The Euro is now well on track. Almost everybody in Europe is convinced, rightly so, that there will be no going back. Under these circumstances, the sooner the structural reforms are implemented, the more quickly Euroland will reap the fruits of an economic and social upswing fostering growth and employment. Europe has been over the last years a land of opportunities for investments coming from abroad and this movement has been profitable for all of us. I am sure that these reforms will give further opportunities for investment in Europe.

Let us hope that our "trialogue" will contribute to the ripening of these ideas in Europe—for our own good, and also for that of our Trilateral partners.

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In the world of yesterday, Europe played the central role in US defense planning. In today's and tomorrow's world, the Europeans are becoming more and more important as allies and partners in a wider context. However, Europe is not yet the strategic actor it is seeking to become nor the global partner America is looking for. Partnership in leadership requires a Europe willing and able to take on more responsibility.

Third, to meet the challenges of the 21st century and the security agenda ahead we need to utilize all and each of the Euro-Atlantic institutions. Each institution has its strengths and offers specific benefits. They all have to work closely together towards our common political goals and shared strategic objectives.

II.
Since 1989 we live in a world that is changing faster than ever before. It is requiring us to adapt our minds and institutions. Yesterday's world provided us with grave, but well-defined challenges. The world of today and tomorrow is much different: A wide range of ill-defined risks calls for a wide variety of highly flexible politico-military instruments. Consensus between the main players is conditio sine qua non. But consensus is now harder to achieve—since there are more players on the field than ever before and there is less time to coordinate their varying interests.

NATO has, undoubtedly, been adapting faster than any other institution of the Euro-Atlantic security network, but there is also no doubt that the Alliance still has to go a long way. Its 1991 Strategic Concept was written for a world much different from today's—it was written for a world in the midst of dramatic transition. It provided the framework for NATO's double enlargement—for building up ever closer cooperation with partners, tailored to their specific needs, and for dealing adequately with new missions such as conflict prevention and crisis management.

The internal and external adaptation has already been extensive. NATO is cutting down the number of headquarters from 65 to 20 and force structures are changing rapidly. The Alliance now successfully conducts operations such as in Bosnia and Kosovo. It has forged strong ties with the countries of Central and Eastern Europe, and this in itself has brought about a fundamental change in the security environment. And NATO has made a big step by successfully institutionalizing its cooperation with Russia and Ukraine.

At the Washington summit we will not only celebrate the 50th anniversary of the most successful politico-military alliance the world has ever seen—not least by welcoming the leaders of Poland, Hungary and the Czech Republic. We will also agree on a new Strategic Concept, outlining how to contend with new challenges and new opportunities. For an Alliance that is capable both of meeting a wide range of threats to our common values and interests and of working in trusting partnership with other nations and organizations. For the only alliance capable of promoting security, prosperity and democracy in and for the whole Euro-Atlantic area. The new Strategic Concept must keep the right balance—affirming the fundamental capability for collective defense and at the same time providing for the full range of future conflict prevention and crisis management tasks.

It is essential:
• to implement the new command structure fully and rapidly,
• to appropriately improve the Alliance's mil-
military capabilities and force structure,

- and it is essential to establish a more operational relationship with our partners.

The success of the April summit will depend not least on the decisions taken on these issues.

Reliable and, therefore, politically meaningful collective defense and crisis management capabilities are based on proper material conditions. Developing key capabilities is especially important in that area where we are facing greater demands—in the ability for rapid and decisive crisis management. The number one key capability is interoperability. It is based on a common strategic and operational understanding of our soldiers which we need to develop further. Interoperability, furthermore, demands flexible organizational structures. And, last but not least, interoperability requires state-of-the-art matériel. The German armed forces have already gone a long way to adequately tailor forces to the mission, deploy them rapidly and sustain them in the field. But this is a challenging undertaking requiring constant effort.

And this, by the way, reminds us once again of the pressing need for restructuring our cooperation with the defense industries in Europe and America alike. Here as in other fields, the benefits of cooperation are in the long run greater than the revenues of acting independently.

III.

To meet the security challenges under the new auspices we must pursue a twofold approach—strengthen NATO’s political cohesion and military cooperation whilst enhancing Europe’s ability to assume responsibility when and where European security interests are involved.

We Europeans must increase our political weight in international affairs—as a part of trans-Atlantic solidarity and of a more balanced sharing of burdens. At present we lack both the joint political will and the instruments to take on greater responsibility. But both are necessary to live up to the challenges of the 21st century.

We will create the required politico-military decision-making structures in the European Union. This will allow for joint action to be taken in European crisis management under one roof. The first step is to appoint a European High Representative for the Common Foreign and Security Policy—and to provide him with the instruments for the early detection of crises, including strategy planning and early warning facilities.

But this will not suffice. We aim for a more ambitious initiative: integration of the West European Union into the EU soon. Practical ideas on how this could be done are being developed in such a way as to implement them within the next two years. The rapid merger of WEU and EU would guarantee and provide the essential prerequisite for an effective and efficient European security and defense policy.

We have no intention at all to duplicate NATO. The military command and force structures must remain within the Alliance. Nevertheless, I feel there is a need for us to start thinking about the European members creating a strategic reconnaissance capability, as well as a strategic air transport component available for independent European operations—supplementing the corresponding U.S. capabilities within the integrated NATO structure. They are operational necessities for Europe to take action within the NATO framework and also under the auspices of the European Union.

Of course, the last we aim at is to sever the European decision-making process from NATO nor do we want to discriminate anyone. On the contrary, we want to strengthen the European pillar within the Alliance to the benefit of the Euro-Atlantic security architecture as a whole.

IV.

The end of Europe's political division has brought less spectacular, but more diversified risks to the fore. And it has raised both the necessities and the possibilities to improve fundamentally the Euro-Atlantic security architecture. The Euro-Atlantic community is meeting new challenges more than ever before together with partners, especially in Central and Eastern Europe, but even far beyond—and by means of close cooperation between the various institutions.
bearing responsibility for Euro-Atlantic stability and security. We should not underrate, but instead underline that NATO continues to contribute immensely to this task.

The "Partnership for Peace" Program and the Euro-Atlantic Partnership Council play major roles in building confidence and trust—not only between the armed forces of NATO and its partners, but also between their peoples and governments.

And the Alliance's relationship with Russia is a key element in shaping a peaceful and stable Europe. What we are looking for is active cooperation on issues of mutual interest. The Permanent Joint Council is working now and constitutes a major step forward in shaping a constructive partnership between the new NATO and the new Russia. Strengthening the transatlantic ties on the basis of shared values and common interests is fundamental to European security—and the basis for the indispensable reaching out to a Russia in transition.

There is, however, still much room for improving the ties between the various Euro-Atlantic institutions. In Bosnia and Kosovo we see that close cooperation between NATO, OSCE, the UN, and the EU is paramount for creating basic conditions for regional security and stability. We need to follow this path vigorously.

The challenge is to respond politically and militarily to multi-dimensional contingencies and to utilize for specific tasks those institutions that are most fitting. We have to prepare for the need to take decisions on a case-by-case basis, because in future—unlike in the past—the response to any such contingency cannot be determined in advance or be automatic. That requires a common effort to develop all the Euro-Atlantic institutions to the best of their abilities.

* * *

This is the path to follow in order to master the ambitious security agenda set for both of us—Europe and America.

Rudolf Scharping is Germany's Minister of Defense.

JOHN DEUTCH

The Security Agenda: Proliferation and Terrorism

I want to discuss two subjects with you. The first subject is the security issues that we will be facing for the next several years. Second, I want to select from that agenda of security issues the issue of proliferation and the connected subject of the threat of foreign terrorism. I shall also make a few specific remarks about what I believe Trilateral countries should be doing to deal with that set of threats. Let me first turn to security challenges.

We Face Urgent Security Issues, Poorly Positioned for Near-Term Progress
We are in a period when there is an unusually large number of serious security issues on the world's agenda, and we are in a relatively poor position to deal with these issues. I will give you my list of those issues which are most pressing and most urgent.

- First, the collapse of the economy, and to some extent the government, in Russia.
- Second, Trilateral countries' engagement with China. I fear that this week as we meet here in Washington, D.C., the United States is about to take an untoward turn in the way it seeks to engage China.
- Third, North Korea and its continued efforts to acquire nuclear weapons and their means of delivery
- Fourth, Iraq and the failure of the U.S. policy of containment.
- Fifth, Iran. There is no agreement among Trilateral countries about how we should engage Iran and there is a growing antipathy towards the U.S. practice of sanctions. To my mind, unilateral U.S. sanctions have

...there is an unusually large number of serious security issues on the world's agenda....
proved largely futile.

- Sixth, now that we have NATO troops in Bosnia, and perhaps soon in Kosovo, how do we get those troops out?

And there are other issues as well. Let me remind you of the issues of (1) drugs and international crime, which are the most serious issues for the public; (2) India and Pakistan, where nuclear stability is most fragile; (3) Greece and Turkey; and (4) the Middle East peace process. This is an overwhelming agenda of issues to deal with as Trilateral countries.

Let me next ask: Are we well positioned to make progress on these issues? My judgment is that we are quite poorly positioned to make progress on these issues in the near term. Why? First, U.S. leadership has been and will be constrained for the foreseeable future because of the political difficulties of President Clinton. Europe for the time being has turned inward, in my judgment, stressing their interest in economic and political integration at the expense of transatlantic cooperation. The economic difficulties in Japan have slowed the process of having this great nation take a greater leadership role in world affairs. And, finally, the international economic instruments on which we rely, the IMF, the World Bank, etc., have neither the resources nor the instruments to deal with the difficulties that we asked them to address, for example, the economic collapse in Russia. So I conclude that we should have very modest expectations about the progress that can be made over the next couple of years.

**Proliferation and International Terrorism**

Among the agenda of issues that I mentioned to you, there are some common features. One of those important common features is the joining of proliferation and foreign terrorism. Let me just mention to you three possibilities we should worry about. First is the loss of weapons or material—nuclear, chemical, or biological agents—from the Russian military complex. Second is the development of biological agents—anthrax is the most likely—by sub-national terrorist groups that release them in Tri-Atlantic cities. Third is the acquisition of nuclear, chemical, and biological weapons by rogue states—the top two countries on the list are North Korea and Iran. These kinds of threats have new features which I want to mention to you.

The first new feature of this threat is that there is an international characteristic to terrorist activities which has never been present before. It is illustrated by the activities of Osama bin Laden, who managed to strike two embassies in two different countries in Africa at the same time; and then the retaliation by the United States against Osama bin Laden's operations in two countries—Afghanistan and the Sudan—on two different continents. Islamic terrorist organizations operate in capitals throughout the world in a concerted matter. This state of affairs is very different than that which existed in the past.

The second new feature I have already mentioned—the possible use of weapons of mass destruction by these terrorist groups. We have the example of the U.S. conviction that Osama bin Laden's organization had been seeking to acquire and develop chemical agents in the Sudan; there is also the evidence of the Japanese cult Aum Shinrikyo's efforts to release a nerve agent in the Tokyo subway system.

And a final common feature is the new element of the great vulnerability of the computer and telecommunication system on which our economies and our societies become progressively more dependent. These are vulnerable to penetration and to destruction. It is especially difficult to tell a difference between a threat from state actors, sub-national actors, and criminal groups.

All of these are tremendously different threats that deserve attention.

Now, it is worthwhile to ask: How serious are these threats—are they real—and what are their origins? Those questions are indeed connected. The answer I believe lies in the realization that the United States and its Trilateral allies are increasingly engaged around the world and hence the target of terrorist groups that have no other way of accomplishing their political or economic agenda. In the long-run the only way to prevent this kind of terrorism is to address the social and political concerns—
the causes of unrest which lead to the desper-
ration and criminal fanaticism of groups oper-
ating in otherwise happy and peaceful
nations. But until we can address those more
fundamental concerns we are going to have to
deal with these threats of foreign terrorism and
related proliferation concerns.

Needed Actions by Trilateral Countries
I want to mention a set of actions that I think
should be taken by Trilateral countries because
today, in my judgment, we are woefully unpre-
pared to deal with this threat. Let me give you
five specific things which I believe Trilateral
countries should be doing:
- First, we need to provide greater assistance
to Russia to manage their decaying weapons
complex and help them get over their eco-
nomic difficulties. I speak here of every-
thing from helping them build plutonium
storage facilities to acquiring highly enriched
uranium more rapidly. Until now, the
United States has been launching these pro-
grams and bearing the costs. I believe it is
time for it to become much more of a Trilateral
activity.
- Second, as Andrei Kokoshin mentioned, we
need new initiatives on export controls,
especially in the areas of biological and
chemical technologies which can lead to
weapons. I believe that this approach
should not be on general prohibitions against
dual-use technology, but rather targeted on
specific transactions which are known to
have a degree of risk.
- Third, the United States and most of the
Trilateral countries are very ambiguous about
whether foreign terrorism should be dealt
with as a law enforcement matter or as a
national security matter. Until that key issue
is resolved it is unlikely that we will make
very effective or efficient progress. It must be
resolved if we are going to deal with
these catastrophic threats that can involve
the penetration of national computer net-
works which control banks, power plants,
or air traffic control systems. It must be
resolved, in my mind, in favor of seeing
these as key national security threats.
- Fourth, we must build the capacity to deal
with the consequences of catastrophic ter-
rorism, should it occur. There is almost no
city in the world which has the ability to
deal with the medical consequences of a
chemical or biological attack. We must have
the training, the equipment, and the tech-
nology to deal with these possibilities.
- Fifth, we must have a shared intelligence
capability among cooperative countries to
warn of potential attacks and to build
understanding of the mode of action and
activity of terrorist groups. We should also
seek to act jointly where appropriate to in-
dict terrorist groups before they attack and
retaliate when appropriate.

All of these are very important actions that
deserve to be taken jointly by Trilateral coun-
tries. The United States is making progress in
these areas; it is developing its own programs
in counter-terrorism and infrastructure pro-
tection. But much can be said for improving
our international cooperation so that we share
the benefits of our knowledge and technology
and reduce the costs of protecting our societies
against the threats of catastrophic terrorism and
proliferation. At present, the international coop-
eration among Trilateral countries is inadequate.
It is based either on a sequence of bilateral rela-
tionships or on multilateral mechanisms that
were designed for other purposes and are much
too small to address this very big job.
* * *

Let me conclude with the following observations.
First, the threats of catastrophic terrorism and
proliferation are real. Second, there is much that
needs to be done to reduce the risks and improve
our defenses against terrorism. Third, there is a
major imperative for improving cooperation
among the Trilateral countries in this fight.

John M. Deutch is Institute Professor of
Chemistry at the Massachusetts Institute of
Technology, former Director of the U.S. Central
Intelligence Agency, and former U.S. Deputy
Secretary of Defense.
Conflict Resolution Mechanisms Do Not Match Today's Conflicts

When I was asked to be part of this panel on security issues I must say I was a little bit hesitant. I don't think any High Commissioner for Refugees has ever addressed this issue. My work with refugees offers a rather interesting perspective on the issue of security because refugees are symptoms of insecurity—sometimes one of its factors, but always its victims. They flee human insecurity and can destabilize the environment, local autonomy, and ethnic balances, as in Rwanda and Zaire. But, of course, they are the victims and my work is to help the victims.

In the kind of conflicts that we face today, conflict resolution mechanisms (and the military measures to back them up) don't match conflicts. Interstate conflicts are rare. The wars of today are usually of an internal nature, often involving ethnic motives or sometimes scarce resources. They are not fought among soldiers, but among civilians, and so civilian victim rates are very high. It is more difficult to convince warring factions to abide by humanitarian law and humanitarian principles. This kind of conflict very seldom leads to clear peace agreements. Dayton might be an exception, but even there it is not conclusive.

Kosovo

What we are facing in Kosovo is a very clear example of the kind of conflict that existing mechanisms cannot address. This situation exposes humanitarian agencies to situations that they cannot resolve, but which they are left to deal with. Yesterday, Count Lambsdorff said that humanitarian action is always necessary to solve these conflict situations. This is very true. My unarmed civilian colleagues have to be exposed to dangerous conflict situations, and there is nobody else to come in. In Kosovo, as in Bosnia, there was no ready-made conflict resolution mechanism. For the first time, the OSCE was called upon to mobilize security forces, a Contact Group established during the Bosnian war handled political negotiations, the UN Security Council was given a kind of authorization role, UN peacekeeping was not brought in, and the UN role was largely humanitarian.

At least the Kosovo situation attracts a lot of attention because the Balkans are very much a European strategic area. During the course of the summer and fall of last year there were about two hundred thousand people displaced within Kosovo; about fifty thousand of them were out in the woods. We knew that the Balkan winter was coming and that they could not be left alone. So there was a lot of interest in avoiding a humanitarian catastrophe. That is exactly what Dick Holbrooke was able to do in negotiations with Milosevic, but there was no political solution. I went there too and said, "We'll have to do something to bring these people back." A civilian mission was deployed in Kosovo that included over a thousand people from OSCE countries, but no military ground forces. We hoped this mechanism would work and, in fact, many people went back. But Christmas time, there was nobody out in the open.

But low-intensity conflict continued and in January or February fighting started again requiring a very serious response by NATO and OSCE. A political solution may now be in the offing, but it is not conclusive. I would say there are three possible scenarios:

- **Best scenario.** A peace agreement will be adopted and NATO ground forces will go in quickly.
- **Next best scenario.** NATO will bomb and then a ground force will be deployed. On a humanitarian basis, I would be very much concerned by a period of bombing and the deployment of ground forces.
• But the worst scenario is that nothing happens. Political negotiations will drag on and the fighting will continue. My colleagues will try to carry on, but KVM [Kosovo Verification Mission] might be withdrawn.

I think there is a chance for any of the three.

The mechanisms that were set up—the OSCE Kosovo Verification Mission, the possibility of NATO bombing and the deployment of ground forces—are all new types of mechanisms. They are being improvised. Despite all the attention that Kosovo is receiving there are no ready-made mechanisms, no ready-made security forces.

Africa
The state of affairs is even worse in Africa. The OAU (Organization of African Unity) has a conflict resolution mechanism in West Africa, but it is not very effective. The Sierra Leone situation is very bad. Four hundred and fifty thousand people from Sierra Leone are in neighboring countries, mostly Guinea and Liberia. There is a sub-regional force—ECOMOG, mostly Nigerian—that has maintained some peace. However, the new Nigerian government has in the course of the election campaign said that they want to withdraw the Nigerian forces because of the very heavy economic burden. If that happens, the region will go back to war. When you look into Central Africa there is nothing—no conflict resolution mechanisms, no peacekeeping forces. The war and the refugee outflow from Rwanda to Tanzania and Zaire—almost two million—are the result of that lack of conflict resolution mechanisms in Central Africa. Eight or nine countries are now involved in the internal wars of the Democratic Republic of Congo. I don't think there has ever been a regional conflict this large. The presence of defeated armies, flows of small arms, and conflicting economic interests in mineral resources all complicate the situation, but there are no conflict resolution mechanisms nor the necessary political will to create them.

Usable Instruments to Deal with Human Insecurity
We have a desperate need for better conflict resolution mechanisms in the world as well as effective forces that would back up conflict resolution. Every conflict has to be in the end solved politically unless you are going to go through all-out war, which I cannot advocate. Carl Bildt said yesterday that in ethnic conflicts what you need is not so much high-precision military equipment, but maybe crowd-control measures. Maybe a little bit more than crowd control is needed, I think; a military presence is also very important. But there is a mismatch between Tomahawk missiles and the need to settle ethnic conflicts.

We have tried to work something out between the United Nations Peacekeeping Department and ourselves. We developed a “ladder of options” for security, especially in conflicts related to humanitarian operations. The “soft” option would be to strengthen the local judiciary and local police capacity, etc. In some of the refugee camps, in fact, my office has given equipment and training to local police so that they can keep law and order in the camps as well as in neighboring areas. These soft options should be examined. The “medium” option would be sub-regional or regional peacekeeping operations, like ECOMOG. In fact, there are initiatives from the United States, Britain, and France to train African peacekeepers. I think this should be very much supported. The “hard” option, traditional international peacekeeping forces, may be necessary, but I think the chances to use these forces are getting smaller.

So, on paper we have a range of options, but I would like to see them realized and usable. These measures would address, at least a little, the total lack of mechanisms and instruments to deal with human insecurity. I think it is a tall order to talk about human security as a global goal. I like that idea, but there is a long way to go before that. If we could contain human insecurity with a little more structured approaches, and with big countries and leaders who are in the position to do something about it, I think
We have to do something that deals with internal wars that exist today rather than big interstate wars.

we may go a long way. But for this to work, we need much more cooperation at the global, regional, and national levels. We have to do something that deals with internal wars that exist today rather than big interstate wars. There has to be much greater attention given to these “unwinnable” wars. This is the kind of war and security issues that should be examined.

Containing or lessening human insecurity and establishing human security on a wide scale requires the kind of comprehensive approach that Minister Scharping described, including development assistance and an emphasis on human and democratic values. I welcome this very much. But there is a gap. Most development assistance systems today do not deal with immediate post-conflict situations. Aid donors wait until the governments become more stabilized for their own development efforts to be more certain to yield results. But the post-conflict situation can easily go back to a conflict situation unless much greater inputs and measures are taken. Not only should economic development be supported, but the judicial system has to be strengthened and human rights commissions set up. We have to help people govern themselves. Post-conflict programs are something to which I would like you to pay attention because they may be the best conflict prevention measures.

Sadako Ogata is the United Nations High Commissioner for Refugees. These remarks were made on March 14, before the Kosovo negotiations collapsed and NATO bombing began.

Section 5
U.S. Perspectives

From the Clinton Administration, Larry Summers and Thomas Pickering spoke to the Trilateral Washington meeting. Lee Hamilton and Chuck Hagel led the session on “Congress and U.S. International Leadership.”

Thomas Pickering

U.S. Policies: Iraq, China, and Russia

The United States faces a wide variety of problems in a complex, fast-paced and increasingly interconnected world. We have lost the luxury of dealing with problems in a leisurely way or in isolation or being able to apply a single overall framework such as we had during the Cold War. Relations between nations may thus appear and probably are more chaotic. But there are certainties. One is that the United States must continue to play a leadership role. We know this and we are running our policy from principles and against a set of benchmarks. We do so in concert with others, but clearly based on the paramountcy of our own interests.

This morning, I would like to look at our policies in relation to three areas. Iraq, China, and Russia.

Iraq

The Iraq and Kosovo issues are similar in several ways. It is not size, influence, or global reach that merits U.S. attention—as in China and Russia—but the potential to destabilize regions of great importance to U.S. interests. The two areas are also not dissimilar in the nature of their leadership even if strategies for resolving the problems are different in each country. An irony in the otherwise welcome end of the Cold War is that people like
Milosevic and Saddam Hussein feel that constraints on aggression are lower and that aggression at home and abroad can pay off. Instead of joining the ever-growing community of responsible countries, they taunt it. They break the norms of acceptable behavior, use force against their own people and others, and then challenge the rest of us to stop them. The silent fact of our unity and power has proven to be an insufficient deterrent.

This poses a problem for all of us because it means that in order to pursue our interests, we have had to ratchet up more quickly from traditional diplomacy to diplomacy backed by a credible threat of force or the actual use of force. For a threat of force to be effective, it must be credible. It must be clear that the U.S. and its partners are willing to use force in these kinds of specific cases to achieve key objectives should diplomacy fail.

The Iraqi regime poses one of the most complex challenges the international community faces. Saddam has repeatedly used force against his neighbors, developed weapons of mass destruction, and used those weapons on Iraqi citizens and neighbors. Since Desert Storm, the regime has consistently refused to meet its commitments to disarm and to accept long-term monitoring of that proven weapons capability.

Our policy, therefore, has clear and consistent objectives. We are committed to containing the threat the regime poses. Politically, we have led the international community's efforts to constrain the regime and prevent it from acquiring the financial means to rearm. At the same time, we seek to ease the burden of sanctions on the people of Iraq, by ensuring that their humanitarian needs are met. Militarily, we maintain the threat of force and we have demonstrated the willingness to use it.

After eight years of leading the international community in this effort to bring Iraq into compliance with international norms—years in which the regime has repeatedly demonstrated its desire to circumvent the demands of the international community—we doubt that compliance by this regime is possible.

The Iraqi people and nation deserve to resume their rightful place in the region, but that is not possible under this regime. We are therefore committed to work for change with Iraqis inside and outside Iraq who share this goal and who want to work for a better future for Iraq—a different regime without Saddam—an Iraq in compliance with international obligations, at peace with its neighbors, respecting the rights of its citizens, and maintaining its territorial integrity.

Radio Free Iraq, an independent station, is now operational and is heard inside Iraq. In early February, the President formally designated seven opposition groups as eligible to receive assistance under the Iraq Liberation Act. We will consider how we can help them more effectively oppose Saddam's rule and help Iraqis to achieve the kind of government they deserve and desire. But let's be clear, change will have to come from working with Iraqis for however long it takes; it can neither be instant nor imposed. In the meantime continued containment must be maintained.

Last winter, after months of international diplomatic effort in which we employed the threat of force to achieve some degree of Iraqi cooperation, it became clear that Iraq was no longer prepared to work with the UNSCOM inspectors and the system of disarmament and monitoring. The U.S. and our friends and allies decided that it was necessary to move from the threat of force to the use of force.

Operation "Desert Fox" accomplished its goal of degrading Saddam's capacity to develop and deliver weapons of mass destruction and his ability to threaten his neighbors. It

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It must be clear that the U.S. and its partners are willing to use force...to achieve key objectives should diplomacy fail.

Lawrence Summers

Larry Summers, then U.S. Deputy Secretary of the Treasury, spoke informally at the Trilateral Commission meeting at lunch on March 13. In May, President Clinton chose Mr. Summers to succeed Robert Rubin as Secretary of the Treasury.

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also appears that the regime has been thrown off balance, as indicated by:

- Saddam's January Army Day speech calling for the overthrow of Arab governments;
- the walk-out by his Foreign Minister from the January Arab League meeting;
- repeated allusions by Iraqi officials to the illegitimacy of the Kuwait border;
- continued and increased Iraqi repression of the internal opposition.

Perhaps just as important, Saddam has not achieved what he announced as his chief goal for 1998: the lifting of sanctions and restoration of his control over Iraq's billions of dollars in oil revenue. Instead, his defiance of the international community has indefinitely prolonged sanctions.

While pursuing containment we are working in the UN Security Council to build council unity around an effort to reestablish an effective disarmament and monitoring presence. Three assessment panels are reviewing the disarmament and monitoring issues, humanitarian issues, and the "Kuwait" basket of issues. In mid-April, the panels will report on the current state of affairs and present ideas about further action. But it will be up to the Security Council to decide on next steps and the Security Council is bound by the consensus formed over the past eight years and more than 40 resolutions. Reestablishing the work of UNSCOM—an effective and necessary apparatus for disarmament and long-term monitoring—would be an important forward step.

While insisting that sanctions remain in place, we remain mindful of the needs of the Iraqi people. We have led the international community to meet those urgent needs. Recently, we have offered proposals at the UN that would increase Iraq's oil export levels to increase the revenue controlled by the UN devoted to meeting the needs of the Iraqi people. We have also offered ideas about streamlining the process. But I must make clear that the responsibility for the humanitarian situation rests with Iraq, which has been slow to order commodities and, as noted in a recent UN publication, has often chosen to warehouse medicine and other supplies rather than distribute them to the citizens of Iraq.

At the same time, we maintain a readiness to use force if Iraq reconstitutes its WMD (weapons of mass destruction), threatens its neighbors, or moves against the people of northern Iraq. And, as the President has said, we will also continue to enforce the No-Fly zones established in accordance with UN Security Council Resolutions to protect the civilian population of northern and southern Iraq from the worst depredations of the Baghdad regime.

Since Desert Fox, Saddam has chosen to challenge the No-Fly zones on an almost daily basis. He has announced a bounty for the capture of our pilots who face a sustained and intense threat from surface-to-air-missiles, anti-aircraft artillery, and radar tracking. We have responded by striking in turn at the integrated air defense systems in the No-Fly zones. Thus, the net effect of Saddam's challenges has been to degrade his weapons capability further.

Our task is complex and will require continued focus and commitment of purpose. In the end, the results of our efforts will be enhanced security for the region, with an Iraq that can be reintegrated into the international community.

**China and Russia**

I would like now to consider U.S. relations with China and Russia, two countries whose current actions and future direction have global effect. Our relationship with each is unique, but a consistent approach is the need for serious engagement over a long period of time. A snapshot taken at any given moment might seem to reveal something more akin to "frustrating engagement" than "constructive engagement." Yet snap shots do not adequately record a relationship over time nor do they reveal what could have gone wrong had we not been engaged. Engagement with both countries is essential to U.S. interests given the role, position, and potential of these states now and into the next century.
China. Few relationships touch as many interests important to Americans as our relationship with China. What China's leaders do, what its people achieve, the kind of nation it becomes, will be vital to the U.S. and our friends and allies in the years ahead.

In terms of our most basic interest, security for our people, China is a prominent factor. North Korea is probably the hottest potential flash-point on my map of the world. We rely on China, through the Four-Party Talks and in more informal ways, to exert positive influence on their neighbors, the North Koreans. While they don't like to take a high public profile, the fact is the Chinese have helped and are continuing to help. They can also help keep South Asia from taking further bad steps down the nuclear road after last year's dangerous tests. More broadly, over time China has itself become a much more responsible actor as regards controlling the transfer of technologies for weapons of mass destruction. It has ratified the Chemical Weapons Convention, joined the Zangger Committee that monitors nuclear-related exports, signed the Comprehensive Test Ban Treaty, and begun to observe the MTCR (Missile Technology Control Regime). It has also terminated assistance to unsafeguarded nuclear facilities, ended nuclear cooperation with Iran, stopped export of anti-ship cruise missiles to Iran, and strengthened controls over chemical-weapons-related materials.

But, we are mindful of the Chinese drive to modernize its military, including its strategic nuclear forces and its ballistic missiles. Since 1989 we have maintained strict controls over U.S. military and security-related technology transfers to China. This has been the case even as commercial dealings—including hi-tech trade in information technology and other items—has burgeoned between the U.S. and China, to the benefit of China's general technological development and of American companies' export-driven growth. By and large our controls on sensitive dual-use technologies have been effective.

We have no illusions about and are not naive concerning China. There clearly have been problem cases outside the export licensing system. China seeks to acquire sensitive information and technology for military uses by many means, some legal, some not. That is why we have established strong measures to protect classified information and prevent acquisition of sensitive technology. We prosecute those who violate our laws.

The Department of Justice continues its investigation into potential illegal transfer of ballistic missile technical information to China by U.S. satellite companies. The Department of Energy has tightened security measures at National Laboratories involved in nuclear weapons and other military research, following discovery of a potentially serious breach of security in the late 1980s involving a research scientist's interactions with the Chinese. These cases, however, do not mean the broader U.S. engagement strategy is not in our interest or wrong. Our policy has clearly led to general improvement in Chinese behavior on proliferation issues, and we must continue to engage to realize our outstanding non-proliferation goals, including MTCR adherence, a fissile material production moratorium, and FMCT.

China's security interests and sovereignty claims, as it defines them in the South China Sea, also impact on the peace and stability of Asia. Peaceful resolution of competing claims depends on dialogue, and in this, the Association of Southeast Asian Nations (ASEAN) and the ASEAN Regional Forum (ARF) are central. Peaceful resolution of the cross-strait issue remains a top policy priority. Only three years ago, China conducted major military exercises on the coast opposite Taiwan and launched unarmed test missiles that landed in splash zones bracketing Taiwan's two main ports. In response, the United States sent two carrier task forces to the seas near Taiwan to demonstrate our commitment to the principle of peaceful resolution of this issue. This experience made us all think hard about the kind of relationship we need with China, the kind of dialogue we

What China's leaders do, what its people achieve, the kind of nation it becomes, will be vital to the U.S. and our friends and allies in the years ahead.
would like to see across the Taiwan Strait, and the kind of security framework the Chinese will
fit into in the next century. We are engaging
with China with a firm goal of shaping a more
secure and stable future. It is good to see rep-
resentatives of the mainland and Taiwan taking
and planning trips across the Strait rather than
engaging in provocative military exercises.

Two Presidential Summits in two years both
symbolized and advanced the cause of the U.S.
and China working towards a constructive
strategic partnership in the 21st century. The
official visit next month of Premier Zhu Rongji
will be an important step in this process. We
will continue to pursue our engagement strat-

ey. We are not blind to the ugly defects of
the Chinese system and some of its govern-
ment's actions. We are not deaf to critics of
engagement. The Administration has its own
strongly-held priorities in our dealings with
China, including a belief that we can and must
counter the Chinese frankly and directly on
their human rights policies and practices.
Secretary Albright pledged to "tell it like it is"
when it comes to China's human rights record,
and she and the President have done just that,
often to Chinese dismay.

We believe China, in order to thrive in the
next century, should adopt internationally
accepted norms in its dealings with the rest of
the world: in trade, through an accession on
commercially-meaningful terms to the World
Trade Organization; in non-proliferation, by
taking the necessary steps in its export con-

trol system to gain membership in the Missile
Technology Control Regime and other mecha-
nisms; and in human rights, through ratifi-
cation and implementation of the International
Covenant on Civil and Political Rights. Our
engagement strategy is designed to assist China
to make the right choices.

As President Clinton put it in his February
26 San Francisco speech: "The question China
faces is how best to assure its stability and progress.
Will it choose openness and engagement? Or
will it choose to limit the aspirations of its peo-
ple without fully embracing the global rules of
the road? In my judgment, only the first path
can really answer the challenges China faces."

WTO accession talks have been the cen-
terpiece of our efforts to open China's market.
Talks continue as we speak. I assure you we
won't accept a deal that doesn't meet the U.S.
business community's needs. If we get such a
deal, we expect strong support from business
to push Congress to approve permanent Normal
Trading Relations (NTR) status for China so we
can reap the benefits of over 12 years of
on-again, off-again tough negotiations.

More broadly, we hope groups in the U.S.
who recognize the benefits of engagement with
China will help bring balance back to discus-
sions on China policy. We must continue to speak
frankly about our disagreements with China, but
must also continue to expand cooperation in
areas where we agree. We will need to work
together in order to accomplish our goals.

Russia. A few words now about Russia. The
United States desires a prosperous Russia at
peace with its neighbors and integrated into
the world community. Russia is at the top
of the U.S. foreign policy agenda as it faces per-
haps its most challenging period since 1991.
At the same time in which it deals with the
political legacy of communism, it also faces a
shrinking economy and problems in control-
ling the flow of funds, weapons, and technol-
ogy across its borders. Recently, President
Clinton said, "we have as much of a stake today
in Russia overcoming these challenges as we
did in checking its expansion during the Cold
War. Now is not a time for complacency or
self-fulfilling prophecies."

The U.S. wants to—must—engage with
Russia on issues of common concern. We should
not forget that Russia is freer now—with bet-
ter constitutional foundations—than at any
time in its history. Our hope is that Russia will
continue to extend its freedoms and the rule
of law, because this is the way to increased
prosperity. When Secretary Albright visited
Russia in January, she went with the message
that the U.S. is committed to fostering a demo-

THE TRILATERAL COMMISSION
ocratic, market-oriented Russia.

Russia will need to work hard to protect its hard-won gains and to address looming dangers—whether nationalist extremism or anti-Semitism. Those that would encroach on Russia's freedom of the press for short-term gain threaten Russia's future. The next year and one half will be critical. One of the achievements of the last eight years has been Russia's adherence to free elections. Russia will undertake parliamentary elections in December and then presidential elections next June. Free and fair contests in December and June will go a long way to solidifying Russia's democratic gains.

Russia is experiencing particular stress as it goes through the transformation to a market economy. We support Russia in that effort and we want to see Russia succeed. In fact, Russia's success is as much a strategic goal of the U.S. as it should be for Russia. Our policy is to remain engaged and give concrete encouragement in the right direction through incentives and advice. However, in the end, the decisions are Russia's to make and we cannot be more in favor of, or energetic towards, Russia's success than Russia's leaders themselves, even though we have a huge stake in how things turn out.

The U.S. and the world community remain very concerned about the economic situation in Russia. All significant economic indicators point to the deterioration of the Russian economy since the government's decision on August 17 to devalue the ruble and default on government debt. Output has fallen. GDP was down about 5 percent last year, and the IMF projects a further 7 percent decline in 1999. Prices rose by over 11 percent in December, although inflation slowed to 8 percent in January and 4.1 percent in February. The ruble has dropped by about 73 percent since August. Imports plummeted by 40-50 percent from mid-August through November compared to the previous year. Exports are down slightly due to low oil prices. The banking system has fallen largely into insolvency. Russia has missed payments on domestic debt and foreign debt to the Paris and London clubs. For the average Russian, the current crisis has sharply increased the cost of living and unemployment, eroded confidence in the banks, and meant growing wage arrearages.

To the government's credit, it has so far avoided the temptation to solve its problems through inflationary monetary emissions. It has pushed important legislation on Oil Production Sharing Agreements and bankruptcy through the Duma. However, the 1999 budget passed by the Duma appears to be based on unrealistic assumptions about revenues, expenditures, inflation and exchange rates. It is clear that Russia's economic problems need economic solutions that actually work. In the short run, the most important thing we can "do" for Russia is to insist that a sustainable budget and workable program with the Fund are necessary or international support would be wasted. The IMF cannot agree to fund a program which cannot promise performance. As Secretary Albright has said, the arithmetic must add up. The fund cannot accept fixes on faith.

Certainly, foreign investment can step in to fill the gap between Russia's needs and its own resources, but that too requires Russian reform. Russia has brought in only a fraction of the investment its tremendous natural wealth and the talent of its people would suggest it is capable of attracting. Undertaking broad measures to improve the investment climate, such as tax and banking reform, securing real property titles, and development of modern commercial law and regulatory structures, is critically important. Without such reform investment will remain stunted in the future. Extreme nationalism is especially misguided when it stands in the way of the people's prosperity.

In the realm of foreign policy, we have a number of high-profile and important issues on the agenda. Secretary Albright is in almost daily contact with Foreign Minister Ivanov on the Balkans, Iraq, and other issues. Vice President Gore will discuss these and many other important issues next week with Russian Prime Minister Primakov in Washington. Deputy Secretary of State Strobe Talbott was in Russia
late last month discussing with Russian colleagues how to move from acknowledgement of the non-proliferation problem to significantly more effective enforcement mechanisms. He also talked with Russian colleagues about how to move our important arms control agenda forward—how to get START II ratified by the Russian Duma which would lead to negotiations on a START III agreement. We are also discussing National Missile Defense with the Russians and assuring them that our concern is directed at the threat from rogue states, not at Russia’s strategic deterrent.

On Iran and proliferation of weapons of mass destruction, we have made some progress through intensive dialogue, but there is much more to be done. Despite the Russian government’s nonproliferation and export control efforts, Russian entities continue to cooperate with Iran’s ballistic missile program, and to engage in dangerous nuclear cooperation with Iran. During the past year, we have imposed penalties on ten Russian entities and we will continue to take such action when it is warranted. We put high priority on ending such dangerous practices in Russia.

In addition, we are continuing our long-standing, broad, and intensive efforts to impede proliferation by working with Russia to bolster its export control and enforcement capabilities. We have an almost continuous shuttle of experts working on these issues with their Russian counterparts. We all recognize the need to continue to work to strengthen our relationship with Russia. Although we built a strong foundation over the last eight years, we cannot afford—not do we wish—to slacken efforts just because the Russians may differ with us or because the problems sometimes seem too difficult.

Our intensive engagement is aimed at helping Russia’s reform, working with Russia on today’s foreign policy challenges where our interests are in common, and continuing to build a partnership for the future.

* * *

I have discussed three countries, three challenges, three places where our deep engagement is necessary in the present tense, to deal with today’s problems, and even more important for building a future that is better for Americans, and for all who place their faith in cooperation among nations. The depth and richness of our agenda in these three areas is complemented all around the globe by other challenges which must be met with determination, vision, and persistence.

Thomas R. Pickering is U.S. Under Secretary of State for Political Affairs.
Congress and U.S. Foreign Policy

I want to share with you a few thoughts about the Congress and American foreign policy. I should begin, of course, with my own bias. I believe that the Congress should have and does have a constitutional responsibility to play a central role in the formulation and development, but not the implementation, of American foreign policy. I believe that a partnership between the president and the Congress that is characterized by a creative tension produces a foreign policy that better reflects the American national interests and the values of the American people. I do not favor unrestricted foreign policy powers in a president. Senator Fulbright said some years ago that such powers were neither necessary nor tolerable in a free society. I have heard too often presidents make the argument, "Give me unchecked power to make and conduct American foreign policy." Or, in other words, "Trust me." I reject that approach.

Now, this view of mine that the Congress and the president have a shared responsibility in the formulation of policy requires that the Congress is able to act competently and effectively. I must say that the Congress’ performance over a period of some years gives me pause on that point. It is obvious to all of us that the international agenda is so formidable today that it requires the sustained involvement and the best thinking of people in the executive and the legislative branches.

I find Congress often acting erratically in foreign policy. It is often engaged primarily for political reasons, displaying little sophistication about very complex and difficult problems.

Sometimes Congress Goes Too Far, Sometimes Not Far Enough

Sometimes I think the Congress goes too far, acting unilaterally; sometimes I think it doesn’t go far enough. Let me begin with those instances when I think the Congress goes too far.

Congress goes too far in its unilateral approach to U.S. foreign policy. There are a number of examples. I’ll not go into a lot of detail on these examples because this is a very sophisticated audience. The Helms-Burton law, with its extraterritorial sanctions, punishes business entities in other countries that are daring to differ with American foreign policy. That law has created huge problems with our friends and our allies and has not accomplished, as far as I can see, very much. We recently celebrated the entry of three more countries into NATO. If you look back on that, Congress insisted that only these three specified countries be included in this round of NATO enlargement. We are unwilling to pay our UN dues on time and in full. We dictate the reform measures that we want the Secretary-General of the United Nations to bring about; we don’t negotiate them. We delayed paying our share of the IMF quota increase for almost two years. Congress often complains about international institutions, and I think a lot of those complaints have considerable merit. But it wants to impose unilateral solutions rather than negotiate reforms.

These unilateral demands often have a high price. What an extraordinary rebuke and spectacle it is for the United States, which pays roughly 25 percent of the UN bill, to be excluded from the UN’s key budget committee. If I understand correctly, if the United States does not pay much more of its arrearages this year, we will lose our vote in the General Assembly.

Congress does not like to be reminded that the U.S. has to work with its allies in order to carry out its policies. You can go down a long list of foreign policy problems—the Middle East, Haiti, North Korea, Bosnia, Iran, Iraq, terrorism, drugs, nuclear proliferation—and you can see that we depend heavily on allies for support to help us reach a satisfactory conclusion.

We like to call ourselves the indispensable nation. That phrase has always bothered me a great deal because there is a touch of arrogance
to it and, of course, it infuriates many of our friends. But the fact is that many important goals that we have in the United States remain out of reach unless we work with friends and allies.

I think the Congress often goes too far and makes judgements that are politically driven. In the final hours of the first session of the 105th Congress, the House of Representatives passed nine anti-China bills, which expressed displeasure with China's policies on everything from human rights to nonproliferation. There were no hearings on any of the bills. The administration was not consulted about the impact they could have on U.S.-China relations. From my point of view at least, those bills were politically driven.

With regard to the Chemical Weapons Convention, we needed legislation to bring the United States into compliance with the convention. The Senate of the United States passed it unanimously. The House refused even to consider it. It attached the CWC implementing legislation to another bill and tried to force the president either to accept that flawed bill, or to veto the implementing legislation.

Congress, quite unwisely I think, loves linkage. Rather than considering issues on their individual merits, the Congress links them together. We link UN funding to the abortion issue. We link the Russia–Iran sanctions bill to the CWC implementing legislation. The principal issues in American foreign policy are tough enough without trying to link several of them together. When you link them to another divisive issue, you make it almost impossible to solve them.

Now, my second major concern with the Congress and the way it approaches foreign policy is that it often does not go far enough. We often exercise our constitutional obligations timidly. The clearest case of Congressional timidity in exercising its constitutional responsibility is its failure to authorize the use of force. In almost every case over the last 15 years save for the Gulf War, Congress has failed to grant prior authority, or subsequent authority, for intervention. The list is long: Grenada, Panama, Somalia, Haiti, Bosnia, and earlier this year, Iraq. Congress has refused to take a stand. Often, it doesn't even debate it. Instead, it leaves it to the president to make the most difficult decision that any government can make, which is whether or not to intervene militarily.

Take a look at Somalia. We had 25,000 American forces there at its peak, often engaged in combat, and the Congress never authorized or approved it. Or, take Bosnia. U.S. troops have now been deployed in Bosnia for better than three years, 20,000 men and women at the peak. Not once in that time has the Congress exercised its constitutional responsibility to authorize the deployment. The House did not authorize action in Kosovo, it merely expressed a non-binding opinion.

Congress also expresses its timidity by passing the buck. For example, Congress loves unilateral sanctions. From nuclear testing to terrorism to religious persecution, it wants to address virtually every foreign policy problem with a unilateral sanction. Unilateral sanctions allow the Congress to moralize and to posture, but they seldom have much of an impact. The president is left to make the hard decisions on the use of any waiver in the legislation and on when and whether to impose sanctions. Congress punts.

Congress also takes a stand on foreign policy issues and tries to solve them on the cheap, or we try to have it both ways. We want to be the country of leadership in the world, but we cut dramatically the 150 Budget Account, and we've done that over the last 10 years. We have done this to the point now that it is difficult for one embassy to communicate with another or with Washington immediately because their technology is so outdated. We favor NATO expansion, but we ultimately approved it only after the president assured us that it wouldn't cost us much. We support the Dayton Accords, but we do not want to take the risk or pay the high cost of implementation. We complain about the refugee flows from Haiti, but we refuse to provide the resources, human or financial, to stabilize the country. This kind of pos-
turing weakens U.S. foreign policy.

Another way in which the Congress fails to take responsibility in foreign policy is by criticizing the president’s policy without offering any alternatives. We passed a resolution last summer in the House of Representatives that detailed all of the grievances we have against Saddam Hussein. In the end, the resolution says the president should take “appropriate action.” We failed to spell out anything, not a single thing, that the president should do to deal with Iraq. So, for too many members, foreign policy has become just another battleground for political advantage over the president. They see foreign policy today as an extension of the open conflict that characterizes much of American domestic policy. They see no difference between criticizing the president’s policy on health care and education, for example, and criticizing his policy on Iraq. They do not see the Congress as a partner with the president in developing American foreign policy. They miss any sense that Congress has a responsibility under the Constitution to help make good policy. Don’t misunderstand me. The president needs criticism. I have done it myself scores of times without reference to the political party of the president, but I am troubled by the failure of the Congress to offer alternatives and to criticize constructively.

Presidents Should Consult More

Now let me mention the role of the president because I have been pretty tough on the Congress. On almost every problem I have mentioned the president must bear some of the responsibility. If a president consulted appropriately, many of the problems I have suggested could have been avoided. I have served with seven presidents of the United States and not a single one of them has consulted enough with the Congress on important questions of American foreign policy. The result is that every president has experienced deep trouble or failure at some point from an inability to convince Congress of the merits of his policies.

I have a suggestion for dealing with this problem. In 1993, I joined several other members of the House in introducing a bill to create a standing consultative committee or group made up of key members of Congress to meet regularly, maybe once a month, with the president or his senior advisers to discuss the full range of foreign policy issues. Every single president with whom I’ve discussed that proposal likes the idea, gives me a pat on the back, nods his head affirmatively—and nothing happens. While every administration seems to like the idea, none of them has shown sufficient interest in implementing it, and I really do not know why.

A president, of course, has the responsibility to articulate policy. More than one failure in American foreign policy has occurred because the policy was neither clearly articulated nor well understood. The president has the obligation to educate the American people about the world in which we live and show them the connections between their lives and events around the world and speak with great clarity about the demands on American leadership in the world. Presidents are often unwilling to take on the burden of articulating policy and educating and guiding public opinion, but this is the essential task of leadership.

The Attitudes of the American Public

Let me say a word about the mood in the United States today. The trend in U.S. foreign policy in the post-Cold War period, as I have suggested, is away from international engagement. It is reflected in many of the things I have already mentioned—the reduction of spending on international diplomacy and foreign aid, and resistance to paying arrearages or to contribute to UN peacekeeping operations. Those of you who are in my generation grew up with the idea, at least the Americans, that the American role in the world was a given, and that America would try to shape the world of which it was a part. Many younger politicians in the Congress today across the political spectrum are more questioning of our role. They do not take a dominant role by America

...I AM TROUBLED BY THE FAILURE OF THE CONGRESS TO OFFER ALTERNATIVES AND TO CRITICIZE CONSTRUCTIVELY.
as a given. They have to be persuaded.

I think the public mood would tend to agree with those younger politicians more than it would with me. The public no longer supports the U.S. taking on a disproportionate share of the world’s problems and it shies away from a dominant role. At the same time, the American public is willing to take on a fair share of international responsibility. I am impressed that there continues to be a very deep moral element to public opinion. Americans really do want the United States to do the right thing. They want to be proud of our role and our national self-image.

There is a gap, however, between the dominant perceptions of public attitudes held by policy practitioners, especially members of Congress, and the attitudes held by the American people. Surveys indicate, over and over again, that Americans are not isolationists, anti-UN, anti-UN peacekeeping, or anti-foreign aid. But many policymakers tend to believe that they are. What is so striking today is that a gap remains between the policymakers’ perceptions and public opinion on the breadth of support for international engagement. Reducing this gap is a prerequisite for a successful policy and for giving policymakers more confidence by ensuring that there is public support for American international engagement.

* * *

I conclude with this: The Congress, at its best, has a lot to contribute to foreign policy. The president is isolated in our system of government. Unlike the British prime minister, he rarely faces his critics face to face. George Reedy, a former press secretary of one of our presidents once said, “No one ever tells the president to go soak his head.” I have seen this phenomenon of deference to the president a hundred times or more and, in my view, it is usually unhealthy. Members of Congress can offer the president unfiltered, independent advice. He can not get that from his own appointees. He may not always take the advice of Congress, but that advice is invaluable to him. When the president does take it into consideration, I think a better policy emerges.

In short, Congress needs to step up to its constitutional obligations and take a full share of responsibility for the formulation of American foreign policy. Our policy works best when the president and the Congress both measure up to their constitutional responsibilities and work together.

Lee H. Hamilton is the Director of the Woodrow Wilson International Center for Scholars and a former Member of the United States House of Representatives. The above remarks were originally given in a different form in November 1998 at the Center for Strategic and International Studies in Washington, D.C.
CHUCK HAGEL

Connecting Foreign Policy: Relevance, Challenge, and the Need for Leadership

I'd like to address the framework in which the Congress of the United States is now working, the future for the Congress and the President in foreign policy, and how it all must connect.

Let me begin by this observation which you all understand very well: Policies must be relevant to the challenges. It has always been my belief that we fail in our policies when we do not connect the policy to the relevant issue. One of the reasons that there is no constituency in foreign policy across America is that we have never really connected foreign policy with the average American.

What is foreign policy? Is it some esoteric, theoretical, Metternich-Kissingeresque kind of thing hanging there? No, foreign policy is relevant. Foreign policy includes trade, exports, our role in the world, our engagement with the world, and national security. It connects to every dynamic of our society. An hour before Madeleine Albright's confirmation hearings before the Senate Foreign Relations Committee in January of 1997, I said to her, "Madame Ambassador, I would ask you one thing. As you embark on your new journey and this new grand adventure as Secretary of State, make foreign policy relevant to America. Help educate America as to why this is important. Work with the Congress and connect foreign policy to all Americans." And I think Secretary Albright has had some successes with that.

The Congress has an immense amount of responsibility for foreign policy. And I would say that, as we go into this next presidential election year, international affairs will very much dominate the national debate. I don't believe we have seen a presidential election in this country since 1980 that has really focused on America's role in the world, international issues, and national defense. And things have certainly gotten more complicated since 1980. (I hope, like all of you, that the United States does not find itself in the same situation in which we found ourselves in 1980. I don't believe we will.) The point is this: No longer is there a domestic policy on this side and an international policy on that side; no longer can we govern and legislate in a vacuum; no longer can we take national defense and put it here, foreign policy there, trade policy here, tax policy there and not connect them. We need and do not yet have an overarching policy that connects them all.

The lack of an overarching policy is not all the fault of the President or the Congress. We're living during a unique, dynamic time in the history of man. But so did Harry Truman. Think back to the decisions he had to make with no blueprint, no road map, nobody to say, "Well, we did this 50 years ago, so you should try this"; think of those momentous decisions—critical decisions—that shaped the world for the better. Go right across the board and what Harry Truman had to deal with was rather significant. I think we are much in the same position today, as we will be over the next few years, with a rather grand opportunity to help shape this world for the better. There is more opportunity and more hope, and, yes, there is also more uncertainty and more danger.

We are still trying to come to grips with developing a consistent, clear, coherent policy on how we deal with the world since the implosion of the Soviet Union. We're not there yet. That is why I believe, one, much of the presidential debate will revolve around international issues in some way; two, the next President is going to be faced with immense international challenges; and three, it will be incumbent upon the new administration that's elected next year

and the Congress to work together in developing that comprehensive, overarching policy.

The Chairman noted in introducing Lee Hamilton and me that we come from the heartland. And I have been asked before, "Senator Hagel, why would you be so presumptuous to think that you might know anything about foreign policy?" What I said was this: The farmers, the ranchers, and the small business people in Nebraska have understood foreign policy long before any fancy professors at Harvard figured it out—long before. And you know why? Not because they're any smarter, but because it was relevant, because they understood a long time ago that if you can't sell your corn, your beef, your pork, and your small business products, that impacts every facet of your life. It back right up to the schoolhouse: If there's not enough tax base that means you're not going to have any new schoolbooks for the kids to learn. Pretty simple.

We tend to complicate things in Washington. There's a whole business out there for complicating things. You hire consultants, then you hire lawyers, then you hire image people and public relations people, and then you've made it more complicated, and then you hire more. But eventually, we are going to have to face up to the need for leadership. Leadership is the core that drives all policies. Policies that reflect the challenges have to be implemented and the Congress is part of that.

You're very familiar with unilateral economic sanctions, what they do and what they don't do. I believe sanctions is an area that the Congress will work on this year. I think it's an area where we have some strong bipartisan cooperation. I have been involved in that area over the last two years with Lee Hamilton's colleague from Indiana, Senator Lugar, who is going to champion this issue. A number of Democrats and Republicans have come together and I think we can actually make some progress. This week before the Senate Foreign Relations Committee we had a hearing on Cuba. I'm not sure how tangible that hearing was, but we did get to some of the issues. The point is that we are starting to confront some of the challenges.

Unfortunately, I think we all are going to have to be careful about holding foreign policy captive to political gain. Both parties do it, have done it, and will continue to try to do it. I was a little disturbed by a front page story in the New York Times today about the Republican Party's new issue for next year: foreign policy. Well, first, it is not wise to build foreign policy on what you believe is a good political party platform. Foreign policy should be based on what's good for the country and what's good for the world. Yes, there are differences, there should be differences, and those differences should be articulated, but we should come to those differences not because they're good for the Republicans or good for the Democrats, but good for the country.

But again, it's going to take leadership—very forthright, tangible, meaningful, gutsy leadership. I think we have been without that kind of leadership in this decade in the Congress and in the White House. Ricocheting from crisis to crisis is not foreign policy. It is not any policy at all.

I said earlier that I believe that we have an immense opportunity to shape this world, maybe like no other nation has had before. I do believe we are right on the edge. If we don't provide the kind of leadership the world is going to require—when I say "we," I don't mean just America, but the civilized world—we will actually see the progress that's been made in the world over the last ten years erode. It will be a more dangerous world if we don't get out in front of it.

We have to face the fact that we live in a global community anchored by a global economy. We all understand that fact rather clearly now. What we all thought more than a year and a half ago was a currency blip problem in Thailand spread to become a rather serious economic crisis in many parts of the world. It touched all of us. The U.S. agriculture community's income for 1998 will be about $5 billion less than what we had in 1997, just the reverse of what agriculture's been doing in this
decade—increases of $2–4 billion a year. You
know the economics of much of this.

This is all going to have to be part of a com-
prehensive policy and you can’t take it piece
by piece. They are connected. And that is going
to require courageous leadership. That lead-
ership must come from the new administra-
tion, but it must also come from the Congress
of the United States. It is our responsibility as
public officials, representatives of society, to
help make the case that this leadership is impor-
tant for all of us.

At a very disturbing hearing this week before
the Senate Foreign Relations Committee, Adm.
Bill Crowe talked about embassy security. We
all know what happened in August in Africa at
two American embassies. Adm. Crowe came up
with a study recently that proposed some rather
significant investments in embassy security to
protect our foreign service people. We have let
that slide, partly because there is no political
constituency out there for me to go back to
Nebraska—or for any Congressman or Senator
to go back to their states and districts—and say,
“It’s important that we put $11 billion more in
embassy security.” And, again, we fail to con-
nect what this investment is about: This is an
investment for stability and peace and for our
country and economy. When you have stable,
secure, peaceful areas of the world that devel-
omp democracies and market economies, it is rea-
sonably likely that you can sell your corn, beef,
and small business products. So, again, we’ve
failed to make that connection. Making that
connection will be the great challenge, I think.

I referred to the challenges that we’re fac-
ing today—borderless challenges. The Congress
is behind in grasping this fact. Most of you in
this room have understood this for many years.
International business has understood this for
many years. There is no such thing as a bor-
der anymore. State borders, national borders—
gone. Telecommunications, the internet, tech-
nology, and transportation have totally changed
the nature of national borders, but we do not
have policies that deal with this change. Whether
it’s commercial policy, national defense policy,
or foreign policy, we have an overarching need
for a complete policy that addresses this change.

The other danger in today’s world is the
China situation. I fear that some people in both
parties of the Congress—probably my party
more than the other party—and some presiden-
tial candidates will use this China prob-
lem—and it’s real—as a way to invent a new
Soviet Union. These people need a new enemy.
So, according to them, we should seize upon
the problems we have with China and magnifi-
cy them, rather than drive to a solution. That
is a very real problem. We all are going to have
to show rather remarkable restraint and disci-
pline, and not allow how we handle the
Chinese to get out of hand. We have differ-
ences, we have problems; yes, we have to address
the problems, but there must be some balance.
As always, there must be some perspective and
balance that we apply to this situation. I would
hope that you all would stay very closely attuned
to this situation in the spheres of influence in
which you all work and live.

*  *  *

Well I am rather optimistic. Even though Lee
Hamilton is out of the Congress, I am still opti-
mistic that we are going to make some
progress. I think that we will, in fact, rise to
the occasion. I think that we are up to the
task. This country will force the changes,
working from the bottom up. We will respond
to our constituencies and to the world chal-
lenages. And I think, as dangerous and uncer-
tain as the world is, that over the next few
years we will, in fact, be able to put together
policies that will make the world safer, better,
and more prosperous. But it will take a lot of
discipline and leadership in working together
to put our country and the world first.

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Chuck Hagel is a Member of the United States
Senate. He serves on the Senate Foreign
Relations Committee and Chairs its
Subcommittee on International Economic Policy,
Export, and Trade Promotion.
SECTION 6
CANADA AND THE INTERNET

JOHN MANLEY

Canada and the Internet Revolution: Connecting Canadians

I want to talk about Canada and the Internet Revolution, and the steps we are taking to make Canada the most connected nation in the world. Globalization of markets in the world economy has pushed the development of Internet technology and the race to provide access to it. In return, the Internet has fueled the growth of a knowledge-based economy, where the ability to harness knowledge and innovation is crucial in determining the wealth of nations and the quality of life within them. It has brought the issue of the free-flow of information to the fore of public policy and international relations. It has provided all nations with opportunities and challenges to open the doors to global trade in knowledge, ideas, and all manner of services that can be reduced to a digital code.

The Information Highway Revolution
For the past six years, the Government of Canada has been implementing policies to develop the Information Highway, provide Canadians with access to it, and use it to build the knowledge-based economy. In just a matter of days, we will reach a milestone in these policies. Canada will become one of the first nations in the world to have all our public schools and libraries on-line. Then we will turn our attention to connecting all classrooms. This is equivalent to having every household in Canada with a phone only 10 years after Alexander Graham Bell conducted the first successful phone conversation in Brantford, Ontario. This achievement will spin off enormous benefits. In this case, Canadian children will be able to ride a wave of technological change that is revolutionizing both the educational system and the workforce they will soon enter.

Nations around the world have shown similar vision and determination in bringing the Information Highway to their people. In 1993, the United States established a National Infrastructure Initiative. Earlier this month, President Clinton pledged to have every classroom in the country connected to the Internet by next year. Prime Minister Blair has announced a program to link every school to the Internet by 2002. Australia, Denmark, Finland, France, and the United Kingdom all have comprehensive initiatives to plug schools into the Internet.

Nations are racing to build the new infrastructure and teaching their people how to use it because the Information Highway will have the same impact on the economy that previous infrastructures had for earlier generations. No one can predict the eventual impact—or how the Internet will transform the economy and society. What we know today is that, in a matter of a few years, the Net has changed from a quiet electronic playground for academics and researchers, to a 24-hour market place for products, ideas, and services. In the old days, sending a 42-page document from Ottawa to Tokyo cost about $39.00 and it took 24 hours. Today, we can send it in two minutes at a cost of 15 cents. That's 720 times faster and 260 times cheaper. The Information Highway is revolutionary, not evolutionary; it is transforming, not tinkering; it is as important socially as it is economically. Our Government has decided we want to put Canada at the leading edge, not in the middle of the pack.

Early in the Government's mandate, we
made the Information Highway a priority. We realized that a high degree of consensus would be required among Canadians if we were to harness the technology's potential. So in the Spring of 1994, within months of assuming office, we appointed an Information Highway Advisory Council (IHAC). It was comprised of 29 members drawn from business, labor, governments, and community groups. In September 1995, IHAC released a report containing over 300 recommendations. The government acted on an overwhelming majority of them. For example, IHAC recommended that building the network and infrastructure of the Information Highway should be left to the private sector. The government limited its role to creating the environment in which the private sector could get on with the job of building the Information Highway. IHAC recommended that the highway should be technology-neutral. We responded by ensuring that four different technologies would compete to build on-ramps to the Information Highway: telephone, cable, wireless, and satellite. The Information Highway Advisory Council helped build consensus on issues. It helped focus the attention of both the general public and public policy-makers on the coming changes that the technology would bring. It provided the foundation for what the Government of Canada introduced, in September 1997, as the "Connecting Canadians" agenda.

Connecting Canadians: A Vision for Canada's Future

"Connecting Canadians" has a stated goal to make Canada the most connected nation in the world—to make Canada a world leader in developing and using an advanced information infrastructure to achieve our social and economic goals in the knowledge economy. Connectedness is about our vision of the Canadian society we want in the 21st century—one with a strong, dynamic, competitive economy, and a strong lifelong-learning culture, but also one that uses connectedness to promote social cohesion, cultural expression and to build new linkages between citizens and government. How does Canada rate in our connectedness objectives? Very well actually. We have the highest level of post-secondary school enrollment in the G-7. We have the lowest annual residential telephone and Internet charges in the G-7. And, the percentage of Canadian small businesses using the Internet jumped from just over 15 percent in 1996 to more than 43 percent in 1998.

Our agenda is built on six priorities:

1. Canada On-Line

We are well on our way to reaching our national targets to give all Canadians access to the Information Highway. This includes connecting all our public schools and libraries; providing 250,000 computers for schools; providing public Internet access for up to 10,000 rural, remote, and urban locations; and building the fastest network in the world.

Canada's SchoolNet program is one of our success stories—a broadly based private and public sector partnership to plug schools and libraries into the Internet. We estimate that, in 1994, there were no more than a handful of schools and libraries connected to the Internet. By the end of 1995, there were 3,200 schools and libraries connected. By the end of 1996, the number had grown to about 7,900. By end of 1997, 14,800. And as I mentioned at the beginning of my remarks, this month we expect that all public schools and libraries will be connected. As well, there are 388 First Nations Schools already connected.

Our Community Access Program has helped more than 4,000 rural and remote communities get online to date. Our goal is to connect every rural community with more than 400 people by the year 2000—that's 5,000 sites. And we will be adding another 5,000 sites in urban centres. The Community Access Program links these communities into a competitive global economy. When the product is knowledge-based, the format is digital, and you have on-line access, you're as
Some people say you can’t turn fishers into computer programmers. I say you can use computers to teach them.

Close to the markets of the world in Yellowknife, Northwest Territories, as you are in New York City. The Program also improves the quality of life in these communities. Children have access to sophisticated education facilities through tele-learning. Medical facilities link up to the most sophisticated hospitals in the country using tele-health. We’ve already seen cases where some of Canada’s foremost specialists have performed on-line diagnosis of patients in communities thousands of miles away.

I’ve recently seen an excellent application of the Program on the Southeast Shore of Nova Scotia, in Sandy Cove and the Western Valley in Lawrencetown. Many people in those communities left school early to follow the trade of their fathers and grandfathers in the off-shore fishery. But with the dramatic decline of the Atlantic fishery in recent years, many were left without a trade, and did not have enough education to pursue new opportunities. So they’ve turned to the Community Access Internet sites, where they are obtaining their high school diplomas and upgrading their skills through distance education. Some people say you can’t turn fishers into computer programmers. I say you can use computers to teach them. New worlds of opportunity will open up once they’ve finished school.

We have also created the Voluntary Sector Network Program (VolNet) to link voluntary and charitable organizations across Canada to the Internet and to each other. Our goal is to link up to 10,000 voluntary organizations to the Internet by the end of fiscal year 2000.

We also want to make sure that Canadians have access to a state-of-the-art information infrastructure. Last year, we announced an investment of $55 million to build the world’s fastest, all-optical research network: CA*net-3. Back in 1993, the original CA*net took about 9 minutes to download the Canadian encyclopedia. With CA*net-3, the process is virtually instantaneous—nearly one million times faster than five years ago.

CA*net-3 is an entire generation beyond all other networks. On CA*net-3, data will move at 40 gigabits per second. With a transmission speed of this level, users will be able to download a digitized two-and-a-half-hour movie such as Titanic in under half a second. This is approximately 16 times faster than the American equivalent, the Abilene network project, which is designed to transport data at 2.4 gigabits per second. Parts of the CA*net-3 research network are already up and running, in the Toronto–Ottawa–Montreal corridor.

2. Smart Communities

The second part of our plan is Smart Communities. Smart communities provide for connectivity at the community level. It uses the Information Highway to link people and organizations together, to share ideas, and to address local needs. We created a blue-ribbon panel of experts who advised on how Canada can develop world-class Smart Communities where technology is used in innovative ways. Last month, we announced funding to establish, by the Year 2000, one world-class Smart Community project in each province, the North, and an Aboriginal community. Proposals from across Canada will be evaluated by an arm’s-length national selection committee on such criteria as: helping people harness the power of the Information Highway; creating business opportunities in the global economy; improving the quality and availability of education for all ages; giving citizens more say in governance; building collaboration among all levels of government; improving health services; and attracting high-tech investment and business. The lessons learned will advance the use of information technology at the community level across Canada.

3. Electronic Commerce

The third element of our agenda is Electronic Commerce. Doing business over the Internet is revolutionizing how people buy and sell products and services. Canadians are willing to
conduct their business by electronic means. According to the Bank for International Settlements, Canadians use their debit cards five times more often than Americans. Our goal is to make Canada a location of choice for developing electronic commerce products and services, to capitalize on the phenomenal growth of on-line business. We aim to have in place a framework we call “The Seven Firsts”:

- a policy on the use of encryption technology;
- a framework for a world-class public key infrastructure;
- new consumer protection guidelines to ensure that Canadians enjoy the same protection on-line that they do in the more traditional forms of transaction;
- electronic signatures that have a basis in law;
- a revenue-neutral taxation regime that treats virtual and physical transactions on an equal footing;
- privacy legislation to protect personal information in the private sector; and
- a Canadian standards road map for electronic commerce to ensure the interoperability of networks and applications. This is the first of its kind, and we will promote it internationally.

4. Canadian Content On-Line
The fourth element of our agenda is Canadian Content On-line. We want to build on Canada’s world-class infrastructure by increasing the availability of Canadian content on-line—content that reflects Canadian institutions and organizations, and Canadian history, aspirations and culture. We can put more major cultural collections on-line to inform and educate people around the world. We can promote social cohesion by facilitating greater knowledge of our heritage. We can promote a healthier society by putting health information on-line and developing new applications in distance medicine.

5. Government On-Line
The fifth element is government on-line. The Information Highway has profound implications for how democracies will operate. The Library of Congress bears a quotation from James Madison. “Knowledge will forever govern ignorance,” he said, “and a people who mean to be their own governors must arm themselves with the power which knowledge gives.” Madison spoke from an age where the printing press had made democracy possible. What kinds of new political processes will the new technology give birth to? How will we govern ourselves when information is only a keyboard away? Government On-Line is about governments showing the way to making the best use of the Information Highway. It’s about moving beyond providing access, setting standards, and investing in technology, to giving Canadians around-the-clock access to the information and services they need.

We have made some impressive beginnings. For example, Revenue Canada provides customs information on-line, information once provided by a customs broker. Industry Canada’s Strategis—Canada’s largest source of business information—provides users with about 80,000 documents per day. It’s one of the most-used web sites in North America and the largest French-language business site in the world. We’ve made great progress, but there is much more to be done. We are now working towards a single integrated electronic gateway into government—providing Canadians with easy access to all government programs and services.

6. Connecting Canada to the World
That leads to the final part of our agenda, Connecting Canada to the World. Connectedness has enormous capacity to bring a better understanding of Canada to the world and help brand Canada as a leading-edge economy. Internationally we are working towards interconnectivity and
interoperability of broadband networks, applications, and services. And we are promoting global standards for electronic commerce. We are helping schools and libraries in the developing world to plug into the Internet. Connectedness allows us to promote Canada in new ways. By branding Canada as the most connected nation, we can attract foreign investors and establish Canada as a global hub of the knowledge economy.

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Ladies and gentlemen, I have been talking about a social and economic revolution that has the amazing capacity to accelerate development, and leapfrog previous technology. Half the world’s population today has yet to make their first phone call. But we can draw inspiration on how fast this can change. When we began looking at Internet policy in 1993, there were only a few million users connected to the Net around the world (22 million in 1995). Today there are over 160 million, and the number grows exponentially. Connecting Canadians is our plan to help provide skills and tools for Canadians in the global, knowledge-based economy. Other nations have similar programs with similar goals.

A Canadian, Marshall McLuhan, predicted in the 1960s that technology would turn the world into a global village. He was referring to television technology—a one-way medium, where people could only watch. Today, we can see how the Internet Revolution is changing the world in ways even McLuhan could not have imagined. It’s an interactive technology, a two-way technology, a technology that brings us together as never before. It is the infrastructure for a new millennium and there are enormous untapped opportunities—opportunities we cannot even envision yet. I’m looking forward to seeing what the future of this technology brings.

John Manley is Canada’s Minister of Industry (since 1993).

SECTION 7

EAST ASIA AND THE INTERNATIONAL SYSTEM

On March 12, the day before the annual meeting began, participants in the Trilateral Commission’s Special Study Group on East Asia and the International System gathered for discussions among themselves and with interested Trilateral members. The Study Group had begun its work with brainstorming discussions on the side of the 1998 annual meeting in Berlin. The final report of the group will come before the 2000 annual meeting in Tokyo. Tommy Koh, Jusuf Wanandi, and Yuan Ming, whose remarks opening the March 14 East Asia session are presented below, are also participating in the Study Group.

TOMMY KOH

East Asian Crosscurrents

I N THE TIME ALLOCATED TO ME I WISH TO MAKE FIVE POINTS.

1. East Asia will recover from the present monetary and economic crisis for three reasons. First, the empirical evidence supports this view. At lunch yesterday, we heard about the Korean recovery. The same can be said for Thailand. The Thai bhat and the Korean won have stabilized, interest rates have declined, exports are up, and their trade and current account balances are positive. Most important of all, foreign direct investment in both Korea and Thailand in 1998 surpassed the levels of FDI in the pre-crisis period of 1997, signalling a return of investor confidence.

Second, in spite of the crisis, East Asia continues to enjoy strong fundamentals. We have a strong work ethic, high savings, and a high respect for education and learning. We have a capacity to accept short-term pain for long-
term gain, and we remain committed to free trade and open economies.

Third, the rise of East Asia in the world economy is inevitable. If you look at the progress which East Asia has made in the last 30 years, it has been quite dramatic. In 1965, the economies of East Asia constituted only 9 percent of world production; in 1975, they constituted 15 percent. By the year 1995, East Asia had caught up with the United States, accounting for 25 percent of world production. I believe that the current crisis is a temporary setback and that East Asia's historical march to economic parity with the West is unstoppable.

2. The durability of East Asia's recovery will depend upon six critical choices:
   - First, we have a choice between clean and competent government and corrupt and incompetent government.
   - Second, we have a choice between governments which are democratic and respect the rule of law, and governments which are not democratic and do not respect the rule of law.
   - Third, we face a critical choice of embracing the concept of good corporate governance or retaining the three evils of corruption, collusion, and nepotism.
   - Fourth, we face a critical choice of turning inward and becoming protectionist or opening up our economies even more to trade and investment.
   - Fifth, we face a choice between protecting our companies, our conglomerates, our banks, and our financial institutions, or allowing market forces to force them to restructure, merge, be acquired, or die.
   - Sixth, we face a choice between building in each of our countries what I would call a "stake-holder" society, with a large measure of social equity and social cohesion, and societies with large disparities between the haves and have-nots.

My fear is not that East Asia will not recover; my fear is that it may recover too soon. If it recovers too soon, the momentum for reform will fade. For example, the Prime Minister of Thailand has submitted ten bills to Parliament to reform the banking and financial sector. So far, only one of the ten has been enacted into law; the other nine have been bottled up in committees. If the Thai economy recovers too soon the pressure for reform will fade.

3. Japan. Americans used to admire Japan, and it was not so long ago that Ezra Vogel wrote Japan as Number One. Today, many Americans look down on Japan. Some Americans have confided in me that they believe that Japan will end up as a second-rate country. I do not share this sentiment. One-hundred-fifty years ago, Japan faced its first historic challenge—the challenge of modernization. Japan was the only Asian country which successfully embraced this challenge and reinvented itself. At the end of the Second World War, Japan faced its second historic challenge—rebuilding the Japanese economy. In less than two generations, Japan has rebuilt a modern economy and has caught up with the West. Today, Japan is faced with its third historic challenge—the challenge of globalization. I have every confidence that Japan will rise to this historic challenge as it did to the two previous ones, and that it will reinvent itself again and reemerge as a competitive global player.

4. China. Yesterday, an American speaker expressed his concern that there are some Americans who miss the Cold War and who have been looking for a new enemy. He also told us that there is a growing coalition of interest groups in America which are determined to demonize China. The perspective from Southeast Asia could not be more different. China has never enjoyed as much prestige and good will as it does today. In spite of China's many difficulties, the Chinese economy grew last year at over seven percent and China's leaders have kept their promise not to devalue the renminbi. Southeast Asia does not perceive China's military modernization as a threat to the region. We have, however, put

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China on notice that any use of force by China to assert its claims to the islands in the South China Sea will result in a serious rupture of the good relations that now exist between China and Southeast Asia. The relationship between China and Taiwan, the Southeast Asian view can be encapsulated in two phrases: no independence for Taiwan, and no use of force to bring about reunification.

5. What will be the nature of the relationships between East Asia, the United States, and Europe in the 21st Century? Will the three regions act in concert or in conflict? The relationship between the three regions is dynamic, not static. In my view, the United States is likely to remain a superpower in the next century. Its economy will remain prosperous, driven by knowledge-intensive industries and creativity. By the year 2005, the Western Hemisphere is likely to be a free-trade area. At the same time, the United States will be a valued partner of a dynamic Pacific economic community.

The European Union is likely to expand and have as many as 25 member states. It will have a collective economic weight equal to, if not greater than that of the United States. And with the successful completion of Economic and Monetary Union—which East Asia warmly welcomes and applauds—our European friends are now in quest of their next great ambition—the forging of a common foreign and security policy. This will probably take one generation to accomplish, but I believe that some time in the 21st century Winston Churchill's 1947 vision of a United States of Europe will come true.

East Asia will not be standing still. If we can bring about a historic reconciliation between China and Japan and between Japan and Korea, the road will be clear for East Asia to come together in the same way as the West Europeans have done, and build a united, peaceful, and prosperous East Asia. If we succeed in this endeavor, East Asia will have a collective economic weight greater than the combined weight of the United States and Europe.

The relationships between East Asia, the United States, and Europe in the 21st century will be characterized in part by cooperation and in part by competition. The three regions will, however, be living in a world very different from the world in which we live now. It will be a highly interdependent and interconnected world. The three regions will have no choice but to cooperate in order to maintain world peace, prosperity, equity, and the environmental health of our one world.

Tommy Koh is the Executive Director of the Asia–Europe Foundation and Ambassador-at-Large of Singapore.

The three regions will have no choice but to cooperate in order to maintain world peace, prosperity, equity, and the environmental health of our one world.
Moving East Asia Forward Again

I N T H E L O N G T E R M for East Asia, like Tommy Koh, I am optimistic. This optimism is based on history, but on more of the emotional part of history. We have achieved growth and a high level of development due to a lot of sacrifices. And, therefore, with this current correction, that is needed anyhow, we should not just lay low and let it get us down. That is a very important point that we have to recognize. We might need in East Asia some visionary project together—as a community—which can again raise the hopes of the community. I am struck that when “Eurosclerosis” set in, the EU came up with the single market idea and delivered; and then with the Euro idea and delivered. These initiatives have brought optimism back to Europe. We still have to find such initiatives for East Asia.

In the short and the medium terms, however, I think we will be facing much tougher changes. We are facing not only a financial crisis—the financial crisis is a symptom—but something much more basic that permeates all sectors of life. It is the challenge, as has been said yesterday by Hisashi Owada, of a globalization process that is so rapid and so fundamental. We are still looking for answers. Of course, every country in East Asia does not face the same depth of challenge because they are in different stages of development. Indonesia is the worst case scenario. We must recognize that these are fundamental challenges and we will have to struggle with those very difficult challenges in the short and medium terms.

New Development Strategies
What we need is a vigorous debate in the region on some of the things that we have to change. Because each country is at a different stage of development, we have to decide for ourselves what kind of development strategy each country might need in the future. The so-called Korean model—economic development first and then automatic political development—is passe. We have learned that it is not relevant anymore. What we don’t need is twenty-five or thirty years of economic development, then a bust and maybe a ten-year setback, as in the case of Indonesia. So we have to define our own development strategies in much more comprehensive and balanced ways, of which political development is a very important part. Otherwise, we cannot even get the fundamentals of the economy right.

We should have inclusive development because the globalization process has created a dichotomy in society where a shallow upper level, 20 percent maybe, has benefitted, while 70–80 percent of the population is being left behind. This dichotomy is already creating havoc, especially in the case of Indonesia, where it is also related to issues of race and social justice. Social safety nets are the next challenge we will have to face.

Development also has to be sustainable. We have learned from our forests burning and the haze problem in Southeast Asia how dramatic and critical environmental disaster can be. At the time, when a poll in Singapore asked, “What is the greatest threat we are facing?”, they said it was the forest fires of Indonesia.

So we have to come to our own conclusions on new development strategies.

Regional Institutions
I would like to mention how we should deal and cope with our regional institutions. We have achieved some very good developments, especially in the case of ASEAN. There is no doubt about it. This non-legal, personal, and informal-relations-based regional institution is why the impact of the economic crisis is not overflowing into the security field. Considerable confidence-building has been achieved through these regional institutions. But at the same time we have to recognize, if we really want to move into regional institution-building in the future,
it has to be much more rules- and norms-based and we have to have many more institutions on which to build. Here we can learn from the EU. Although we cannot emulate the EU (historically, it has much more experience and we are a much more diverse and much bigger region), I think we can learn from how parts of the EU have been built. Therefore, it is an important model for us.

Let me come to some concrete problems we are facing now with these regional institutions. A lot has happened and a lot of achievements have been accomplished in ASEAN. That it will stay open is very important. The idea that we have to have agreements, norms, and rules has started. We have declared ASEAN to be an investment area in the year 2002 and that has to be based on solid agreements. We have agreed to transparency and to reviews of macro-economic indicators to watch each other with help by the ADB, also based on very rigorous agreements. But at the same time, we have to recognize that we are facing a lot of challenges in ASEAN, not only because of the crisis, but also because there are new leaders coming up who have never met each other before and they have to get through to each other. The challenge of new members is a real challenge, and we just don’t know yet how to cope. And, of course, we have to look for new principles of cooperation in the future.

APEC is in a critical period. How do we reinstate its idealism and cooperation? I do think, though, that this year, with the leadership of New Zealand, it will achieve a better result than last year. APEC is very dependent on the country in the Chair to guide the results of APEC every year. Unfortunately, last year the chair was held by Malaysia, which had internal problems limiting its capacity to lead APEC to a further stage of development. So, I hope at least, and we are working very hard, that APEC this year will be better than last year. It is important that we keep APEC alive because it is the only regional institution where the heads of governments are coming together, and the institution upon which regional-ism, in the end, has to be built.

Now one footnote in relation to APEC is the idea of an East Asian summit. This summit has been established by ASEAN to be used for policy coordination and consultation among East Asian leaders, including Australia and New Zealand in the near future. This summit is where we can have effective consultations and policy coordination, as core members of APEC, so that we will be able to move APEC, and the ASEAN Regional Forum as well, in a much better direction in the future and have much better input into global issues as East Asians. That process already started in ASEM, the Asia–Europe Meeting.

Now, these activities have been kept alive because of the activities of society itself. Regionalism is dependent not only on the governments. I think the “second track” activities of these regional institutions that have been established in the meantime, like PECC (Pacific Economic Cooperation Council) are very important sources of support for the future of all the regional institutions to come. PECC, for instance, has started an independent peer review of macro-economic indicators. If we can achieve a full-fledged review in the next five to ten years, then I think we will be much better off; we will then be keeping the idea of regional cooperation alive and going.

Regional Security
The last point that I would like to make is on security. The good thing that has happened is that the financial crisis has not brought in the instabilities about which we were worried. This fact lends credence to the idea that our regional institutions have created enough confidence to maintain stability, despite the crisis. Southeast Asian leaders have more problems because they have historical grievances as well as new leaders coming up, but relationships have not become more acrimonious. In Northeast Asia, the situation has improved, especially between Japan and Korea. The Japan–China relationship also is going to be built up, slowly, in the near future. Our main
concern, however, is the shadow of the China-U.S. relationship hanging over East Asia. This is a very critical problem because the presence of the United States is critically important to the region, politically, economically, and militarily. I hope this shadow will not become a storm and, instead, will fade away. This is a very crucial matter that, of course, the American political body has to decide in the end; but we are hoping that cooler heads will prevail, and that this very important relationship, which is so broad-based, will not be looked upon only from one angle.

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The region is facing a lot of turbulence, and we will have to work very hard to turn this around. We might need between three and ten years to be able to do that; in some countries, it can be done better and quicker, but it will not be an easy job. For the region as a whole, maybe in the next decade or so we can become a better East Asia, not only turning around the macro-economic indicators, but having societies that are democratic and looking to include the masses that they have left behind over the last decade; and, at the same time, have much more stable relationships among one another.

Jusuf Wanandi is Chairman of the Supervisory Board of the Center for Strategic and International Studies in Jakarta, Indonesia.

YUAN MING

China and the International System

This panel's assignment is East Asia and the Trilateral countries, but I'd like to focus on my own country, China, because it's such an issue now, especially in Washington.

I believe East Asia and the Trilateral countries are converging culturally, but this mutual understanding will take more time and effort. For example, when the Conference of Westphalia was held in 1648, what was happening in China? In 1640, just eight years before Westphalia, the Manchu people from northeast China entered the heartland, conquered Beijing, built up the Qing Dynasty, and found that they themselves had to respect the Han culture and Confucianism. This was a sort of cultural convergence within the Chinese people.

But, for the Chinese, there has been no knowledge at all of international law, the Westphalian system, and international regimes—none at all. Eventually, especially last century and then in the 20th century, the Chinese became a little bit more open-minded, especially the elites, and there were some efforts by Chinese to understand the system of international regimes and international law from the West. But those efforts, in retrospect, were very weak.

The momentum for changing the Chinese understanding of the West didn't come until Deng Xiaoping initiated the "open door" policy in the late 1970s—just 20 years ago. So I agree with some of my colleagues that Deng Xiaoping's greatest contribution was not in the economic dimension, but in changing the mentality of Chinese people. And the momentum was started within China—not from outside force or pressure.

...FOR THE CHINESE, THERE HAS BEEN NO KNOWLEDGE AT ALL OF INTERNATIONAL LAW, THE WESTPHALIAN SYSTEM, AND INTERNATIONAL REGIMES....
Dilemmas Confronting China

We are still struggling with several domestic dilemmas. Let me give you some details on them.

The first dilemma is keeping the door open, that's for sure. Keeping the door open is in the interest of Chinese people, the region, and also the world. But to keep the door open and, in the meantime, deal with the instabilities caused by the open door is a huge dilemma. For example, we talk about political reform at home. I believe that many Chinese, among both the leadership and average people, realize the importance of political reform. As a matter of fact, I think the desire for political reform was, to some extent, present from the very beginning. The change of mentality of the people was part of it. And I think in this regard, Chinese leaders and average Chinese are equal in terms of being students, of learning those fresh new ideas in different ways. Average people don't know what Lord Acton said about power, that "Absolute power corrupts absolutely." I don't think they understand that idea. They express their dissatisfaction in daily observations that "we've got to do something against corruption, to make some changes." But the leadership understands, especially the current leading body. The dilemma is how to carry out those political changes gradually and not repeat some of the mistakes, in our view, our Russian friends have made.

The second dilemma is maintaining a comparatively powerful central government in the face of the decentralizing impact of globalization. This tension is also very important for China. I have two recent examples.

First, when Premier Zhu Rongji took office last March, he raised the gross growth rate target to eight percent—definitely, he said. When he said this at the National People's Congress and the People's Political Concert of Conferences, he won a lot of applause—enormous applause—from the audience. Later, because of the deterioration of the international financial situation, many questions and doubts were raised about this target. At first, I don't think Premier Zhu himself and some of his colleagues realized the seriousness of that kind of challenge and pressure and still insisted on eight percent. More and more differing voices were raised, especially among their leading consultants. Some leading economist said, "We've got to be very realistic. If we keep this eight percent as a target with no change, then it will cause some very false statistics. Local leaders will send false essential government information and then where will that lead? This would be a very big mistake." Finally, late last year, Premier Zhu and his colleagues accepted that advice and said we've got to be more realistic.

My second example is the flooding in China last year. It was the worst flooding in 100 years, threatening 200 million people's lives and property and directly causing economic damage of 25 billion U.S. dollars. It certainly wasn't expected at the beginning of last year or in March when Zhu Rongji took office. These kinds of unexpected events need strong leadership to keep the country together.

And the third dilemma is how to keep the merits of our cultural tradition which preserves our national identity and also, in the meantime, introduce foreign cultures, which could help the Chinese people develop a healthier world outlook. This is also a very real challenge for us.

So all of those dilemmas are real and are very challenging. It is a matter of managing the relationship between change and stability—keep the stabilities which would guarantee the changes. No society can develop in chaos.

Challenges in the Year Ahead

During a recent session of the National People's Congress, Premier Zhu and his colleagues, especially the Premier himself, pointed very seriously to the challenges we are facing this year, including how we are to stimulate our domestic market. Last year we tried to learn from some experiences abroad. When Alan Greenspan announced the reduction of interest rates in the United States a couple of times, we did, too, but without results. The central government reduced the interest rates four times last year, but these reductions did not really stim-
ulate the economy. People are discussing why they did not. We are facing other very serious challenges this year, like continuing the reform of SOEs (State-Owned Enterprises); restructuring the government, including local government; and reforming our banking system, which we learned, I think profoundly, from the East Asian financial crisis. We will also be faced with about 20 million more people who will be added to the waiting list for jobs.

This year, I believe the leadership will be preoccupied with the domestic agenda, so the need for a stable and peaceful international environment is crucial for us. Having said that, I have to mention a little bit about China's foreign relations. We are very much concerned about our relations with our neighboring countries. I have to mention the Korean Peninsula about which I am very much concerned. I keep asking my American colleagues, "Is Washington going to depart from the policy established by the 1994 Framework Agreement with North Korea, minus or plus?" The memory of the Korean War in the early 1950s is still very fresh in our minds.

And, finally, I would raise one concrete thought on East Asian regional institution-building, which Jusuf Wanandi mentioned, and that thought is how to pave the way for a constructive trilateral relationship among the United States, China, and Japan. Some efforts have already started based on academic exchanges. But how can we institutionalize this very crucial triangular relationship? Another general thought on East Asia and the Trilateral countries is how to set a balanced intellectual foundation for all of us, especially vis-à-vis the tremendous flows of information in an era of an information revolution. This foundation is so important not only for ourselves, but for the younger generations who will shape the global future.

Yuan Ming is the Director of the Institute of International Relations at Peking University.

SECTION 8
BRAZIL'S CHALLENGE

ANDRÉ LARA RESENDE

Brazil: Analyzing the Crisis and Prospects for Recovery

I will talk briefly on two schematic interpretations of what went wrong in Brazil. Of course, you could simply say nothing was wrong domestically and that we were simply the victims of the contagion from the crisis of emerging markets. I don't think this view should be taken seriously. The important question anyway is why Brazil was vulnerable to such a crisis.

Why Was Brazil Vulnerable? Exchange Rate Policy, Inadequate Fiscal Adjustment

The first view is that the root of the problem in Brazil was the exchange rate policy. When the real was introduced in July 1994, it managed very successfully to stabilize prices after three decades of chronic inflation. The real was left free to float from July 1994 until approximately April 1995 and became overvalued in relation to the dollar. The starting parity was one real per dollar, but the parity went up to 83 cents of the real per dollar, and then came back slightly. The reason that the real revalued was the fact that extremely high domestic interest rates had to be maintained to consolidate the stabilization of prices. The resulting differential between domestic and external interest rates attracted a lot of short-term capital.

For many analysts, this was a huge mistake and there was no reason whatsoever to allow the real to revalue immediately after the stabilization program began. The revaluation of the real was, however, very important to reverse
some of the currency substitution—the dollarization—in the Brazilian economy; and the importance of this revaluation in bringing inflation down quickly cannot be underestimated. However, in April 1995, the exchange rate policy was changed, and though it was presented as an exchange rate band, it was, in fact, a crawling peg. The only difference between this crawling peg and the crawling peg of the inflationary period was that now it had no fixed relation with domestic inflation; Brazil simply devalued by approximately a rate of six or seven percent per year (on a monthly basis, 0.5 or 0.6 percent) with respect to the US dollar.

According to this view, these actions were not enough to reverse the original revaluation of the real; inflation was under control, but the exchange rate was dangerously overvalued. This put domestic industry in a difficult situation, squeezed between an extremely high cost of capital due to high interest rates, on the one side, and foreign competition due to an overvalued exchange rate, on the other. As a result, the large trade surplus that Brazil had maintained for many years was reversed. The current account deficit started to increase rapidly. The government insisted on playing the card of high interest rates to finance the increasing current account deficit. Therefore, when we were hit by the crisis in Asia, and then in Russia, confidence went down and to float the real was imperative to stop losing reserves. According to this view, the use of an overvalued exchange rate for so long, com-

DOMINGO CAVALLO

Success for Cardoso and Brazil is Critical for the Region

I want to tell you what we have learned in Latin America, not about economic reform because I think we have not learned much more than we already knew in the 1980’s, but about the politics of economic reform. There we have learned a lot; in particular, Fernando Henrique Cardoso has learned a lot. I think that the big teacher was Carlos Menem, the President of Argentina, because he discovered that you can build very strong political support if you are able to stabilize the currency and eliminate inflation in a country with a long history of high inflation. If you find a way to suddenly deliver price stability and currency stability, then you receive much popular support, you win elections, and you are able to assemble a coalition in congress that will approve the necessary measures to open up the economy, to deregulate, to privatize, and to undertake economic reform programs. The key to fundamental success over the middle or long term is to use this opportunity to find a way to stabilize the currency and eliminate inflation and implement reforms in a sustainable way.

Fernando Henrique Cardoso learned this lesson very well. He built up his popular support and his political support by implementing the Real Plan and then he won the election. He became president and was able to get enough support in congress. Political support for Fernando Henrique Cardoso is completely tied to the real, so if the real devalues, then political support for him and his government will devalue also, and may even collapse. That is why I think the situation right now in Brazil is critically important not only for Brazil, but for all of Latin America.

There is another political circumstance that makes the situation in Brazil critically important—the end of Menem’s leadership in Argentina and Latin America. Unfortunately, he is not helping generate a new leadership in Argentina, so it is very uncertain what
ulate the economy. People are discussing why they did not. We are facing other very serious challenges this year, like continuing the reform of SOEs (State-Owned Enterprises); restructuring the government, including local government; and reforming our banking system, which we learned, I think profoundly, from the East Asian financial crisis. We will also be faced with about 20 million more people who will be added to the waiting list for jobs.

This year, I believe the leadership will be preoccupied with the domestic agenda, so the need for a stable and peaceful international environment is crucial for us. Having said that, I have to mention a little bit about China’s foreign relations. We are very much concerned about our relations with our neighboring countries. I have to mention the Korean Peninsula about which I am very much concerned. I keep asking my American colleagues, “Is Washington going to depart from the policy established by the 1994 Framework Agreement with North Korea, minus or plus?” The memory of the Korean War in the early 1950’s is still very fresh in our minds.

And, finally, I would raise one concrete thought on East Asian regional institution-building, which Jusuf Wanandi mentioned, and that thought is how to pave the way for a constructive trilateral relationship among the United States, China, and Japan. Some efforts have already started based on academic exchanges. But how can we institutionalize this very crucial triangular relationship? Another general thought on East Asia and the Trilateral countries is how to set a balanced intellectual foundation for all of us, especially vis-à-vis the tremendous flows of information in an era of an information revolution. This foundation is so important not only for ourselves, but for the younger generations who will shape the global future.

Yuan Ming is the Director of the Institute of International Relations at Peking University.

SECTION 8
BRAZIL’S CHALLENGE

ANDRÉ LARA RESENDE

Brazil: Analyzing the Crisis and Prospects for Recovery

I will talk briefly on two schematic interpretations of what went wrong in Brazil. Of course, you could simply say nothing was wrong domestically and that we were simply the victims of the contagion from the crisis of emerging markets. I don’t think this view should be taken seriously. The important question anyway is why Brazil was vulnerable to such a crisis.

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THE IMPORTANT QUESTION... IS WHY BRAZIL WAS VULNERABLE TO SUCH A CRISIS.
bined with high interest rates to attract short-term speculative capital, now risked threatening domestic inflation stabilization.

According to a second view, the problem in Brazil was not really related to the exchange rate; it was simply a question of not being able to promote the necessary fiscal adjustment. When the Real Plan was introduced, it included a very specific constitutional amendment to guarantee some kind of fiscal relief. This was, however, only a transitory measure that would maintain fiscal balance for a few years. Everybody knew that the real equilibrium in the long run would depend on institutional reforms. Resistance from pressure groups with interests in maintaining a heavy state sector delayed these reforms. The government had to go on financing a rapidly increasing public debt with higher and higher interest rates. The fiscal deterioration caused a loss of confidence. Low confidence ended up provoking the crisis when other emerging markets collapsed. According to this view, the exchange rate was not in question, and if the real had been devalued, the only winners would have been those forces against the structural reform and the quest for fiscal equilibrium. It would have been the victory of those accustomed to living under an apparatus of protection from outside competition and dependent on public subsidies.

Of course, it is possible to recognize in these two views the two classical cases of wrong relative prices and the necessity of expenditure-switching policies, on the one hand, and, on}

kind of leadership we will have in Argentina in the next four years. With no clear prospects of efficient leadership in Argentina, it is critically important to have a leader like Fernando Henrique Cardoso in Brazil to provide leadership for Brazil and the region.

Brazil needs to prevent re-introduction of inflation and indexation into the Brazilian economy. It is critical that Brazil in the next few months stabilize the real at a price lower than 1.7 reals per dollar. If Brazil stabilizes the real at a higher price, inflation will build within the Brazilian economy. Once inflation is introduced into the Brazilian economy, the popularity of President Fernando Henrique Cardoso will disappear, and he still has four years ahead as leader of Brazil. He needs support in congress to approve many more laws than those that have been approved so far. The last package just increased taxes, some of them very distorted taxes. The kind of laws that Fernando Henrique Cardoso needs to have approved in congress are, for example, the deregulation and the privatization of the energy sector and, of course, social security reform.

How Brazil stabilizes the real again, to keep political power and the economy functioning and expanding, is critically important now. I prefer the Argentina way. To prevent the re-introduction of inflation into the Argentinean and Brazilian economies depends on a monetary rule that has to be strictly enforced by the central bank of Brazil. Industrialists, bankers, and ordinary Brazilians will put pressure on the central bank to relax its monetary policy because the interest rates are very high and the recession is very deep. But if monetary policy is relaxed, inflation will be re-introduced into the Brazilian economy.

Brazil needs all Brazilians working for the stability of the real, and the way to have the Brazilians working for the stability of the real is to have the system that we have in Argentina. You give them, like we gave the Argentineans, freedom to choose between two currencies—the real and the dollar. Backing the reals in dollars like we did in Argentina is not dollarizing the economy. Brazil will have a period during which it can rebuild confidence in the real using the dollar as a supporting currency. If Brazil in four, five, or even ten years, together with Argentina, has increasing productivity
In my view, the attempt to change the crawling peg to a band was technically correct, but the timing was wrong. It was too late. Immediately after the agreement with the IMF, the government suffered two important political defeats. First, it failed to approve a piece of legislation on the Social Security reform which was vital for meeting the fiscal targets agreed with the Fund. Second, in early January, the new governor of the state of Minas Gerais, ex-President Itamar Franco, declared a moratorium on that state's domestic and external debt. These two factors, associated with the substitution of the Central Bank Governor, who had defended the previous exchange policy, led to a complete loss of confidence in Brazil's ability to defend the newly announced band. The fact that the IMF was surprised by the change of policy—and did not hide the fact that it was not very happy—was also very important in aggravating the confidence crisis. In these circumstances, I think it was the right decision not to try to defend something that had become clearly indefensible.

What happened next? The real fell from 1.21 per dollar to 1.45. It held there for a few days. There was some initial optimism that this rate could be sustained. Well, not so. When the excess reserves of the banks dried up, there was complete illiquidity in the exchange market, and the real started to devalue more and more, ending up below 2.2 per U.S. dollar, far beyond any reasonable point of long-term equilibrium. All credit lines to the country were significantly reduced; even trade lines were called back. Since external payments still had to be paid, any additional demand on the exchange market only added to the pressure on the price of foreign reserves.

The Central Bank of Brazil had its hands completely tied by the IMF. The first "tranche" of nine billion dollars had already been drawn. Before using the money to try to stabilize the exchange market, Brazil had to renegotiate with the Fund. So for all practical purposes, the Central Bank—with about 39 billion dollars of reserves, counting the IMF money—had to act as if it had zero reserves, and could not intervene in the market for two weeks. After a new agreement was negotiated and the IMF agreed that the Central Bank of Brazil could intervene in the market, the real recovered to levels around 1.80 per U.S. dollar.

Prospects for Recovery
Where are we now and what are the perspectives? Well, I think that after a few extremely rough weeks, things are much better. Those who subscribe to the view that the roots of the Brazilian problems were the overvalued exchange rate would certainly say that we have a high probability of a fast recovery. The current exchange rate seems to be, by all means, undervalued. Brazil's exports will recover, even if the world situation does not improve significantly, and imports have collapsed. The trade surplus will, therefore, reappear soon. The current account deficit will be reduced; confidence should then come back and credit lines return. Finance Minister Malan is now with the new governor of the Central Bank, Arminio Fraga, in Paris to discuss with banks the possibility of reestablishing the credit lines so that the market can stabilize. A short recession seems unavoidable but the economy should probably start to recover before the end of the year.

If, however, you take the view that Brazil's difficulties are due to the lack of long-term fiscal adjustment, you would still have to ask if the agreement with the IMF will finally lead to serious fiscal homework before taking a positive stance on the economy. Is it sufficient to guarantee that inflation will not come back after
the large nominal devaluation of the currency? There is one additional restriction that tends to be overlooked in most analyses, which is the socio-political restriction. The crucial question is why are interest rates in Brazil still so high? The lack of confidence is certainly an important part of the answer. High interest rates are due to the lack of confidence, but high interest rates aggravate the fiscal situation that is the main cause of the lack of confidence.

**A Mercosur Currency Union?**

Is there an alternative to this difficult situation? The alternative of adopting a "currency board," of using a fixed exchange rate with a currency fully backed by foreign reserves, has many supporters. This is, of course, what Domingo Cavallo has adopted in Argentina and what he defends as the best alternative for countries that come from a recent experience of hyperinflation, like Argentina and Brazil.

The consensus today on exchange rates seems to be that there is a superiority of the extremes—either you float or you go to a fixed exchange rate. The float is believed to be more adequate for large closed countries and fixed exchange rates for small open economies; so Brazil would clearly qualify as a candidate for the float. This would be certainly true if Brazil were not coming from a long period of chronic inflation and a serious crisis of confidence in its currency.

There is strong political resistance to the Currency Board. This resistance seems to be, at first, of a psychological nature, probably due to the association of currency boards to the colonial regimes of the past. There are, however, two recent misconceptions associated with the adoption of the currency board. The first is that the adoption of a currency board has to be preceded by a forced restructuring of public debt. The second is the idea that it is not the stock of M0, the monetary base, which has to be fully backed by external reserves, but indeed M4, the broadest definition of a monetary aggregate. The reasoning is the following: Since domestic public debt is mostly short-term debt, it could, in principle, be totally transformed into money; in order to avoid a run it would, therefore, have to be fully backed by foreign reserves. This is, however, a case of the classical confusion between stocks and flows. All you need is a guarantee that no additional currency will be issued without an equivalent increase in the stock of the reserve currency. The current stock of domestic currency is being held under very adverse circumstances. Introducing the restriction on the issuance of additional currency will only increase the quality of the stock of financial assets denominated in the domestic currency and, therefore, lead to an increase in the demand for money and debt.

There is one additional risk with respect to the idea of a currency board. There is always the temptation to look at it as a short-term panacea to which you can turn in a desperate situation. Most of the benefits of the currency board come in the short run: a higher degree of confidence and lower interest rates. The fiscal constraints and the restrictions on the ability to react to adverse external shocks, however, are longer-term consequences.

I believe that to consider the possibility of adopting a fixed exchange rate in the near future, fully backed by foreign reserves, only makes sense as part of a long-term program towards a currency union for the Mercosur region. This is not incompatible with all with a successful way out of the current crisis with a floating exchange rate. On the contrary, I believe that the monetary union should not be viewed as an easy alternative to short-term difficulties, but as part of the process of going toward a new world. Everything seems to indicate that, in the future, there will be fewer currencies. There seems to be too many currencies and too much instability for an increasingly integrated world economy.

André Lara Resende was Special Advisor to the President of Brazil from August 1997 to April 1998, and then President of the National Bank of Development (May–November 1998).
SECTION 9
RUSSIA

ANDREI KOKOSHIN

Reform and Russia’s Future

In Russia we are attempting to create both a political democracy and a modern economic system with a market economy. In Asia, sometimes a choice has been made between a modern economy and a modern political system. We tried to do it in Russian style, simultaneously, and each of these tasks was, of course, and still is of tremendous complexity and tremendous scale. As you may remember, our radical reformers who came into the power in 1992 actually tried to use some kind of shock therapy for our economy.

What complicated a lot of our political and economic reforms was the existence in Russia of a very large military machine with all its plants and assets. Russia is still, in terms of its nuclear capacity, a superpower and this factor remains a very important factor for our foreign policy, and for our domestic political scene and economic reforms.

The situation in Russia after the financial crisis in August 1998 is still quite serious, from both the political and economic points of view. Primakov’s government brought substantial political stability, and we still enjoy that stability in the country. I am not quite sure for how long, but this is a very important factor, though in the area of economics we are still facing the same problems.

I can mention only some of the most important elements of this situation, like the growth of unemployment (officially, we now have 12.4 percent unemployment in the country); there is still a substantial debt problem of the government to teachers, medical doctors, the armed forces and the defense industry, personnel of the ministry of the interior, and so on; and the situation in the banking sector is still very far from satisfactory. In order to estimate where we are right now and what could be done in the short term, mid term, and long term we should have a serious analysis of the results of the previous stage of the course of reforms in Russia.

The Mistakes of the Radical Reformers

It is now the overall consensus that one of the biggest mistakes of our radical reformers in Russia was that they concentrated almost exclusively on macroeconomic stabilization with a minimal role for the state. A majority of them became even greater followers of the ideas of Milton Friedman and Friedrich von Hayek than some of the followers of these distinguished economists in the United States. These radical reformers were preoccupied with this idea of minimizing control by the state and primarily using this monetary method to stabilize the economy. But they did not pay attention to the creation of a modern banking system according to international standards nor did they deal seriously with restructuring our industry, especially the most valuable part of our industry for potential economic growth—the defense industry.

In the press of radical reforms important factors of the contemporary global economy, such as human capital, were almost ignored. And this is especially tragic because we still have a pretty high level of education and we still have a substantial level of scientific activity and scientific achievement and cultural development and principles. We now have more universities than we had before the reform started—we have 427 research centers and laboratories in the Academy of Sciences—and this is one of the good signs of the reforms. But another sign, a bad sign, of the reforms is that factors such as education and the substantial technological potential of universities and research centers of the Academy of Sciences are not used in a proper way and we have not created the necessary conditions to use this human capital.

We did not have efforts on the part of the government, in spite of the insistence from some
of us, to create techno-parks and incubators for small high-tech firms. We are trying to do it now, though, of course, with substantial delays and losses, losses in terms of brain drain, for example. A lot of our best scientists, including computer scientists and mathematicians, come to the West for the benefit of the American economy or the benefit of the Western European economy. This is our positive contribution, at least, to the world economy!

Practically nothing was done by the majority of Russian reformers in terms of facilitating the process of greater participation of our high-tech and mid-tech industry in the world division of labor. We are still, in my view, quite competitive in the world economy with rocket launchers, laser technologies, super-high-frequency electronics, and many kinds of aircraft. And we are especially potentially competitive in areas like the production of software, which is now the most important part of economic development in the world.

As a result, the role of exports of raw materials in the Russian Federation became even more substantial than it was in the Soviet Union. It was one of the features of the collapse of the Soviet economy that oil, for example, had more and more of a role to play in our exports and foreign trade. And we saw the impact of this role recently: The substantial decline in the price of oil was one of the major reasons for the financial crisis of the Russian Federation in August 1998. The financial crisis was not just the result of concrete mismanagement of the situation by the Kiriienko government, the pyramid of Russian treasury bonds, or mismanagement on the part of the Central Bank of Russia. It was, in many respects, a result of the mistakes in strategic decisions made in 1992 and 1993 regarding the Russian economy and Russian industry. Unfortunately, the survival of Russian high-tech industry in many respects now depends on exports of weapons. And, in my view, it is not the best solution for our country; it is bad economically and it is sometimes counterproductive politically.

The scale of support and direct help from the West for Russian reconstruction was, in my view, not adequate to the tasks which we announced in 1991 and 1992. As I said before, we tried to substantially change the political system—the whole of our history for several centuries and maybe for a thousand years—and simultaneously to create quickly a market economy in a country which never experienced it on a large scale, maybe excepting a couple of decades before the October Revolution. We needed much larger help, comparable to the aid from the United States to Western European countries after World War II through the Marshall Plan. The aid from the West to the Russian Federation and to other CIS countries, according to some Western estimates, is several hundred times less than the aid provided by the United States to the Western European countries through the Marshall Plan. And mostly the aid from the West came in terms of loans which are now the cause of big debt problems for both us and the West.

Another very important factor is that a majority of radical reformers ignored traditional values of the Russian population, like patriotism. As a result, the idea of patriotism started to be exploited, and quite successfully, by communists and radical nationalists. The reformers were also unable to create a strong enough law enforcement system, which was badly needed during this period. In the Security Council, I was in charge of coordination of many of our law enforcement agencies fighting corruption, terrorism, illegal transactions of military technologies, etc., so I know how difficult it was to use these law enforcement agencies after their substantial weakening and fragmentation during the first phase of reforms.

The Next Phase of Reform
And now, taking into account these long-term and mid-term problems which we face after the first phase of reform, I think that the most important and the most urgent tasks for us to continue these reforms are the following:

- First of all, we should combine the ideas of political democracy, human rights, and market economy with ideas of traditional Russian patriotism. If we don't do this, we will leave patriotic sentiment entirely in the hands of
those who are entirely against these reforms.

- Second, we should formulate a clear-cut national industrial-technological policy based on the wide use of our human capital and the creation of market economy mechanisms to utilize this human capital for the benefit of Russia's economy and integration into the world economy and for the benefit of global growth.

- Third, we should restructure our high-tech industry and, first of all, our defense industry. We should create large industrial corporations according to the standards existing in the West—we are now looking for the best models for our corporations through my newly created organization, the Confederation of Industrial Corporations of Russia—and, at the same time, we should create small and medium-size companies, including in high-tech areas.

Part of this task is entering the world market not with raw materials or steel—we don't want more situations like we had recently with the steel workers of the United States objecting heavily to our cheap steel coming to the United States market—but with high-tech and mid-tech products through active cooperation and strategic partnerships with Japanese, Western European, and American companies. Fortunately, we have some examples for these kinds of cooperation—good examples and some cases of success. We should now develop the right model for the role of the state in the economy in scientific technological development. And in this respect there is a growing understanding and even consensus in Russia that we should borrow more from Western Europe and Japan, even taking into account the current problems in the Japanese economy, rather than from the United States, and maybe even from Israel. There have been very good and interesting recent developments in the high-tech industry in Israel, which has about one million Russian-speaking people now.

Cooperation in a Changed Strategic Landscape
We had very substantial changes which occurred in political and military affairs in 1998. First of all was the appearance of two new official nuclear states, India and Pakistan; in the same context there are tests of rockets—one successful, one unsuccessful—in Iran and North Korea; and there are other developments not very well-known to the general public. All of these developments are significant enough to make the conclusion that the world will have a substantially different strategic landscape in the 21st century from what was seen by the majority of analysts right after the Cold War and the collapse of the Soviet Union. Trilateral countries and Russia should devote substantial intellectual efforts to understand the nature of this new strategic landscape. We need joint work in this area. There is no military answer to these issues; no theater nor strategic ballistic missile defense could cope with these kinds of threats, that is for sure.

One should take into account that Russia is still one of the most important factors in all of these geopolitical equations, especially in the nuclear field. I should also point out that there is a very serious issue in connection with non-proliferation of weapons of mass destruction and rocket technologies. We should work together—Trilateral countries, Russia, and other CIS countries—to have more sophisticated export control systems. My personal experience shows that existing export control systems not just in Russia, but in the West as well, are not sufficient. This issue should also be a serious topic for the work for Trilateral countries with the Russian Federation and other CIS countries.

In conclusion, I think that we are facing new problems, new challenges, and new opportunities. Russia suffered a lot before and during the reforms, but is ready to proceed anyway with both political and economic reforms, and is ready to become a real member of the international community of developed countries.

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Ukraine at the Crossroads: Perspectives on Independence, Democracy, and Reform

Ukraine is at a critical crossroads in its development as an independent state. It is confronted with choices which will determine the future of democracy in Ukraine and impact upon the security and stability of Europe. Whether to pursue a course like Poland’s, of further integration into the European family of nations, or to follow Belarus into a murky pan-Slavist union lead by an economically crippled, increasingly chaotic Russia.

Two events this month have painted these options in stark relief. The first was the symbolic vote on March 3 by the Verkhovna Rada of Ukraine, the Parliament, to join the Parliamentary Assembly of the CIS. The second was the admission of Poland, the Czech Republic, and Hungary to NATO. Ukraine’s choices are clear. However, the route it will ultimately choose is more ambiguous.

At its root, the debate over Ukraine’s future course belies a profound struggle within the Ukrainian nation to identify its place in the world; a world which it only feebly comprehends and which poorly understands Ukraine. Ukraine’s history of foreign domination, colonial servitude and divided rule has left deep scars on the national psyche. It has left the new state woefully unprepared to define its national ideals and objectives in a brave new world. The country’s leadership, Ukraine’s legacy from the Soviet Union, is more interested in pursuing and preserving selfish commercial/financial interests than it is in defining and securing Ukraine’s strategic interests and in building a prosperous, democratic nation for the benefit of present and future generations. Directionless and poverty-stricken, Ukraine is sinking into a morass of creeping despotism.

The Euphoria

It did not have to be this way. With the euphoria of independence, Ukraine anxiously sought ways to secure its new freedom against Russian hegemony. Accordingly, it embarked on a European-oriented nation-building exercise. Ukraine successfully laid out the framework for the development of vital democratic institutions—a balance of power between Parliament, president, and an independent judiciary; the provision for local self-government; and constitutional guarantees of human rights and freedoms, property rights, and the like. Ukraine achieved membership in the Council of Europe (ahead of Russia); it solemnly promised to enact reforms to transform post-Soviet Ukrainian society in accordance with the democratic values, norms, and standards of human rights required of Member States. Only three years ago, the passage of the Constitution of Ukraine was heralded by the Council of Europe as the embodiment of European constitutional progress.

On the economic front, Ukraine defeated hyper-inflation, achieved a respectable degree of macro-economic stabilization, successfully introduced a new currency, privatized most small and medium-sized businesses and established a legislative framework for market development.

To facilitate this process, the Verkhovna Rada not only passed laws on privatization and foreign investment; it has since 1993 delegated to the government and the president extraordinary powers to regulate the economy by decree.

The Disappointment

The tragedy of these efforts is that, with few
exceptions, Ukraine has only imitated real reform. The economy has shrunk every year since independence. Most of the private sector has fled to the shadow economy, hounded to the periphery of legal entrepreneurial activity by state over-regulation, unfair tax collection measures, and the blind corruption of officials. Millions of pensioners, teachers, doctors, and other state employees await payments which are more than a year overdue. Privatization and other reforms have stalled, foreign financial aid is in constant jeopardy of being suspended, and democracy is weaker than at any other time since independence. The government interferes with local and Parliamentary election results and harasses the media with impunity. Ukraine is on the edge of being suspended from the Council of Europe for violations of human rights, electoral fraud, repression of the media, and interference with the independence of the judiciary.

Ukraine’s nation-building efforts have not resulted in Polish-style economic vitality, but in stagnation and economic collapse. As the twenty-first century approaches, Ukraine is confronted by the specter of unremitting misery for its people, debt default, currency collapse, the imperial embrace of Russia and the resurgence of the Communist left. The people’s attitude towards democracy, reform, and the national ideal are characterized by cynicism, skepticism, and fatigue rather than by hope, faith, and contentment.

The Nomenklatura and the Rise of the Oligarchs: Where Did Ukraine Go Wrong? What Are the Perspectives for the Future?
The response to these questions goes to the heart of the Soviet legacy in Ukraine. A defining characteristic of post-Soviet society is the continued depth and breadth of power exercised by the state over every aspect of a citizen’s life. The Soviet nomenklatura was able to retain power in Ukraine upon independence in 1991. During Soviet times, it wielded tremendous administrative control over the lives and activities of the people.

Today, the nomenklatura continues to exercise a virtual monopoly on state power, its decisions immune from public scrutiny. With control by the Communist Party over its activities now only a distant memory, its actions are practically accountable to no one. As a result, the nomenklatura is now the unfettered arbiter of the distribution and use of state property.

This phenomenon has bred rampant corruption in every branch of the civil service, degraded the development of democratic institutions, retarded the constitutional imperative of decentralizing authority to the regions, and stymied economic reform in Ukraine.

Over the past five years it has also fostered the emergence of another post-Soviet phenomenon: the “oligarchs.” As in Russia, the current structure of government is propped up by “clans” of financiers and industrialists who enter into cozy and lucrative relationships with the nomenklatura to carve up the wealth and power of the state. They specialize in rigging privatization programs in order to cheaply acquire state assets. As the respected economist Anders Aslund has noted, Ukraine has effectively become a closed joint stock company caught in the grip of the oligarchs.

The oligarchs were initially content to merely become obscenely rich. However, the allure of power proved too strong. With the Parliamentary elections held last year, the oligarchs emerged from the shadows to run for seats in Parliament. They invested heavily in their campaigns, attracted by the immunity their commercial activities would enjoy, the veneer of respectability they would gain, and above all, the direct power and influence they would wield not just over the distribution of state property, but the direction of the economy as well.

The result has been the effective criminalization of the Verkhovna Rada. From an institution of democracy, the Ukrainian parliament is being transformed into a shelter for the criminally inclined.

The oligarchs sitting in Parliament have united with the clans represented in the president’s administration to rally around the pres-
President's bid for a second term. Their support is dictated by calculated self-interest: President Kuchma has provided the conditions for the accumulation of their wealth and power, his possible defeat jeopardizes their holdings and influence.

The president, for his part, has sought to deflect criticism for the lack of progress on reforms onto the Verkhovna Rada, accusing it of blocking his reform efforts. The president tries to portray the situation as an epic power struggle between a reform-oriented president and the "Red Revanche" in Parliament.

This characterization, developed largely for consumption by Western donors and financial institutions, is not credible. Far from being held back by Parliament in a radical reform effort, the president and the government have had a virtually free hand in conducting and directing economic reform through the grant of extraordinary privileges. First as prime minister and then as president, Kuchma demanded from the Verkhovna Rada, and was granted, extraordinary powers to enact economic reforms by decree. These were even enshrined in the transitional provisions of the Constitution for a period of three years. Thus, in one leadership capacity or another, Mr. Kuchma has held in his hands the essential levers of economic management in Ukraine for seven years.

The fact remains that this power has been squandered by a combination of cronynism and incompetence. To date, the president and his government have failed to put before Parliament any coherent or systemic reform strategy for consideration.

The Threat to Independence—
The "Slavic Union"
The question therefore arises: how much more can Ukraine afford to continue with policies of this nature without jeopardizing its independence? The president is becoming more desperate in the face of the decline in living standards. He is under pressure from the Council of Europe, Western donors, and international financial institutions to take hard decisions regarding substantive reforms.

Yet, in the lead up to presidential elections in October, President Kuchma is increasingly adopting populist positions. These reaffirm Soviet-era themes and values, and espouse positions which require the least effort at reform. Implemented, they would bring Ukraine closer to Moscow than they would to Strasbourg or Brussels. They also ensure him and his allies maximum power with minimum accountability. In this context, advocating closer ties with Belarus and Russia would secure votes among Communist constituents, as well as preserve existing privileges.

The effect on Ukraine's economy of further integration with Belarus and Russia would be catastrophic; its impact on the Eurasian geopolity, profound. It could easily occur in the following way. In the near future, Ukraine could default on its debt obligations and face the type of financial meltdown which prostrated Russia. Ukraine would come under immense pressure from Russia to recreate, along with Belarus, a so-called "Slavic common market." This will form the economic basis for the reconstitution of the Soviet Union in the form of a "Slavic Union." The partners would devise a closed "ruble zone," re-establishing an economic curtain between the "Slavic Union" and the West. Moscow will be more than content to renew its place as the political center of such an arrangement. Russia will again begin to throw its weight around the Eurasian playing field, a role denied to it following the collapse of the Soviet Union.

Ukraine's hitherto tentative westward-leaning foreign policy will collapse. As a result of weak and corrupt government, the current leadership in Ukraine is incapable of deciding between the competing tendencies of the Polish and Belarus models. Consequently, a number of voices claim to speak in the name of Ukrainian foreign policy. The president's foreign policy is ambiguous to say the least, that of the Speaker of Parliament is distinctly pan-Slavist, while the Foreign Ministry tries to take a pro-European integration line. Unclear as to its own strate-
gic security interest, Ukraine has voluntarily, at least for the moment, become a political “buffer” between East and West. Its only coherent strategy is to play off the desire of the West to help secure Ukrainian independence against the West’s interests in seeing real reforms which would entrench democracy in Ukraine.

Tempting as it would be under this scenario, it would be a grave mistake for the West to turn its back on Ukraine. A Russia reeling from economic collapse would soon look to Ukraine to provide it with goods and produce within a closed market. Russia would become more belligerent and Ukraine more xenophobic. A lager mentality would prevail within a “Slavic Union,” endangering Western security interests. Therefore, the West must pursue separate strategies regarding Ukraine and Russia. With respect to Ukraine, however, such a strategy must be far more insightful and subtle than it has been to date.

Security Interests and Strategies
On the one hand, the issue of Ukraine’s place in the world is of significant importance to the West. As the draft report prepared for this annual meeting suggests, significant security challenges await the West arising out of the weakness of post-Soviet states. Western countries must therefore try harder to bolster all of the states on Russia’s fringes. Yet, it is patently obvious that Ukraine is unwilling and unable to fully safeguard its own security. It can only do so with the understanding and active assistance of the West.

The West can positively nudge Ukraine toward the Polish variant. Promoting democratic values in countries like Ukraine and facilitating the construction of institutions of civil society remain in the long-term interests of peace and security in Europe. By helping empower non-governmental organizations, civic associations, and professional and business groups to demand greater accountability and services from their government, conditions will be set for improvement in governance, especially at the local level. The infusion of Western liberal values will, over time, break the government’s stranglehold on power, and facilitate democratic and market reforms.

Further, the NATO “Partnership for Peace” program serves to promote Ukrainian self-confidence in withstanding Russian territorial aspirations (especially vis-à-vis Crimea), to foster among Ukrainians a sense of belonging to the European democratic polity, and to blunt the attraction of a “Slavic Union.” It also reinforces a message the West should consistently repeat to Russia: that Russian bullying of any of its neighbors will not be tolerated.

Ukrainian decision-makers, for their part, find engagement with NATO at this level convenient. The relationship poses little risk and allows Ukraine to keep its options open. The leadership fully realizes that NATO is not prepared to offer Ukraine partnership in the Atlantic alliance any time soon.

On the other hand, there are two ways in which the West is actually making the existing situation worse. First, it is foolish to think that the West can “buy” reform by giving money or credits to the current regime in exchange for the performance of certain conditions. The recipient, the Ukrainian government, has no ownership of the reform process, and can ultimately reject it as having been externally mandated. There is therefore no sustainability and predictability to the reform effort. Western donors and international financial institutions have allowed themselves to be cynically manipulated by Ukrainian officials and have nothing to show for their efforts but frustration. The current leadership leverages Ukraine’s geopolitical importance to the West, safe in the knowledge that, despite flouted conditions, Ukraine will get most of what it has been promised. These are classic Soviet tactics, executed by skilled practitioners.

This raises the second issue: The West is now faced with a dilemma of its own making. Initially, donors believed the president’s rhetoric that Ukraine was pursuing pro-Western policies and that the Ukrainian leadership was genuinely interested in economic reform. The West, ...IT IS FOOLISH TO THINK THAT THE WEST CAN "BUY" REFORM....
INEPT AND CORRUPT GOVERNMENT POLICIES GIVE CREDIBILITY AND CREDENCE TO COMMUNISTS AND OTHERS WHO CRAVE A RECONSTITUTED SOVIET UNION.

particularly America, having made out President Kuchma to be a “reformer,” is now not sure what to do about him. Although it has seen through the rhetoric, the West feels it has no choice but to continue to back the existing regime, however reluctantly, in the face of the so-called “Red Revanche.”

This position is as dangerous as it is wrong. Things are seldom what they seem in the former Soviet Union, and playing politics by betting on one politician is a folly’s lottery. Politics in Ukraine is not a zero-sum game. Palatable alternatives from the right and left exist for Ukraine from among the current potential candidates for president. These need to be objectively assessed by Western policy analysts.

Future Prospects for Reform

More profoundly, Western strategy toward Ukraine should focus on medium-term interests, beyond the upcoming presidential race. Indeed, the election is only the first stage in the determination of Ukraine’s future course. The real prize comes in three years, when the next Parliamentary elections will be held. The West should set itself the objective to support a victory by democrat/reformers at that time.

Therefore, it does not follow that a victory in October 1999 for President Kuchma constitutes a victory for the democratic process over the Communist “hordes” he would like the West to see in Parliament. In fact, it is best for the development of democracy in Ukraine that President Kuchma not be re-elected. Another mandate will only perpetuate further social and economic stagnation, and instability. Based on the results of the president’s policies to date, in a new term we can expect further expansion of the state’s monopoly of power; further suppression of dissent, further criminalization of the Ukrainian economy through the influx of Russian capital, a continued poor investment climate for Western capital, the continued spread of corruption, and the continued degradation of the rule of law and democratic development. If he loses, like former President Kravchuk, he will go into opposition to a new president. A fresh team will come to power breaking the grip of the existing oligarchs over the country.

Having clothed himself in the garb of reform and democracy, President Kuchma will continue to profane both concepts in the eyes of the people. Inept and corrupt government policies inevitably give credibility and credence to Communists and others who crave a reconstituted Soviet Union. Just as President Kuchma needs the Communists to oppose him to have any chance for a second term, so too the Communists need a Kuchma victory to drive the economy further into the ground, further discredit the concepts of reform and democracy, and assure them a future majority in Parliament.

In short, President Kuchma’s re-election will ensure the ultimate victory of the “Red Revanche” he is ostensibly trying to keep at bay.

Ultimately, what distinguishes Ukraine from Belarus and Russia is the pivotal role the Verkhovna Rada plays in determining Ukraine’s future course. In 1991 Moscow envisioned a model of development for the states of the former Soviet Union based on a strong president and a weak Parliament. The result in Russia and Belarus has been a slide toward autarky. Ukraine went a different route, building into its Constitution a reasonable balance and separation of authority between the executive, legislative and judicial branches of power based on democratic principles.

The Verkhovna Rada, like all of Ukraine’s embryonic democratic institutions, is imperfect. It is not generally viewed as a catalyst for reform in Ukraine, yet all of Ukraine’s achievements in the twin processes of reform and democratic development are associated with Parliament. This “leftist” institution laid the constitutional foundation for democracy in Ukraine. It initially proclaimed sovereignty, then independence for Ukraine. It initiated the Constitutional Accord to diffuse tensions with the executive, then passed a very democratic Constitution, one which the president opposed.

Parliament, therefore, is a key institution in Ukrainian democratic development. In the
present circumstances, it is a vital bulwark to Ukraine's national security against any unconstitutional expansion of executive power.

Conclusion
There is a need for a leadership change in Ukraine for Ukraine to realize its democratic potential and to become a fully integrated member of the European family of nations. The West must maintain its engagement with and pressure on Ukraine over the short to medium term. This will buttress the forces in Ukraine interested in serious change. While a frustrating partner at present, Ukraine in a “Slavic Union” would be a destabilizing influence on the region and European security as a whole.

At the end of the day, I believe that if left to a democratic choice, the people of Ukraine historically, culturally, and psychologically would affirm the same path Poland took. They will choose Europe. We need to ensure that Ukraine’s leaders are as wise.

Serhiy Holovaty is a Member of the Ukrainian Parliament and former Minister of Justice. He is also Chairman of the Ukrainian Legal Foundation.
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