WASHINGTON ECONOMIC WATCH

A Digest of Development Policy Information

A Project of the Overseas Development Council

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QUARTER 4, 1990

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WASHINGTON ECONOMIC WATCH

A Digest of Development Policy Information

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A Project of the Overseas Development Council

John W. Sewell, President

January 23, 1990

Dear Reader:

With this issue, the Washington Economic Watch is pleased celebrate its first anniversary. Once again our digest provide you with a timely and diverse selection of policy information the present state of U.S.-Third World economic relations.

Throughout the year, the digest has undergone several changes, including the reorganization of several of our functional categories, the addition of a table of contents, an the inclusion of our "rapporteur's reports"--summaries by ODC staff of seminars and conferences given in the Washington area topics of relevance to international economic policy. These changes have developed in response to feedback from our reader in an attempt to make the digest a more efficient and useful service for you.

As we close our series for 1990, we would like to offer y the opportunity to critique the digest in a more constructive fashion. Enclosed you will find a survey which can be used to evaluate the content and format of our packets. We ask that yo kindly fill out this brief two page questionaire and return it us at your earliest convenience. Your responses will provide u with a better understanding of your research needs as well as help us make any appropriate changes for future editions of WEW

We appreciate your continued interest in and endorsement our digest, and welcome the opportunity to continue to provide you with this service in 1991.

Sincerely,

Richard E. Feinberg
Executive Vice President
and Director of Studies

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Washington DC 20503

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Office of National Drug Control
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Executive Office of the
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Office of the United States
Trade Representative
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Seventeenth St.,NW
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Department of Agriculture
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LatinFinance
2121 Ponce de Leon Blvd.
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Coral Gables, FL 33134

National Journal
1730 M St. NW Suite 1100
Washington, DC 20036

TRADE

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GATT Ministerial

Brussels, December 3 - 7, 1990

U.S. Briefing Transcript

Following is the transcript of a press conference held on December 7, 1990, in Brussels, following the adjournment of the GATT negotiations by a U.S. delegation which included: USTR ***Carla Hills****; Secretary of Agriculture* ***Clayton K. Yeutter****; Secretary of Commerce* ***Robert A. Mosbacher****; and Acting Secretary of Labor* ***Roderick DeArment:***

Ambassador Hills: The United States came to Brussels prepared to conclude ambitious, market-opening agreements in each of the 15 areas of the Uruguay Round negotiations. This week, we made visible progress in many of these areas. Indeed, in some areas, differences were substantially narrowed.

However, it is now sadly apparent that the deadlock on agriculture cannot be resolved here in Brussels. The Chairman of the Agriculture Group put forward a creative proposal that provided a basis for successfully concluding the negotiations. Unfortunately, this proposal was rejected by a few countries with substantial economic strength who were not prepared to negotiate fundamental agricultural reform. This was all the more disappointing in light of the very constructive attitude taken in the Round by many developing countries.

We are compelled to agree that no useful purpose can be served by prolonging the Brussels meeting. In adjourning, Chairman Gros-Espiell is merely acknowledging this reality. We encourage participants to take this opportunity now to reflect upon their positions at the highest political level. And, we endorse the proposal for Director General Dunkel, when conditions are appropriate, to use his good offices to work with participants to narrow differences.

I speak for the President in saying that the United States remains committed to maintaining and strengthening the multilateral trading system and to bringing the Uruguay Round to a positive and timely conclusion. We will do all that we can to achieve this result while continuing to insist that the agreements genuinely liberalize trade. When it is clear that a basis exists for successfully concluding this Round, the United States will return to the negotiating table. I am pleased, as are my colleagues, to answer your questions.

Q: (INAUDIBLE)

Ambassador Hills: The legislation which we call the fast-track agreement is in place, and it requires that a notice be given to Congress on March 1, if we are to go forward with fast-track authority which, for those of you not familiar with our legislation, merely means that Congress votes a package of trade agreements up or down, and we give that notice on March 1 and the signed agreement on June 1. And so we don't have a lot of time, if we are to use this fast-track authority.

Q: You will know that among all the European Community governments the British government has historically been among the most critical of aspects of the Common Agricultural Policy. But British Ministers today and this week have described your negotiating tactics as outrageous, resented the manner in which the world's greatest trading bloc has been addressed by the world's second greatest trading bloc, and have said, generally speaking, that your objectives have been totally unrealistic. Did you really come here knowing that there couldn't be an agreement on agriculture?

And secondly, if I might ask you, can you assess the political, the wider, non-trade, political damage created by this impasse?

Ambassador Hills: We came, as I said the first day that we arrived, anxious to conclude the Uruguay Round here at Brussels. And we have encountered enormous obstacles in negotiating fundamental agricultural reform. I would point out that the majority of the nations here at the meeting were favoring fundamental agricultural reform which will require specific commitments in each of three areas, that is, reduction in export subsidies, reductions in border protections, and reduction in internal supports that are connected to trade distorting effects. And we will continue to negotiate for fundamental agricultural reform. We hope that in negotiating in good faith for high principle, and for trade liberalization, that we can maintain greater tranquility rather than lesser tranquility among the great trading partners. And we're hopeful that by negotiating in good faith, that we can achieve our objectives.

Q. Mrs. Hills, in the last several years you have been very successful in warding off Congressional pressure, as well as private sector pressure, for you to take action under 301 and other mechanisms. How long can you continue to hold that pressure off, given the state of play in these multilateral discussions.

Ambassador Hills: Congress looks to using unilateral measures under 301 as a means of resolving trade barriers that prevent us from trading in the international trading system. And so long as we do not have agreed-to multilateral rules, it is very difficult to tell the elected representatives of our people that they cannot protect the national interest. We will work with Congress, we consult very regularly with Congress, and we will try to take actions that are consistent with maintaining and building the multilateral system, while protecting our national interests at the same time.

Q. (INAUDIBLE) some of the Cairns countries of the agricultural exporters developing countries won't come back to Geneva until the EC gets its act together on agriculture? I know you've expressed concern in the past about some of these countries just bowing out of the whole show.

Ambassador Hills: I do not think it's going to be possible to narrow the differences that exist in the other 14 negotiating groups, without having negotiations proceed in the agricultural negotiating group, and the Latin American countries, in addition to those that are active members in the Cairns group, made quite clear that they need to have fundamental reform in agriculture if they are going to proceed with the negotiations. So I hope that that message reaches the highest political levels and we are able to proceed with the negotiations in agriculture.

Q: Two questions, first one for Mrs. Hills. Do I gather from your opening statement that the United States is not unconditionally committed to returning to the talks in Geneva? Second, a question for Secretary Yeutter. It was widely predicted four years ago that the United States was risking precisely this outcome by taking a maximalist approach on export subsidies. To what degree does the United States accept responsibility for this outcome by ignoring those predictions?

Ambassador Hills: In answer to your first question, the United States, indeed, no nation will be returning to Geneva to continue with talks until the Director General has probed to find that the conditions are appropriate and would make such talks beneficial and effective in accomplishing our objectives. We sincerely hope that those conditions will become apparent soon, but I have no guarantee that they will.

Secretary Yeutter: I'd like to respond to that and perhaps add a comment to the earlier question which implied also that the United States took an unrealistic negotiating stance. I don't happen to agree with that at all, and that viewpoint is certainly not shared by vast numbers of countries in this world. If any of you had sat in the discussions last night, or throughout the week, that would have been evident. It becomes a question of whether the Community is out of step in agricultural trade policy, or whether the rest of the world is out of step. And there were a lot of representatives sitting around these tables this week who would uniformly and universally conclude that it is the Community that has been out of step in agricultural trade policy.

Now, with respect to export subsidies in particular, no one will ever be able to persuade me that we, the United States, or we, the exporting countries, which would include the entire Cairns group, took an unrealistic stance by suggesting the ultimate phase-out of export subsidies. Because export subsidies have no redeeming qualities. Everybody understands that. I do not believe you will find one trade policy practitioner in the world, who would disagree with that statement. So the question is how far and how fast. And the fact is that the United States has been willing to negotiate a reasonable outcome on that issue from the very beginning. We were prepared to do so this week, and in fact we indicated a willingness to do so in the context of the Hellstrom proposal last evening. At no time this week, has the European Community surfaced a proposal that evidenced any specific commitments to reduce or phase down agricultural export subsidies. There was a commitment that they were prepared to discuss this subject but there has never been a specific proposal in the entire four-day period.

Q: Is it the position of the U.S. that the EC will have to accept something along the lines of the Hellstrom proposal, either in number or in concept, and you can elaborate on that, in order for there to be this clear basis to return to the talks?

Ambassador Hills: Let's be quite clear that Chairman DeZeeuw, when he prepared his report as chairman of the negotiating group in Geneva, said that for fundamental reform there must be a reduction of export subsidies, as well as border protections and internal supports. Chairman Hellstrom, who did a very effective job here in Brussels, said the very same thing. And it would be impossible, Secretary Yeutter has just very clearly said, to have fundamental reform in agriculture without addressing export subsidies which really do constitute a form of economic warfare against your neighbors. You are exporting your problems to the outside world and requiring them to pay for them, and it is unacceptable to a majority of the world's nations.

Q: Mrs. Hills, you said at the beginning that Mr. Hellstrom's creative proposals were rejected by a few countries with substantial economic strength. Indeed, is that not the "real politik" of this meeting, the fact that these countries have less to lose from a failed Uruguay Round than the United States or the Cairns. The EC and Japan will be less disadvantaged, if this whole thing flops than you will, or anyone else here, in the bottom line, dollars and cents. Is that not what this week's meeting tells us?

Ambassador Hills: No. We all lose big by a failure of a successful result in the Uruguay Round. And it doesn't matter whether you're Europe, or the United States, or the lesser developed world, you miss the opportunity to grow the global economy in the decade of the 90's by over 4 trillion dollars. You forego the opportunity of creating greater harmony and economy tranquility among the trading nations of the world. And perhaps most selfish and worst of all, you deny the developing world their aspirations for economic gain. So, we all lose because that latter point means that we have a greater chance for political instability rather than global

stability. And I think that therefore, at the highest political levels, all around the world, we must muster the political will to deal with those issues that separate us. And one, of course, has been designated as fundamental.

Q: Would you say, Madame Hills, that this position of the Community gives a signal about what will be the Europe from now on. Are we confronting as a whole the creation of two new blocs based on the commercial subjects. Do we have now these two blocs, two economic blocs confronting each other?

Ambassador Hills: We do not need to conclude, as a result of the Brussels meeting, that the world immediately fissions into two blocs. Not at all. We still have the opportunity ahead of us to achieve a successful conclusion of the Uruguay Round. And the United States will leave no stone unturned to achieve that objective. And I hope other nations of the world, and many here did so demonstrate, will join us to achieve that objective.

Q: Mrs. Hills, now since the United States has found the European Community to be so recalcitrant and unable to respond to the impulses of liberalization, would the U.S. consider using some measures to discipline it, such as Super 301 or countervailing duties?

Ambassador Hills: I think it is unlikely that this is the moment to ask Congress to give up its means of protecting the national interest, when we have not achieved a blue print for having multilateral rules protect the national interest. So my greatest energies, of course, will be directed to accomplishing the successful conclusion of the Uruguay Round.

Q: To follow up on my colleague's question, listening to the acrimony this week, it was very hard to imagine that the U.S. and the EC are allies. Can you tell us how the U.S. and the EC will be able to face a potential crisis in the Gulf in the next month with this hanging over the Alliance's head?

Ambassador Hills: First of all, you didn't hear any acrimonious words from me, and I do work effectively with my counterparts in the EC, notwithstanding our differences of view. I would hope that the effects of the Brussels meeting, and the very visible outcome of a majority of the world's nations yearning to have fundamental reform in agriculture, as well as rules in that one-third area of trade where now we do not have rules, that the EC will be able to muster the political will to deal with agricultural reform. So we needn't have acrimony. And, indeed, there is not one of my colleagues here who wants to have acrimony, not only not toward the EC, but not toward any nation. We simply want to have fundamental reform of our trading system and the opportunity to spark that economic renaissance that could occur, were we to get market access as envisioned by my colleague here, who launched the Uruguay Round four years ago.

Q: I just wanted to ask Secretary Yeutter, who as you mentioned did launch the Round four years ago, if you feel that you, in any way, made a mistake in pushing so hard for fundamental reform in agriculture and bringing in so many other areas which were not part of the GATT?

Secretary Yeutter: Ambassador Hills may want to embellish this. I assuredly do not believe it was a mistake to include agriculture as one of the priorities of the Uruguay Round. That action is just long overdue. As you well know, agriculture received some discussion and some attention in earlier rounds of trade negotiations, but with no work product emanating from those activities at all. In other words, for all practical purposes, agriculture has been excluded from the rules of the GATT for more than forty years, even though it is one of the major international trading activities. So, it is incumbent upon us if we expect to exert any political leadership in this world, and if we expect to develop an institution such as the GATT that will do its job effectively, it is incumbent to deal with the major international trading issues of the day. Agriculture falls in that category. Agriculture has essentially been ignored for forty years of GATT history. It can not be ignored because it is too important in international commerce. So

we must develop effective rules in agriculture trade. That's why it's on the agenda of the Uruguay Round. It deserves to be there. It is regrettable that we have not yet been able to reach agreement for significant trade reform in agriculture. It is today the most distortive sector of international trade. There are more trade distortions in agriculture than any other major segment of international commerce, without a doubt. Therefore, it is a problem that is on our desks. It is now on Ambassador Hills' desk, as well as mine, and on the desk of every other trade minister and ag minister in the world and will not go away, irrespective of what transpires here in Brussels or elsewhere in the Uruguay Round. But we should not yet assume that we will not achieve the essential reforms in the Uruguay Round. The time to make that judgment is when the Uruguay Round concludes, not today. We did not achieve those reforms here in Brussels. That is regrettable because they are so essential, but I haven't given up on the process and I don't believe Ambassador Hills has either. Let's hope that our European Community friends have not given up on the process, and that they will be able to find the political will to move forward.

Q: With the close of this meeting, a certain sense of urgency is lost for most of the participants, but not the U.S. obviously because you have this March 1 deadline. Given that this immediacy is lost for most others, aren't you likely to have to go back to Congress and ask for the extension of the fast-track that is under the law, and if so, do you think, given the circumstances, that Congress would go ahead and grant you that extension?

Ambassador Hills: Let me deal first with your premise. I think that the sense of immediacy is very much on the 107 nations that were preceding, and I can not speculate how fast, or even if, we will be able to narrow our differences in the areas that are creating the problem today. I hope that we are. If it comes that we have March arrive and we have to ask for fast-track authority, I will have to consult closely with Congress. I think you're right, that it will be very difficult without having a showing of progress. And at this present time, we do not have a showing of progress, so that it behooves all of us to move quickly, so that we don't have an impossible impediment.

Q: What will you tell the supporters of the Round in the services field, the intellectual property field, those who had interests other than agriculture, why they should keep their hopes up, why they should continue to be optimistic about a successful conclusion of the Round, based on what's happened here?

Ambassador Hills: They should certainly keep their hopes up. And they'll have to decide themselves about their degree of optimism. The fundamental issue separating us is whether we are able to deal with agriculture, which as Secretary Yeutter has said, has been on the table for over thirty years and has not been dealt with. And that is a key to persuading the developing countries to deal with the issues of services, investment, and intellectual property protections, areas that you mentioned. And so whether you're in the manufacturing sector, the high-technology sector, or simply a farmer from Nebraska, you've got to want to have fundamental reform in agriculture. Because without fundamental reform in agriculture, you're not going to bring aboard those nations who only care about agriculture and in return will provide access to services, protection for intellectual property, remove restrictions on investors. And that's what the negotiations are all about. We do want to achieve access for our entrepreneurs across the board. And that requires a participation of 107, not an elite group of just a few, but all. And to get all to stay at the table, as we saw last night, is going to take fundamental reform in agriculture.

Q: Ambassador Hills, I'd like to ask you whether you think this week was a failure, and secondly, everyone had his or her hopes up yesterday, and then those hopes were dashed sometime last night. What exactly happened?

Ambassador Hills: I don't think this week was a failure. We did cause 107 trade ministers to focus very intensely upon issues where many of them had not done so with such intensity before. I think that we did narrow differences in several of the groups. The chair was effective

and appointed chairs of seven different groups to address issues, and highlighted the differences that exist among nations, and narrowed many of those areas in services, protection of intellectual property, in TRIMS. And even the efforts in agriculture by Chairman Hellstrom, I think, were constructive. Now, your second question, what are my hopes...

Q: What happened to dash those hopes?

Ambassador Hills: Well, a proposal was put on the table by Chairman Hellstrom that would have dealt with each of the three areas that we had mentioned were required for fundamental agricultural reform, and the Community was not prepared to deal with the specific commitments necessary in the areas of export subsidies and market access. And Secretary Yeutter was at the meeting with the discussion, and you may want to amplify what you thought happened last night that disappointed our very strong hopes of earlier that day.

Secretary Yeutter: Just a quick comment on that. Certainly hopes did arise yesterday, in the aftermath of indications from the Community that they were prepared to consider specific commitments in each of these three areas, as Ambassador Hills indicated. That was a significant step forward and we hope it will carry forth beyond Brussels. It's a commitment we've been awaiting from the Community for many, many months. But then, when Chairman Hellstrom, in following through on that good news, developed a specific proposal, a non-paper for the consideration of all the member nations who were there, a non-paper that, by the way, received a lot of approbation as a negotiating document from many of us, including the United States. It became apparent that the Community was ready to make specific commitments in these three areas, but only with several conditions being attached. And these were conditions that have long been declared unacceptable, not only by the United States, but by the rest of the world. And when it became apparent that those preconditions for negotiation had not yet changed, it likewise became apparent that we were all wasting our time, at least insofar as the Brussels meeting was concerned. We hope that situation will change in the future. And if I may just add one further comment. I don't mean to take up all the time here on agriculture, but as you know we had thirty thousand farmers demonstrating earlier this week, evidencing concern about agricultural trade reform. I'd just like to say through the European press in particular to those farmers that all of us would like to increase the income of our farmers, and all of us would like to develop conditions that will lead to a higher quality of life for those farmers. That's not at issue here at all. We're not, in the Uruguay Round, in the process of attempting to reduce farm incomes in Western Europe. There was nothing in the U.S. proposal, nothing in the Cairns Group proposal, that would require that outcome, nothing whatsoever. All those proposals seek is to reduce the trade distortions of present agricultural policies. In my judgment, it is possible for the European Community, or anyone else, to develop an agricultural policy structure that will serves its farmers well while also minimizing the adverse effects of those policies on their trading partners. That is the objective. In my judgment, that is an achievable objective here in the European Community.

Q: Mrs. Hills, over the past two, three, four years, a number of trade complaints by U.S. interest groups have been put off on the basis of a successful conclusion of the Uruguay Round. As USTR, Mr. Yeutter took away a trade complaint by rice millers against Japan on the express agreement by the Japanese that they would act constructively in this Round. There are now problems with Europe and Korea on various issues. What are going to happen to these problems in the next few months?

Ambassador Hills: Those petitions that are on my desk will be assessed under the law, as we pledged when we took this office to uphold the law.

Q: Prior to the EC summit in October, the President and the Secretary of State made representations to EC leaders to try and get their impetus to try to break the deadlock. Can you foresee further action this week, prior to the EC summit next week-end, and secondly, do you

think that the absence of political leadership by Germany, and particularly Japan this week, undermined the negotiations?

Ambassador Hills: President Bush has made the successful conclusion of the Uruguay Round and the building of a strong multilateral trading system his top trade priority. And he has been more effective and more energetic in carrying out his objective than any President I can remember. He made this objective top of his agenda at Houston for the Houston Summit, and he has carried through and talked to leaders intensely about the need to modernize and to build out a good trading system. I believe he will stay committed to these objectives. The problems that have occurred here are well known and will be even better known, with your coverage, to the heads of state all around the globe. And we hope that each and every one of them will exhibit the leadership, and try to take actions, that will enable us to have a successful conclusion to this Round. And I am not here to point fingers at any government, or any head of state, and to criticize their lack of leadership in the past. What we need from all 107, is strong leadership from now to the future.

Q: (INAUDIBLE)

Ambasador Hills: We have never made a suggestion for a two-year moratorium and I would not recommend that at this time.

Q. (INAUDIBLE)

Ambassador Hills: Well, at least, Chairman Hellstrom, on paper, will become the equivalent of a working paper. They are part of the minutes of this meeting. And I do think that it was a very creative and constructive effort to try to provide a framework for future negotiations. The problem that we have in agriculture, which is a problem we do not have in the other fourteen areas, is that we do not have a framework, an agreed framework for the negotiations. And that is absolutely indispensable that we negotiate on the area of export subsidies, internal support and border protections. And I do think that other chairmen made successful contributions. Chairman Gradin of Sweden was chairing the TRIMS Group, and I do believe that she was effectively finding there was more support for Trims and fewer differences, as she had her bilateral and plurilateral consultations. The same would go for TRIPS.

Q: (INAUDIBLE)

Secretary Yeutter: Well, I am certainly not in favor of market sharing in any way. That is contrary to my own economic philosophy, contrary to President Bush' philosophy and contrary to the basic precepts of the GATT and the Uruguay Round. But nothing of that has been contemplated in any of the negotiating proposals that I have seen and I doubt that it will be contemplated in the future. It is imperative that we have volume discipline on export subsidies. That is the heart of the matter. It is not the amount of money that any of us spend on export subsidies, because that varies from time to time, depending on market conditions, supplies available, demand and a whole lot of other factors. The onerous element of export subsidies is the quantity of product that is dumped on the world market, therefore distorting and disrupting market conditions. So we must begin to reduce the volume of subsidized product that nations push into the world market through their various mechanims. So volume disciplines are crucial, but there is no need whatsoever for volume disciplines to in any way become a market-sharing arrangement. In fact, precisely the contrary will occur if those disciplines are effective. More and more of the quantity of product moving into the world market will move on a free and open trading basis, and that is just the opposite of market-sharing.

Q: Given the fact that the agriculture deadlock does continue, what are the prospects for the U.S. Export Enhancement Program, and do you see agricultural trade wars in the coming months and years.

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Secretary Yeutter: Well, I do not think that any of us should be threatening trade wars in the aftermath of Brussels, or at any other time. It seems to me that international commerce is too important for all of us to have that occur. At the same time, we must recognize that we are today in a very confrontational environment in agricultural trade because of some of the distortive features of trade policies, various nations' trade policies that we have been discussing this morning. In other words, the system is broke, in agriculture, and it does need to be fixed. And until it is fixed, it will be confrontational and contentious. That is really what this aspect of the Uruguay Round is all about. That is why agriculture is such a high priority in the Uruguay Round. That is why it is so important to ultimately reach an agreement. But, as I said, we should not give up on the negotiations, and if we can move forward and reach a satisfactory agreement in the relatively near future, the issue or question you have posted will become irrelevant. If not, of course, we will continue to see great stress in that situation. I have often made the point that my perception from traveling through Europe is that there is a great fear that success in the agricultural negotiations would extract a tremendous political and economic price in European agriculture. I really believe that failure of the agricultural negotiations will extract an even higher price, and that should have been evident here in Brussels this week. So we hope that will result in some changes in attitudes over time.

Q. Mr. Mac Sharry and Mr. Andriessen said that United States and other countries expectations were much too high and that negotiating is about give-and-take, and there was no give-and-take on your side this week.

Ambassador Hills: I think that our positions have been flexible and constructive for several weeks. And indeed, you in the press and our colleagues at this Brussels meeting have noted changes of positions across a range of topics. The problem that I think Mr. Mac Sharry and Mr. Andriessen are confusing, is that we have put forward a proposal for fundamental reform that deals with export subsidies. They have not responded to that proposal. Indeed they have told us they have no mandate to negotiate, with respect to export subsidies. And almost every nation in the world believes that there must be a reduction of export subsidies, or there will not be fundamental reform in agriculture. And without fundamental reform in agriculture, these nations which constitute a majority will not talk about other topics in a constructive way. So the key to our success, our mutual success, Mr. Andriessen's success and our success, is to have fundamental reform in agriculture, which requires negotiating about export subsidies.

Q: (INAUDIBLE)

Ambassador Hills: We have submitted a proposal that we think is fundamentally sound. The Chairman of the Agricultural Group in Geneva has submitted a proposal that tracks our proposal to some extent. At least it deals with export subsidies. Chairman Hellstrom put forward a proposal last night, a non-paper, which is not at all like our proposal in many respects, but requires fundamental reform with respect to export subsidies. We think that it is realistic to say that the European Community must deal with export subsidies. The affluent nations are wasting, in terms of their protections around agriculture, 250 billion dollars a year, and are taking away market opportunity for the LDC's in a way that will generate their lack of economic gain and perhaps seed their instability. It is therefore an issue that we must get on and address. I think our expectations are realistic, and the question is: "Is the political resolve of our negotiating partners in Europe going to be sufficient to deal with this very visible need?"

Secretary Yeutter: If I may just add one sentence to that. Let me clarify by pointing out that the European Community has not yet offered definitive export subsidy disciplines on one ton of any kind of product, not even one pound of any kind of product. And in our judgment, that is hardly a constructive evidence of reform.

Ambassador Hills: Thank you very much.

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TREASURY NEWS

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Treasury Releases 1990 National Treatment Study Report on Foreign Treatment of U.S. Financial Institutions

Secretary of the Treasury Nicholas F. Brady today submitted to Congress the 1990 Report on Foreign Treatment of U.S. Financial Institutions.

In transmitting the Report, Secretary Brady noted that progress in reducing barriers abroad is occurring at a varied pace, but generally not as rapidly as the Treasury would like. Significant improvements have been made in Canada and in many European countries. Only modest progress has been made in many Asian economies. Numerous Latin American countries still maintain restrictive financial systems. Thus, while notable strides have been made in opening and liberalizing many markets, the pace and degree with which this has occurred in other regions have been slow. The U.S. Treasury will continue to pursue vigorously its efforts to remove remaining obstacles to national treatment for U.S. financial firms operating abroad.

The Report updates and expands upon the National Treatment Studies completed by the U.S. Treasury in 1979, 1984, and 1986. It examines the degree of national treatment afforded U.S. financial institutions in twenty-one banking and eighteen securities markets. As required by law, the 1990 Report also addresses, for the first time, U.S. Government efforts to remove barriers in those markets and reviews the presence and treatment of foreign firms in the United States.

This Report is required by the Financial Reports Act of 1988 (Pub. L. 100-418, sec. 3601, et seq.; 22 U.S.C. 5351 et seq.).

The Report's Preface and Conclusion are attached.

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NB-1060

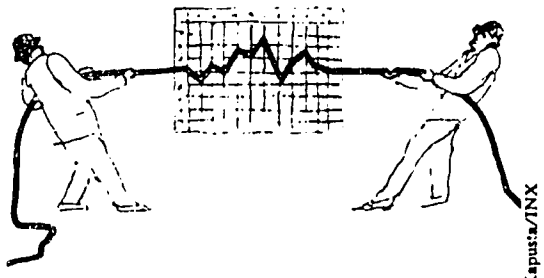
TRADE

BRUCE STOKES

STATE RULES AND WORLD BUSINESS

Earlier this year, Maine banned the sale of some types of plastic beverage containers. The state's landfills were choking on throwaways, and Maine decided that the only solution was to force a return to recyclable packaging.

As was expected, various American packaging and beverage companies complained vociferously about Maine's action. What was unexpected was the sharp protest heard from the Commission of the European Community (EC) in Brussels.



Janusz Kapusta/INX

That was a sign of things to come. For some time, state governments have been promoting foreign trade and investment, looking to the world market as a cornucopia. But now, states are awakening to the fact that being a part of a global economy cuts both ways and that the price of admission to the world economy may well be contraints on state action. As states become more involved with international commerce, their actions affect the well-being of others—who will protest, perhaps even retaliate, if their interests are jeopardized.

Europeans first commercialized the now-widespread sealing process that enables juice and other liquids to be stored in plastic containers for long periods without refrigeration or preservatives. Sales of these products boomed. But there's a drawback: The packaging isn't biodegradable. The containers are a boon to parents packing school lunches but a bane to municipalities charged with disposing of solid waste. *(See NJ, 4/21/90, p. 993.)*

Maine's ban drew protests from European firms that sell vacuum-sealed beverages and license the packaging technology. "It is obviously a nontariff barrier to trade," EC official Derek Taylor complained in June, "whether it's designed as such or not. We want action in GATT [the General Agreement on Tariffs and Trade] to see that the hand of federal agencies is strengthened with regard to such state actions."

The EC's protest fell on deaf ears, but the issue refuses to go away. On Nov. 6, California voters will be asked to approve the "Big Green" environmental initiative, which, among other things, would set maximum levels of exposure to toxic substances for groups such as children and farm workers. Because the proposed state standards would be tougher than current international standards, Big Green could block the sale in California of some imported food products. *(See this issue, p. 0000.)*

The United States and the EC have been embroiled in a fight over Europe's limits on permissible levels of hormones in imported beef. Washington charges that Brussels's tough standards discriminate against American beef. Passage of Big Green could put the Bush Administration in the embarrassing position of having to respond to the Europeans' charges that California discriminates against them.

A number of U.S. environmental and consumer groups worry that the Administration, to wriggle out of this dilemma, will use the current Uruguay Round of multilateral trade negotiations to bargain away the states' power to protect consumer health, natural resources and the environment.

U.S. Trade Representative (USTR) Carla A. Hills has denied any intention to force states to harmonize their regulations with federal policy. Testifying on Sept. 24 before the House Energy and Commerce Subcommittee on Oversight and Investigations, Hills said that the Administration does not seek uniformity in state laws and that a new trade agreement would require only that states have a scientific basis for their regulations.

"With respect to states' rights, our concerns have been pretty much addressed," said Eric Christensen, an attorney with the Natural Resources Defense Council Inc. in Washington. But the question of how the scientific test will be interpreted could still pose problems, he added. Morover, Christensen argued, "USTR could still bargain away the states' position" on some issues—Oregon's new ban on the export of unprocessed logs from state forests, for example.

Congress this year legalized state controls on timber exports. Such constraints are permissible under the GATT if imposed for environmental reasons. But Japan is seeking an international agreement that such constraints violate the GATT. And the Administration acknowledges that if the bans are imposed to preserve timber-processing jobs, which is the motivation of many supporters of the bans, they would be impermissible.

"It is not in our interest that the environment be used for protectionist purposes," said Stewart Hudson, legislative representative of the National Wildlife Federation. "But we also do not want to weaken a state's right to use trade measures for environmental purposes."

Environmentalists are not the only ones who have begun to scrutinize the Uruguay Round. The insurance business and the legal profession, traditionally regulated by the states, now realize that decisions made in trade talks in Geneva will affect regulators in Albany, Columbus and Sacramento.

"It's evident that we are heading for an even more international insurance market, and it's a two-way street," said David J. Pratt, vice president for federal affairs of the Washington-based American Insurance Association. "They want to sell into the U.S. market, just as we want to sell abroad." Pratt said, "We are not at the hue-and-cry stage yet, but at the let's-look-at-this-closely stage, to make sure we have not given away something."

USTR, which is quick to say that the GATT talks pose no threat to federalism, has long had an intergovernmental policy advisory committee to smooth relations with the states. But this group is made up mostly of politicians, not regulators. It's the regulators who are likely to scream the loudest if concessions in Geneva cut into state prerogatives.

Cut they will, if Europe has anything to say about it. The devolution of regulatory responsibility in the United States and the trade barriers that result are "an area of rapidly growing concern for us," the EC's Taylor said.

States that have benefited from foreign trade and investment in recent years are about to learn a new twist to an old lesson: No matter what kind of container the drink comes in, there's still no such thing as a free lunch. ■

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JOURNAL OF COMMERCE, November 7, 1990

A Lively Year for Trade Policy

WASHINGTON — 1991 promises to be a lively, perhaps even landmark, year on Capitol Hill. The congressional calendar on international trade issues already looks full.

Item Number One is the Uruguay Round trade agreements, or what to do if there are none. Other big issues include the proposed

TRADE SCENE

Richard Lawrence

U.S.-Mexico free trade negotiation, the U.S.-Soviet trade pact, the continuing China trade conundrum and President Bush's "Enterprise for the Americas" initiative.

Add to that export controls legislation and what could be the most comprehensive reform in years for the U.S Customs Service. Once again, "competitiveness" bills will be in the hopper and Congress will take up the foreign investment debate.

Much of the 1991 international trade agenda reflects what Congress did, or didn't do, in 1990.

Congress left the China trade question hanging, although the House tried to resolve it by passing at the last minute a bill that tightens conditions on preferential tariff status for China. The House also tried to implement, at least in part, the president's plan to assist Latin America through debt relief and a network of free trade pacts. But the Senate did not respond to either of the House measures in these areas.

Congress did approve new export controls legislation, but Mr. Bush is likely to veto it, thus depriving the government indefinitely of its basic export controls authority.

Proposals to help make the U.S. high-tech industry more competitive, through such measures as a permanent research and development tax credit and easier antitrust rules for joint manufacturing ventures, went by the boards. These issues will be revived in the next Congress, however.

Congress also failed to renew the Defense Production Act, which happens to include a provision empowering the president to block or order divestment of unwanted foreign investments in the United States. That must be addressed in the new Congress. A host of other bills discriminating against, or at least singling out, foreign investors are expected to resurface.

Hardly all of the prospective legislation is deja vu. In 1991 Congress will consider for the first time legislation that could lead to sweeping changes in both customs management and banking rules.

The U.S. Customs Service wants to "go electronic" and improve its efficiency. Some U.S. banks seek to shed federal regulations that they and others feel hamper their international competitiveness. Congressional panels laid the basis this year for possible action in both these areas in 1991.

"Fast track" — the procedure providing a quick, up-or-down vote on trade agreements — promises to be a prominent congressional buzzword in early 1991, no matter what happens at the Uruguay Round trade negotiations.

So far, 36 senators are sponsoring a resolution that would exclude whatever Uruguay Round agreements the administration negotiates from consideration under the fast-track procedure. A concerted drive by the textile industry and other interests probably would bring out additional supporters.

Withdrawing fast track could be tantamount to trashing the Uruguay Round, because it would allow Congress to pick apart an intricate agreement sentence by sentence.

If the administration wants more time to conclude the Uruguay Round and retain fast track — existing fast-track authority expires June 1 — it must request the extension by March 1. The Uruguay Round would be put squarely in Congress' lap, just as the trade liberalizing negotiations are at their most crucial stage.

Even if the Uruguay Round collapses of its own weight, fast track will still be an issue. Mr. Bush is certain to ask Congress by March 1 to give him extended fast-track authority for the proposed U.S.-Mexico trade agreement negotiations.

This request will bolster Congress' leverage on how the administration negotiates the prospective Mexican trade accord. How much Congress exerts its influence, especially on labor, environmental and farm matters, could be important.

A Uruguay Round failure likely would give impetus to Mr. Bush's Enterprise for the Americas initiative.

Trade negotiations next year with any Latin American country besides Mexico seem unlikely. But the debt relief proposal — mainly for Caribbean basin countries — probably will be approved.

Even though the House overwhelmingly passed a bill limiting China's most-favored-nation status, the odds are that China will retain favorable U.S. tariffs. Whether Congress will approve similar benefits for the Soviet Union, however, remains uncertain. The U.S. government is still waiting for the Supreme Soviet to enact a new emigration law, but the Soviets may not do so until Congress signals it would approve the U.S.-Soviet trade pact. Democracy for the Baltic states is partly at issue.

Despite the seeming stalemate, some U.S. analysts say they are confident that by spring the Soviet Union will have become a "most favored" nation.

Richard Lawrence is a senior correspondent in the Washington bureau of The Journal of Commerce.

JOURNAL OF COMMERCE, December 26, 1990

Renaissance or the Dark Ages?

By JOHN P. CREGAN

Take your pick. economic renaissance or Dark Age of protectionism. According to many observers, the decision is up to world trade negotiators who are trying to salvage the current round of mululateral trade talks under the General Agreement on Tariffs and Trade The U.S. ambassador, Carla Hills, has predicted that a new multilateral trade agreement will "trigger an economic renaissance." She and others likewise have forecast that the world may drift into a Dark Age of protectionism and trading blocks if the current Uruguay Round of trade talks falls apart.

Once again, reality lies somewhere in the middle. Neither the success or failure of the GATT talks will result in either of these stark scenarios.

While GATT has been a driving force behind the tremendous upsurge in global trade since its inception in 1948, its success has been closely linked to the willingness of the United States to lead by example Trade liberalization by the United States is the foundation upon which the fantastic growth in world commerce was launched during the last 50 years But precisely because the United States is one of the world's most open markets, we have fewer concessions to give to achieve a final GATT agreement.

Moreover, as America's relative economic power has declined, a greater share of the GATT burden has fallen on our major trading partners in Western Europe and Japan. These countries, however, have not shown a desire to exercise leadership within GATT that is proportionate to their economic status. And this is a big reason the GATT talks encountered so many problems.

Thus, worried discussions abound centering on a world without GATT. Not only do these doomsday forecasts put pressure on American negotiators to make damaging concessions as they work toward a final agreement, but the predictions themselves may be just plain wrong.

A look back at the record of the most recent GATT accord, the so-called Tokyo Round signed in 1979, reveals that this latest GATT round may not be all that it's touted to be. It is apparent now that much of the 1979 accord's promise has gone unrealized.

It would be too easy to charge that (from the United States' standpoint) the 1979 Tokyo Round's failures are as blatant as the string of $100 billion-plus trade deficits that have plagued the United States for nearly a decade But the fact is, the Carter administration looked upon the accord as a solution to America's trade problems and predicted the Tokyo Round would lead to reduced trade tensions internationally.

Specifically, the Carter administration predicted that 50,000 to 100,000 American jobs would be created as a result of the agreement's liberalization in procurement by foreign governments. According to a General Accounting Office study, however, it is more likely that less than 1,000 new jobs were created by these reforms.

Currently, the Bush administration is claiming that a Uruguay Round agreement will increase U.S. domestic output by $125 billion in the first year alone after its signing But the Economic Strategy Institute, a private think tank in Washington, has produced a study estimating that figure overstates the economic benefits by more than 700%.

More significantly, Mrs. Hills and others have made liberalized trade reforms in services and agriculture the top U.S priority in this GATT Round While it is indeed desirable to bring services into the purview of GATT, neither this sector nor agriculture have the potential to make much of a dent in our persistent trade imbalances. At best, a full liberalization of agricultural trade would result in only $3 billion in increased U.S. agricultural exports. Likewise, ESI estimates the United States could hope for no more than a services trade surplus of $2.7 billion annually.

Unfortunately, America's manufacturing sector, which accounts for fully two-thirds of our exports, was a poor relation when the United States went to Uruguay to launch the latest GATT Round. There is very little in this round for manufacturers. There is, however, the danger that the United States might be pressured to trade away U.S. laws designed to respond to other country's unfair trade practices to get an agreement on agriculture and services.

Considering that our goals for both services and agriculture have been down-sized substantially, it might be best to heed President Bush's oft-stated advice that no agreement is better than a bad one.

John P. Cregan is president of the Business and Industrial Council, an organization representing 1,500 small and mid-sized companies.

THE JOURNAL OF COMMERCE, Friday, December 28, 1990

Game Plan for Saving GATT

By HARRY LAMAR

The confrontational tone of many analysts as to what happened — or didn't happen — in the recent round of world trade talks in Brussels is disturbing, particularly coming from those who normally would counsel patience and understanding.

It is true that the Brussels meeting of the General Agreement on Tariffs and Trade foundered on the unwillingness of the European Community to compromise its high-cost agricultural policies. It is also true that the Japanese failed to "just say no" to agricultural subsidies and said "no" instead to a last-minute compromise on agriculture, presumably for the benefit of its rice farmers and for political expediency.

But this is not the entire story of the failure to meet the self-imposed deadlines of the Uruguay Round, nor should the center-stage story of agriculture be allowed to color the future of U.S. trade relations with Europe and Japan.

Close observers of world trade talks differentiate between the current Uruguay Round negotiations and past rounds. The Uruguay Round addresses complex issues affecting domestic laws, practices and cultural factors mostly new to GATT negotiations. With some important exceptions, past negotiations dealt with the fairly simple analyses of whether tariff concessions and percentage cuts being considered were balanced between countries.

It is not clear that this vast difference in the subject matter of negotiations was recognized, ever, in setting the negotiating deadlines. Certainly, in calculating what the wrap-up meeting in Brussels could reasonably be expected to accomplish, the impact of the tremendous developments in the Soviet Union and Eastern Europe and the growing maturity of a number of developing countries was not given sufficient weight.

While those in government and some in the private sector would disagree, it is fairly clear that the 13 negotiating areas other than agriculture had in no way reached a sign-off stage at the Brussels meeting. For the most part, top ministers simply were not prepared to make political decisions on the strategic technical questions that remained in the negotiating documents where such documents actually had been prepared.

In some negotiating areas, no real framework document existed at the beginning of the Brussels meeting. In some cases, the ministers who were in Brussels to make the tough political decisions were not familiar with the technical details and the political implications of the decisions they were being asked to make.

The lesson that should be drawn from all this is that trade officials should not rush to resume negotiating agreements that must be presented to Congress by March 1, 1991. That's the deadline for an agreement to be considered under the existing "fast track, no amendment" authority. Even if negotiations could be resumed, many complex technical details, which involve serious political commitments and have domestic political implications, would have to be decided.

Moreover, those agreements must be framed in acceptable language and initialed. And within the same short period, the administration and the Congress would have to agree to a legislative

package with stated administrative intentions concerning proposed amendments to U.S. law. In some cases, some state laws and ordinances might have to be pre-empted. Finally, the package would have to be enacted with no amendments under the "fast track" procedure. If they said it couldn't be done, they would be right.

Some in the Congress and the private sector would oppose extending the fast-track authority and the trade negotiating authority beyond current law. But in view of the disasters that can occur if the administration tries to implement a less-than-complete trade agreement under current legislative deadlines, a different scenario should be followed.

The president, in his State of the Union message, could request that his trade negotiating authority and the "fast-track" procedures be extended until 1994, considerably beyond the next presidential election. Mr. Bush probably will need such an extension to accommodate the proposed free trade agreement with Mexico.

The president can tell the Congress that:

- He has kept faith with the commitment made in 1988 when Congress enacted, and the president approved, the Trade Act of 1988, and he expects Congress to keep its commitment as to how completion and implementation of trade negotiations will be handled.
- While the state of the world trading system is precarious, the United States will not sign-off on a bad agreement. While the limits of flexibility in negotiating positions obviously were reached, more time is needed to sort out in private talks what needs to be done. World leaders also must recommit themselves to finishing the negotiations.
- Much has been accomplished in the Uruguay Round thus far; those accomplishments should not be jeopardized by hasty reactions to a temporary negotiating setback.
- The business community is largely supportive of the negotiations. No business sector will be any better or worse off than if the negotiations had been completed in a more timely fashion and implemented under the existing fast track provisions.
- The world economy is too fragile to risk not continuing the negotiations. The remaining time under the existing "fast track" negotiating deadline is far too short to successfully conclude the talks and implement an agreement.
- There must be a commitment to continued negotiations to encourage economic growth and to make it possible for many countries to gain the market access needed for political stability and economic development.

Such an initiative by the president will be welcomed by those who believe that the new world order must not only recognize the tremendous changes that have taken place in political and economic relations in the past four years, but that international trade cooperation is more important than ever to a positive accommodation of those changes.

Harry Lamar is president of Monticello Associates, an international trade consulting firm in Washington.

THE CITIZENS NETWORK FOR FOREIGN AFFAIRS

Global Focus

Fall 1990

U.S. Agriculture and the GATT: The Benefits of Trade Reform

*Executive Summary**

The United States needs trade more than ever before. With the U.S. economy weakening, increased exports could mean the difference between a mild and a severe recession. In the longer term, growing exports will create jobs and prosperity in the United States.

Growing U.S. exports depend on continued elimination of protectionism in world markets. Over 100 nations are now engaged in negotiations to achieve freer trade. They are attempting to reverse protectionist trends that threaten to unravel the gains made from trade over the last forty years.

These global trade talks, called the "Uruguay Round," are sponsored by the General Agreement on Tariffs and Trade (GATT), the principal international organization governing world trade. The Uruguay Round is scheduled to end December 1990, but participating nations have yet to agree on several major issues, including trade in agriculture and services.

The *Wall Street Journal* states that the GATT talks "may hold the key to the future of the global economy." The *Journal* goes on to say that:

> **The stakes are huge. Even a moderately successful conclusion to the talks... would spark a $100 billion-a-year expansion in world trade... And trade representative Carla Hills says the U.S. could enjoy a $200 billion increase in exports to developing countries over the next decade [if the GATT talks are successful].**

A strengthened and expanded GATT can play a vital role in furthering U.S. global economic interests. The United States, fully committed to a global trade system based on market principles, has made a successful Uruguay Round a top priority.

Agricultural trade, of critical importance to the United States as well as many other GATT members, has become the linchpin of the Uruguay Round. Over 60 countries have threatened to derail the Round if agricultural reform is not achieved, making a GATT farm trade agreement a prerequisite for successful agreements in other areas of interest to U.S. industry. For example, failure to reach an accord on agriculture could endanger:

- Continued growth in trade of manufactured goods, which have been the traditional focus of the GATT (See Figure 1).

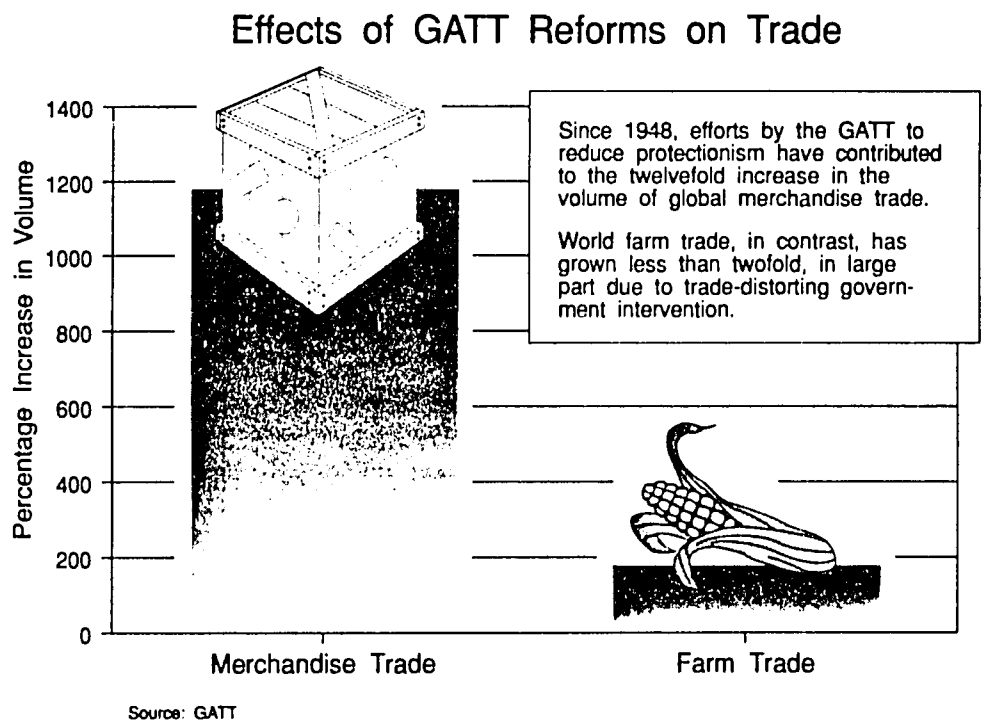

Figure 1.

Copies of the full report, "U.S. Agriculture and the GATT: The Benefits of Trade Reform," are available for $10 from the Citizens Network for Foreign Affairs, 1616 H Street, N.W., Washington, D.C. 20006, Tel: (202)639-8889, FAX (202) 639-8648

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- A GATT agreement on intellectual property protection that could save U.S. industry $60 billion yearly, currently lost as a result of overseas infringements on U.S. patents, copyrights, and trademarks.

- A GATT agreement to liberalize services trade that could benefit U.S. business in areas such as banking, insurance, and engineering. Services currently constitute 25% of U.S. exports. Services exports could increase markedly with a successful Uruguay Round.

Government intervention in agriculture — including tariffs, quotas, and subsidies that totalled $245 billion in 1989 — is a major contributor to the slow growth of world farm trade (See Figure 1).

As the world's largest agricultural exporter, the United States has much to gain from GATT reforms (See Figure 2). Two-fifths of U.S. cropland was devoted to producing commodities for export in 1989. In 1990, the United States will export 64% of its wheat, 53% of its rice, 63% of its cotton, and 41% of its soybeans. While U.S. merchandise trade registered a $139 billion deficit, U.S. farm exports generated a surplus of $18 billion last year (See Figure 3).

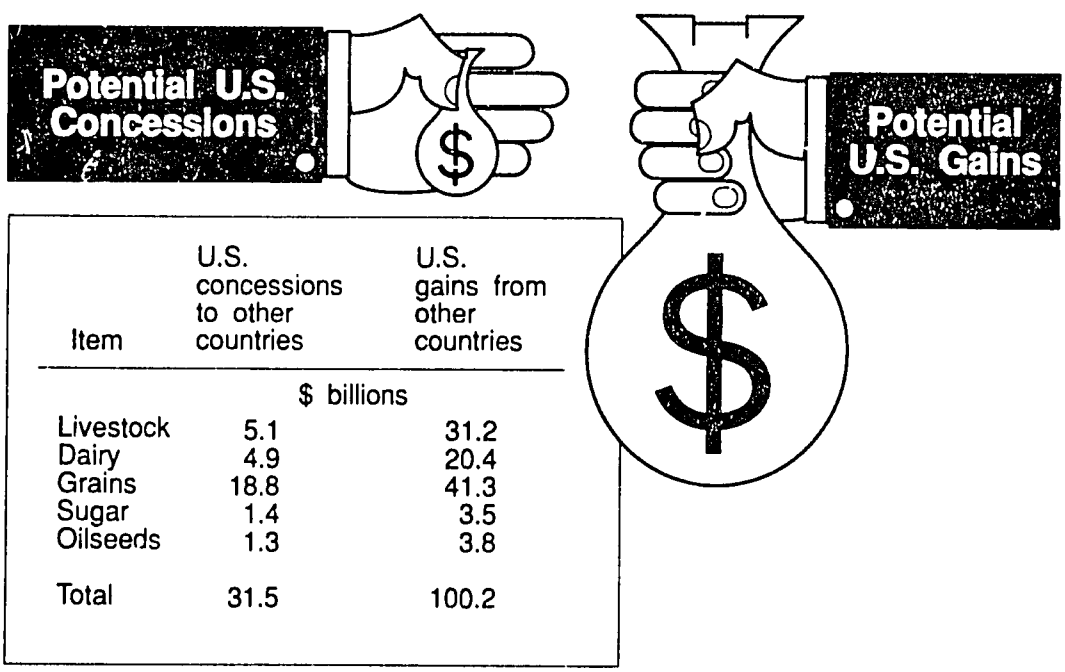
Together the 12 nations of the European Community (EC) are the world's second largest exporter of agricultural products. The EC maintains very high levels of government support and protection for agriculture (See Figure 4). The EC also uses a "variable import levy" to ensure that imported goods cost more than domestic goods. U.S. exports to the EC could increase greatly if these measures were removed (See Figure 5).

The EC, the main stumbling block to U.S. goals in farm trade, is seeking cosmetic changes which would continue high-level support and protection for selected commodities, thereby ensuring continued market instability and failing to allow efficient producers to compete fairly.

The surest way to reform EC farm trade policy is through the multilateral GATT process, not through bilateral confrontation.

The U.S. GATT proposal, by far the most comprehensive, calls for fundamental reforms that would enable U.S. farmers to compete in global markets based on efficiency and market principles.

Economic Benefits of Multilateral GATT Reforms



Item	U.S. concessions to other countries	U.S. gains from other countries
	$ billions	
Livestock	5.1	31.2
Dairy	4.9	20.4
Grains	18.8	41.3
Sugar	1.4	3.5
Oilseeds	1.3	3.8
Total	31.5	100.2

In practice, the GATT rule of reciprocity means that concessions made by our trading partners in total will be greater than what we concede in return. (Note: Potential concessions are equivalent to aggregate values of agricultural supports in 1986.)

Source: U.S.D.A.

Figure 2.

The United States has proposed:

- converting all nontariff barriers (i.e., quotas, levies) to tariffs, which would then be substantially reduced over 10 years,
- reducing the most trade-distorting internal support measures by 75% over ten years, with reductions of other trade-distorting measures by 30%,
- reducing export subsidies on primary agricultural products by 90% over ten years,
- eliminating export subsidies on processed agricultural products within six years, and
- developing new rules to settle trade disputes involving health and sanitary measures.

The American farmer, well endowed with high quality human resources, excellent climate and soil, and advanced technology, is well positioned to compete in the international

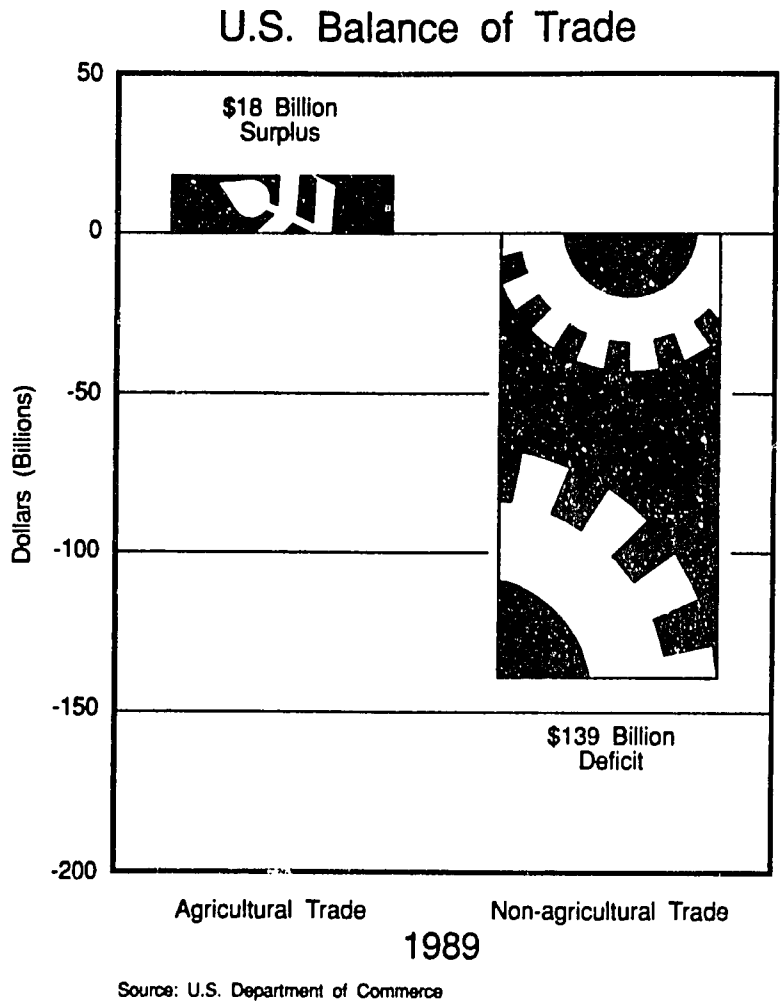


Figure 3.

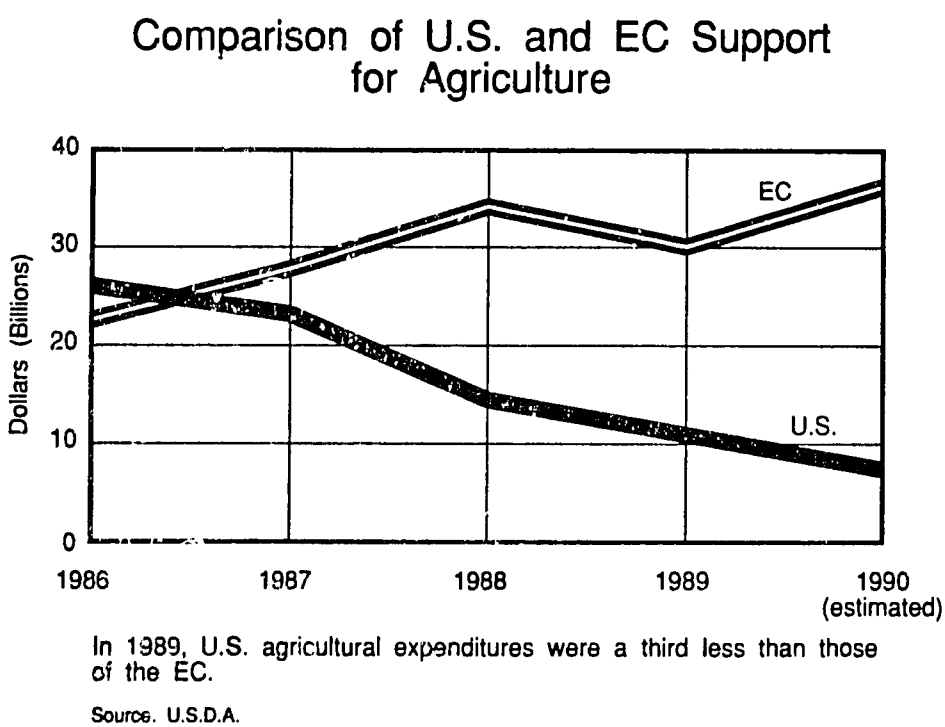


Figure 4.

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marketplace — *if* everyone plays by fair rules. The American Farm Bureau Federation, the nation's largest general farm organization, strongly endorses U.S. objectives:

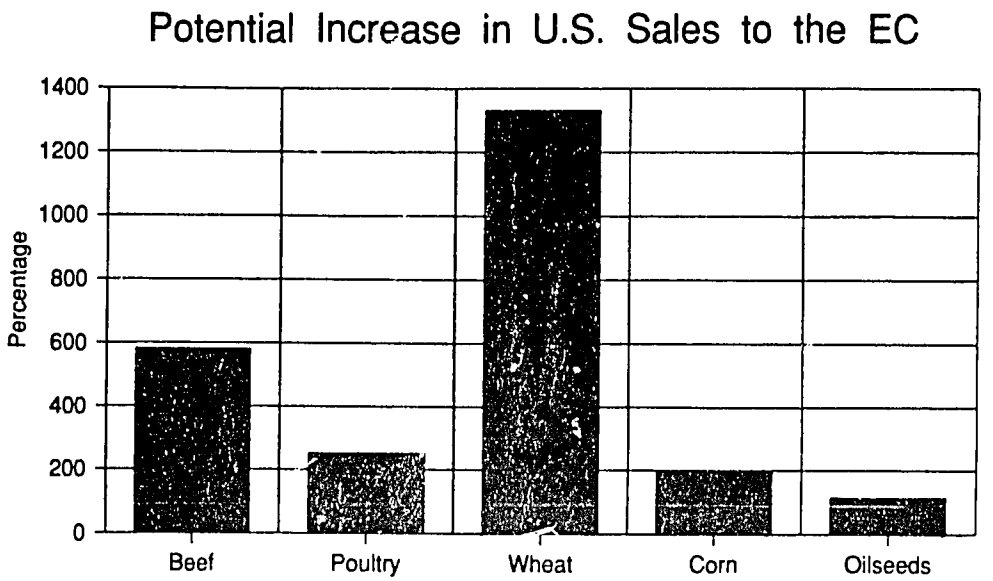
> **The GATT can improve U.S. farming if the end result creates a level playing field. By failing to strongly advocate market-oriented reforms in world agricultural policies, U.S. farmers send the message that we will let the EC off the hook. Without the Uruguay Round, the EC will feel no compulsion to change its policies.**

Though some groups have voiced their opposition, many U.S. farmers stand behind the U.S. GATT initiative. As the Uruguay Round draws to a close, however, American farmers say that a final GATT agreement must achieve genuine mutual gains if it is to be acceptable to U.S. agriculture.

Government intervention in agriculture has imposed heavy burdens on taxpayers, consumers, *and* farmers. Current policies carry a high price tag for society (See Figure 6) and harm U.S. farmers by distorting trade, lowering world prices, and reducing U.S. exports. Current policies also harm developing countries. Artificially low import prices have squeezed out Third World farmers, contributing to unstable food supplies, urbanization, and unemployment.

Freer farm trade, in contrast, would:

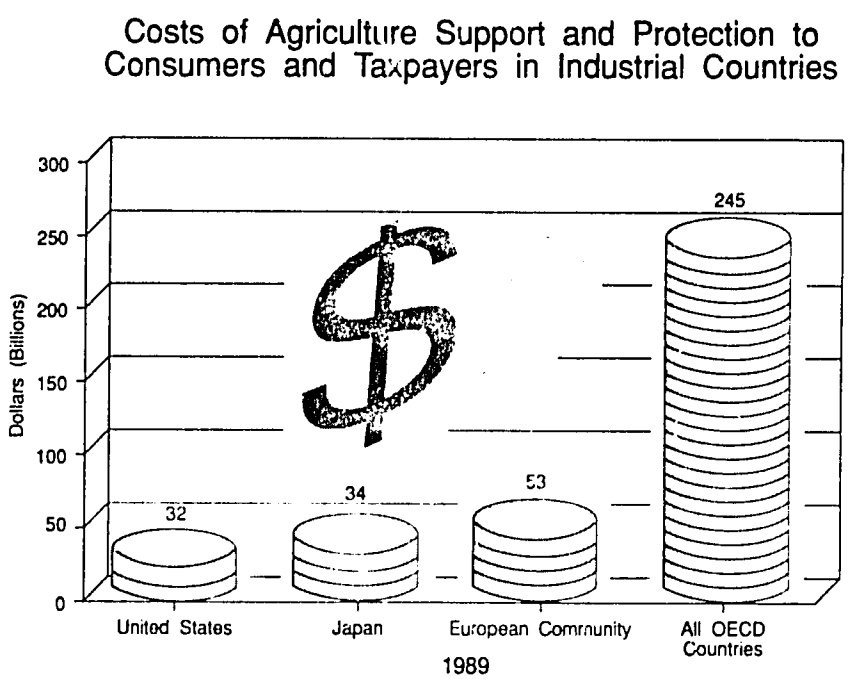
- expand the volume of world trade,
- lower foreign barriers to trade, thereby in-



U.S. agricultural exports to the EC could grow tremendously if trade-distorting EC barriers and support, such as export subsidies, import levies, price supports and other barriers were removed.
(Note: These estimates assume removal of EC barriers only, and therefore are not directly comparable to results of worldwide reforms. Base year is 1988.)

Source: U.S.D.A.

Figure 5.

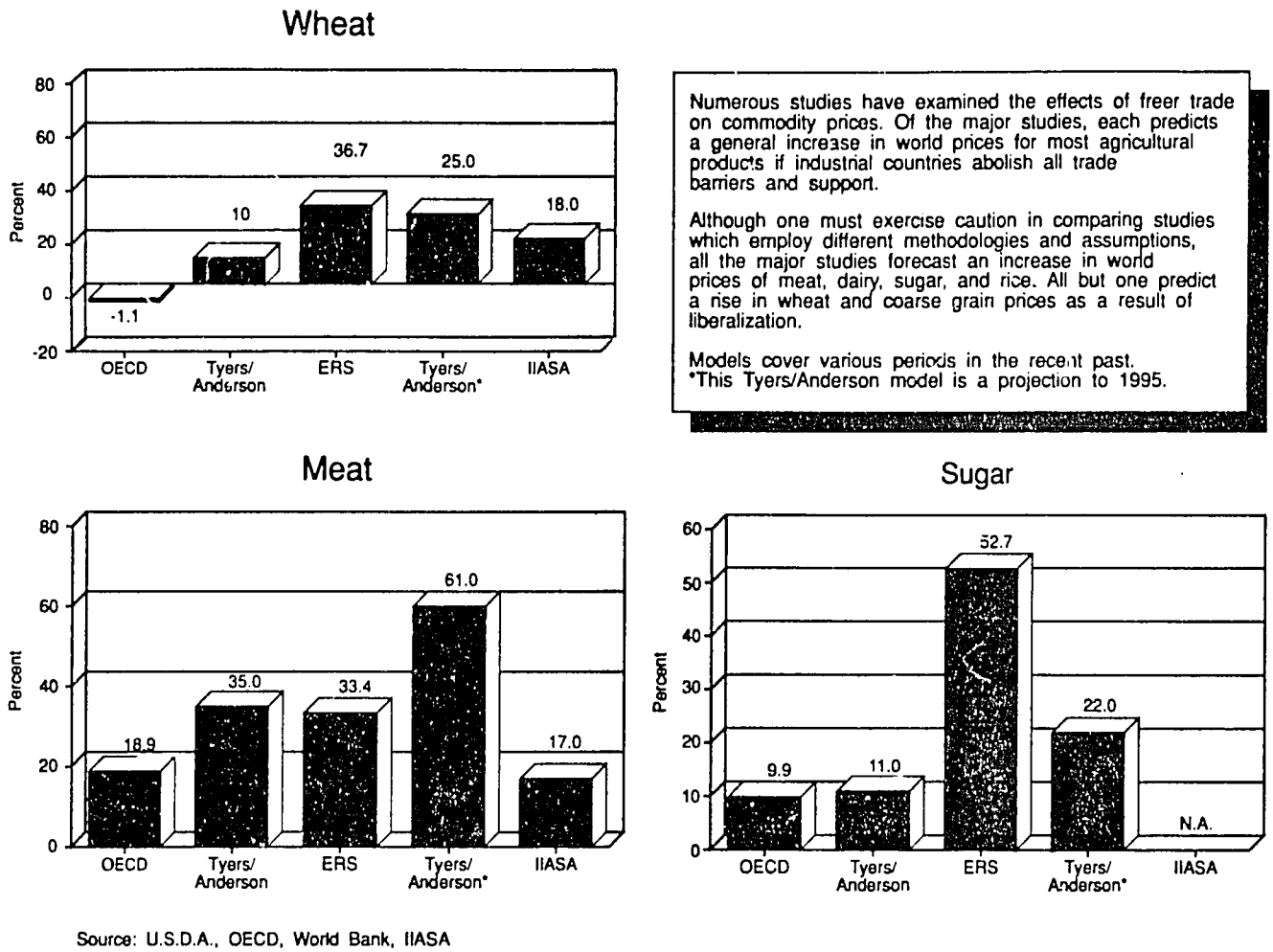


(Note: Consumers in industrialized countries, by paying artificially high prices for food, are implicitly taxed as a result of protectionist policies.)

Source: OECD

Figure 6.

Price Effects of Free Trade: Various Models



Source: U.S.D.A., OECD, World Bank, IIASA

Figure 7.

creasing export opportunities for the United States,

- raise export incomes of efficient producers by significantly increasing world prices for many agricultural products (See Figure 7),
- save taxpayers and consumers in the industrialized countries $245 billion each year, and
- restore optimal resource use and increase overall employment, income, and competitiveness.

Very importantly, a successful GATT round would increase U.S. access to rapidly growing markets in the emerging economies of Asia and Latin America. More open farm trade would help alleviate Third World debt by increasing debtor nations' export earnings, as well as freeing up global resources for investment in development. With more foreign exchange and more rapid economic growth, developing countries would be able to buy more U.S. agricultural commodities.

Continued prosperity in the United States depends on increased exports, including agricultural exports. Growing exports in turn depend on a successful completion to the Uruguay Round. As Ambassador Julius Katz, Deputy U.S. Trade Representative, succinctly stated:

> **What we are striving for in the GATT Uruguay Round is no less than the reconstruction of the engine of growth for the 21st century.** ❑

WALL STREET JOURNAL, December 13, 1990

Trade Nuttiness

By JAMES BOVARD

With the GATT talks broken off, agricultural trade disputes remain at the forefront. Yet, while U.S. officials busy themselves denouncing foreign farm-trade barriers, a U.S. trade barrier is devastating many American food companies.

It is easier to import semi-automatic rifles or toxic chemicals into the U.S. than to import peanuts. Since 1953, Americans have been permitted to buy only 1.7 million pounds of foreign peanuts each year. This amounts to roughly two foreign peanuts per year for each American citizen.

Import quotas help keep U.S. peanut prices far higher than world prices: The U.S. International Trade Commission concluded that the quota was equivalent to a tariff of up to 90% on peanut imports in 1988. The import quota, along with federal price supports and strict federal controls on who is allowed to grow peanuts, guarantees domestic peanut farmers generous profits. A 1990 Agriculture Department report noted that the federal price support was 44% higher than the total economic costs of peanut production.

This year, a severe drought hit Georgia, where almost half of all U.S. peanuts are grown. As a result, prices are soaring far above their usual heights. The Agriculture Department reported on Nov. 21 that prices for jumbo shelled peanuts have increased 119% in the past year, to $1.25 a pound. Peanut prices are now roughly double the federal price-support level.

High prices and shortages are skewering companies that use peanuts. Ed Goodrich, president of Plantation Peanuts in Wakefield, Va., observes, "We are now faced with the possibility of having to shut down." The chairman of one of the nation's largest nut processors fears that his company "could be forced out of business" with a resulting loss of 150 jobs. Tasty Fresh Nuts Co. of Ferndale, Mich., reports, "We have less than half our need contracted for with no guarantee that we will receive all of these." King Nut Co. of Solon, Ohio, complains, "We have been [unable to purchase any] Jumbo runner peanuts for three weeks." Even large companies are suffering: M&M/Mars is seriously concerned over the peanut shortage.

The Peanut Butter and Nut Processors Association, alarmed at the skyrocketing prices, petitioned the Agriculture Department and the ITC to allow 400 million pounds of peanuts to be imported in the coming months. The petition outraged farm organizations.

Rep. Walter Jones (D., N.C.) wrote to the ITC: "The Peanut Growers Association has assured me there is no shortage of peanuts for the domestic market at the present time." The American Farm Bureau agreed: "The real argument is not with supplies but with price." Perhaps the congressman and the Farm Bureau believe that as long as there is one homegrown peanut left in the U.S. (regardless of its price) there is no real shortage. The fact that peanut prices have doubled does not indicate any type of shortage, but simply that God decided to inflict his wrath on American consumers.

Hancock Peanut Co., a peanut-shelling company in Courtland, Va., argued that no additional peanut imports should be allowed because "the free market is working." The Southwestern Peanut Shellers Association told the ITC that additional peanut supplies are unnecessary because consumer demand for peanuts is plummeting (down 14% in September alone, according to the Agriculture Department). Thus, as long as government-caused high prices drive consumers out of the market, the market is doing just fine.

Peanut growers have beseeched Congress for drought relief. Georgia farmers feel they are entitled to be compensated by taxpayers for the peanuts that did not grow, and that Uncle Sam is obliged to keep consumer prices high on the peanuts that did grow. This is the rural American version of the doctrine of divine right.

Clayton Yeutter, the secretary of agriculture, could recommend that the president issue an emergency proclamation permitting more foreign goobers to invade American stomachs. But Mr. Yeutter is preoccupied these days with European import barriers. He is gravely concerned about the current low price of wheat—but has said nothing about the high price of peanuts.

The peanut import quota is perceived abroad as the epitome of U.S. hypocrisy. Japan has made the point that the U.S. ought to end its peanut import quota before demanding that Japan remove its rice import ban. The peanut import quota makes it more difficult for peanut exporters like Argentina and Brazil to earn dollars to pay their debts to U.S. banks. And it makes it difficult for low-income Americans to enjoy that most American of treats—a peanut butter sandwich.

Mr. Bovard is an associate policy analyst for the Cato Institute.

EDITORIAL/OPINION

Before We Kill Off Textiles . . .

By CLYDE V. PRESTOWITZ Jr.

In all probability, this week will see the textile and apparel industries consigned to the ash heap of American history.

The administration is already committed to scrap existing restraints on textile and apparel imports as part of the Uruguay Round of international trade negotiations, and it appears that Congress lacks the votes to override the president's expected veto of its recent textile bill. Thus, most of the protection from unfair foreign competition that textiles manufacturers have received over the past 10 years is likely to be lifted, and the industry is likely to go the way of the dodo bird.

Free-trade zealots have anticipated this result with a sigh of relief, while barraging the media with statistics purporting to show that continued protection would cost consumers hundreds of billions of dollars. And the textile and apparel industries have become symbols of the selfish protectionism we have all been taught to hate.

Clearly, these industries are seeking straight-out protection. Such protection may indeed entail some cost to consumers — although certainly much less than that adduced by free trade purists. But is the industry position so totally without merit that it can be dismissed as a product of unreasoning greed?

The same Congress that will probably uphold the president's veto has passed a new minimum wage law. In effect, this new legislation says that every American is worth $3.35 an hour just because he or she is an American. In addition, the United States has old and venerable laws preventing child labor, excessive labor hours and other undesirable conditions.

All of these rules represent massive intervention in the market place by the government. They are, in effect, industrial policies.

They also cost consumers vast sums of money. Yet when products from countries that do nothing to protect their own workers arrive on our shores and threaten American jobs, champions of these domestic reforms invoke the sanctity of free trade and insist that any government intervention in the market is unthinkable. They even do their best to keep the American market wide open to countries such as communist China (our largest single textile and apparel supplier, with exports to America of $10 billion), which turn tanks on their own children.

Particularly distasteful is the dishonest use of numbers by people who know better. The normally cited costs to consumers are never net numbers. They ignore the costs of worker dislocation and retraining, of unemployment-induced increases in crime, drug use, etc., and other consequences that would surely follow if the U.S. textile and apparel industries died.

The importance of industry linkage is also forgotten. The U.S. textile industry — the producers of fabric — is as efficient as any in the world. According to the laissez-faire free traders, this industry should not support protection of the less efficient U.S. apparel industry because it will be able to sell its textiles to foreign apparel makers.

But although that may be true in theory, it is not true in fact. Other countries are attempting to integrate backwards into textile manufacturing, and are using the low wages of their apparel makers to subsidize that move. Thus, if apparel, which is admittedly not competitive, goes down, so does fabric, which is in fact very competitive.

Although the textile industry is commonly thought of as the classic "low-tech" industry, textile mills are big users of robots, computers, and lasers. If the U.S. textile industry disappears, so will a major market for U.S. high-tech producers. And these high-tech companies also will find it difficult to substitute foreign for domestic customers. Purveyors of the standard calculations never mention these substantial future costs.

Finally, there is a curious contradiction in the position of the administration and of many laissez-faire free traders.

Although they abhor protecting textiles, they are making it a matter of the highest priority to strengthen world trade rules covering intellectual property, which protect businesses from counterfeiting and other cheap knock-offs of their patented products. But wouldn't that sacrifice consumer interests? If a consumer who today can buy a Taiwanese-made Apple computer clone for $200 has to pay $2,000 because of better patent protection for Apple, doesn't his welfare suffer?

Why should Washington insist on forcing Singapore or Taiwan to adopt U.S.-style patent and copyright regimes, but ignore the conditions under which they make textiles? Why should we protect American engineers and scientists and patent attorneys while turning a cold shoulder to the problems of seamstresses and cutters? Is it fair? Is it even logical?

Wouldn't it be better to develop a policy that considers the problem as a whole? For instance, we might bargain to make entry to U.S. apparel markets conditional on some reasonable level of use of U.S. textiles. Or we might for some reasonable period of time auction the right to sell in the U.S. market and use the proceeds to cover the costs of retraining, relocating and starting life over once more. But what we need most at this stage is time to think. We won't have it if Congress upholds President Bush's veto of the textile bill.

Clyde V. Prestowitz Jr. is president of the Economic Strategy Institute, a Washington policy research organization.

THE JOURNAL OF COMMERCE, Wednesday, October 17, 1990

A Bittersweet Sugar Policy

By STUART K. TUCKER

At the beginning of this month, U.S. sugar import policy was transformed. Hurray for progress, but do we really want to live with (and pay for) this new system?

The Bush administration decided to put U.S. sugar import policy back into compliance with U.S. obligations to the members of the General Agreement on Tariffs and Trade, the institution governing world trade. This is a most welcome step in the right direction.

The new program continues to allocate an import quota to each sugar-exporting country, and those imports will continue to face the small tariffs that applied to imports under the previous system. Imports above those quota levels are now allowed — a big step toward freer trade. But there is a catch: those increased imports will be charged a high tariff rate, aimed at keeping the quantity small.

The administration deserves credit for also taking the step of increasing the quotas for sugar entering at the lower tariff rate. The new annual quotas are roughly 39% higher than those for 1990. But they are still protectionist. Sugar imports under the new quotas will be about 60% lower than they were in the late 1970s.

Reducing sugar trade barriers and thereby increasing imports can do a lot of good for the U.S. economy as well as for the economies of America's trading partners. The old barriers supported higher domestic sugar and sweetener prices and cost U.S. manufacturers and consumers about $3 billion annually. The employment loss has been 7,000 U.S. sugar refinery jobs and an additional 9,000 U.S. jobs in related food manufacturing industries.

Developing-country trading partners have lost three-quarters of their sugar trade with the United States, reducing their exports by $800 million a year. The trade losses caused by U.S. sugar import policy outweigh the total trade benefits that the United States is trying to offer its sugar-exporting neighbors through the Caribbean Basin Initiative.

Of course, the United States is by no means the only industrial country to restrict sugar imports. All told, barriers in the industrial world cost developing countries an estimated $4 billion in export revenue each year.

Those losses reverberate through the world economy, reducing developing countries' ability to buy goods and services from U.S. non-food industries. Moreover, the most efficient producers are prevented by the quotas from expanding their market shares, while the high-cost producers are guaranteed a piece of the market.

The new sugar import system, at least, shows Americans how much sugar trade is impeded. And the truth is striking. The new tariff for sugar imports above the base quota will be 16 cents a pound — more than 100% of the world free market price for sugar.

This 100%-plus tariff is the highest tariff the United States imposes on any product. It is one of the highest tariffs in U.S. history. Even the ruinous Smoot-Hawley tariff of 1930, widely considered to have curtailed world trade and prevented recovery from the Great Depression, averaged only about 60%.

Despite the Bush administration's laudable reforms, sugar policy remains unacceptable. The administration has been reluctant to undertake more sweeping changes because virtually the whole of U.S. agriculture policy is under review in the Uruguay Round of multilateral trade negotiations. U.S. negotiators are angling for an agreement by the end of this year that would reduce production and export subsidies and import barriers, leading to large changes in the policies of the European Community as well as the United States.

Although sugar is the worst barrier to U.S. imports, it is consistent with a general U.S. agriculture policy that is extremely trade-distorting and restrictive. The current U.S. farm bill has been one of the most expensive government doles to producers in the 1980s, leading to irrational global agricultural production trends.

This law is about to expire, but Congress is on the brink of passing a new farm bill that is little more than a renewal of the old one. Although this may be a great stick for our negotiators at the trade bargaining table, should we have to live with this inefficient system for five more years?

American consumers, taxpayers, producers and, yes, even farmers have a lot to gain from worldwide farm trade liberalization. The new U.S. sugar tariff-rate quota system beckons us to correct outdated agricultural policies.

Stuart K. Tucker is an economist at the Overseas Development Council, a non-profit research organization in Washington.

THE WALL STREET JOURNAL MONDAY, OCTOBER 15, 1990

Anti-Dumping's Dirty Secrets . . .

By Brink Lindsey

Most people probably assume that anti-dumping law has something to do with the environment. Despite this obscurity, or perhaps because of it, anti-dumping law has over the past decade become a major vehicle for protecting U.S. industry from foreign competition. But this little-known law has rather unexpectedly become the subject of heated controversy in the current Uruguay Round of General Agreement on Tariffs and Trade negotiations.

Anti-dumping law's purpose is to impose special duties on "unfairly priced" or "dumped" imported goods, that is, merchandise sold for less in an export market than in the market in which it was produced. The European Community, Canada, Australia and a handful of developing countries all have anti-dumping laws broadly similar to that of the U.S. America's anti-dumping law is jointly administered by the Commerce Department and the U.S. International Trade Commission. Commerce determines whether a given product is being dumped, and the ITC decides whether that dumping is injuring a U.S. industry. Both findings must be made before special duties can be imposed. Although the law has been on the books since 1921, its use has increased dramatically during the past 10 years.

Puzzles Economists

It may puzzle the average person that his government is taking such pains to make sure he doesn't pay too little for the things he buys. It puzzles economists even more.

Dumping is commonly characterized as an international form of predatory pricing. Foreign producers, the theory goes, unload their goods at cut-rate prices in hopes of driving out the U.S. industry and charging inflated monopoly prices later. But the whole concept of predatory pricing is now regarded by most economists with suspicion. Research indicates that predation seldom if ever works – the up-front costs are just too high, and the chances of ultimately prevailing (i.e., enjoying monopoly profits) are too slim and speculative.

In the case of dumping, the likelihood of predatory behavior is even more remote. After all, allegations of dumping usually involve several competing companies from a given foreign country, and often target imports from more than one country. If even domestic predation is farfetched, then international predatory conspiracies border on paranoia.

More plausibly, dumping is thought to reflect the "unfair" advantage that foreign producers enjoy because of their less efficient home markets. With their profits swollen by anti-competitive environments at home, foreign companies can afford to sell goods here on the cheap. It is true that competitive conditions are generally superior in the U.S., and that prices are lower here than in other countries. It does not follow, however, that foreign producers are using domestic profits to "subsidize" sales in the U.S. market.

First, just because a company charges higher prices on sales at home doesn't mean that it is making a larger profit margin – its costs may be higher, too. Many foreign companies enjoy higher profits on their U.S. operations than on their home-market sales. Second, many companies' export operations dwarf their domestic business. The tail is simply in no position to subsidize the dog.

Any company that sells more than one product or in more than one market is open to the charge that its most profitable line is subsidizing the rest of its operations.

Even if a company does have large domestic profits, why is this "unfair"? After all, it is not considered unfair when a U.S. company has profitable export operations. The argument proves too much: Any company that sells more than one product or in more than one market is open to the charge that its most profitable line of business is unfairly subsidizing the rest of its operations.

If the theory of anti-dumping is shaky at best, the actual enforcement of the law is even worse. There are tremendous obstacles to comparing prices of goods that may be physically different, and that are sold in different currencies, through different channels of trade and with different terms (for example, with different warranties or credit arrangements). Adding to these difficulties, the anti-dumping law is riddled with provisions that skew the dumping calculation toward a finding of "unfair trade." While pretending to measure margins of dumping to within one one-hundredth of a percent, the law contains the following methodological howlers:

- Individual U.S. sales are compared to an average foreign market price. Since companies receive no credit for "negative dumping" (that is, charging more at home than they do abroad), dumping margins can be found even when pricing patterns are identical in the two countries.
- The currency exchange rate is normally determined as of the date of the individual U.S. sale being examined. As a consequence, sudden shifts or fluctuations in exchange rates can generate dumping margins that have nothing to do with a company's pricing policies.
- The Commerce Department frequently compares U.S. sales not to actual sales in a foreign market, but instead to something called "constructed value." This artificial price is built up from a company's costs and selling expenses, with an utterly arbitrary 8% minimum profit margin added on. Use of constructed value, which has no relationship at all to economic reality, can produce wildly exaggerated dumping margins.

Beyond all this, the anti-dumping law is a procedural monstrosity. A U.S. industry seeking protection need provide only the flimsiest evidence of dumping to get an investigation initiated. Once under investigation, a company must provide excruciatingly intricate pricing and cost information, and then allow Commerce Department officials to visit its offices and pore through its records to "verify" that the information is correct. The cost to a company in legal expenses alone can exceed $1 million.

If dumping is found and duties are imposed, the whole process can be repeated every year in an "administrative review" to recalculate the company's dumping liability. These reviews are just as onerous as an original investigation; they also have a tendency to get behind schedule, sometimes by several years, as subsequent reviews continue to pile up. A dumping case, once started, is hard to kill; duty orders will frequently still be in place 10 or 15 years after the original dumping finding.

It is only to be expected that the anti-dumping law, dreadful as it is, enjoys strong support in the protectionist Congress. What is curious is that the law has also been championed by free trade Republican administrations. The reason for this lies in the strategy adopted by President Reagan and now by President Bush in dealing with Congress on trade issues: offering measured concessions designed to keep protectionist momentum from getting completely out of control. The wisdom of such a policy is debatable; it's hard to distinguish an indefinitely continued tactical retreat from outright defeat.

Whatever the merits of this strategy, though, the anti-dumping law has been an integral part of it. The process works like this. Congress proposes some form of protectionism, citing the allegedly unfair practices of U.S. trading partners. The administration responds that no new laws are necessary. There are already unfair trade laws on the books, chief among them the anti-dumping law, and all that is needed is vigorous enforcement.

The results of this approach are evident in the Bush administration's handling of the Uruguay Round negotiations. In general, the U.S. has strongly supported trade liberalization, even in areas, such as agriculture and textiles, where there are powerful domestic lobbies that oppose reform. But in the case of anti-dumping, American negotiators have doggedly resisted proposals for change.

Of course, inconsistency and double-standards are nothing new in the politics of trade. This particular inconsistency, however, has come under heavy fire from America's trading partners.

Stricter Code

At issue are proposed amendments to the Anti-dumping Code, an international agreement entered into in 1979 that sets standards for national anti-dumping laws. On one side, Japan and other exporting countries hard hit by these laws are urging that the code's provisions be strengthened – in other words, that there be stricter rules on what governments can do in the name of fighting dumping. Standing on the other side are the U.S. and the European Community. They reject a tougher code as unnecessary, and are actually seeking expanded authority to address the so-called "circumvention" of dumping duties.

However these negotiations turn out, the basic problem of anti-dumping will remain: The law is fundamentally misconceived. The best that can be expected from any agreement is some amelioration of the more egregious anti-dumping abuses. Nonetheless, the Uruguay Round has succeeded in subjecting anti-dumping to unaccustomed scrutiny. Though the round officially concludes in December, the debate over anti-dumping may just be beginning.

Mr. Lindsey is an attorney in Washington, D.C. He has represented foreign companies in anti-dumping cases.

JOURNAL OF COMMERCE, November 26, 1990

US Firms Create a Monster

By JOHN T. BENNETT

American chemical exporters are outraged. A Korean chemical company, Korea Engineering Plastics, has accused two U.S.-based manufacturers — Du Pont and Hoechst Celanese Corp. — of dumping, or selling their products below fair value, in the Korean market.

Although a finding in the Korean investigation of the charges is months away, the two U.S. exporters and one other firm, Asahi Chemicals Industry Co. of Japan, are likely to be found culpable and subject to levies that will make their exports uncompetitive in that market.

The situation is rich with irony. Koreans generally have viewed dumping laws as protectionist. Over the past decade, U.S. companies have hit Korean firms with a series of dumping complaints, many of them spurious and, Koreans believe, initiated with the sole purpose of protecting U.S. domestic market shares.

Now the U.S. chemical industry is incensed over the charge that U.S. exporters have injured the Korean chemical industry by seeking an unfair price advantage. The accused firms say the prices they charge for polyacetal, the chemical in question, are fair. The Korean firm filing the complaint is the largest local supplier of the plastic resin, which is used in making cassette tape cases and automobile parts.

Korea didn't even have an anti-dumping law until a few years ago, when it adopted one modeled on the U.S. law. Korea was being pressured by the United States and other trading partners to remove its major imports barriers.

The dumping law was enacted, in part, to appease Korean manufacturers, who feared that the government's new market-opening measures would bring in a flood of cheap imports that would hurt their businesses. At the time, however, Japan, not the United States, was considered the threat.

Until now, many assumed that American manufacturers would never "dump" or that Korean manufacturers would never have the bad manners to cite them. After all, the United States is the largest market for Korea.

The Koreans apparently have allowed this understanding, too. That is, until recently, when Korea's trade balance turned negative and officials became concerned that it might get a great deal worse, especially since Iraq's invasion of Kuwait drove oil prices up.

"Dumping" is defined in most countries as the practice of selling goods abroad for less than the price charged in the country of origin. U.S. laws define dumping as selling below cost or "fair market value." That value is calculated to include direct outlays, overhead and an arbitrary rate of profit on invested capital. Once dumping has been determined, importers must deposit levies reflecting the difference between the dumping price and the "fair" market price.

Economists generally view anti-dumping measures as anti-competitive. Economic theory assumes that sellers are rational and set prices that at least cover their direct or variable costs. But the prices need not cover fixed costs that already have been incurred, or produce a profit. For many industries, variable costs are a small part of the total cost of production and prices can be very low for a time.

Manufacturers may quite innocently charge a lower price abroad than at home as their output expands and variable costs fall. Manufacturers who behave rationally suddenly may find themselves caught by the anti-dumping laws.

Korean companies initially had difficulty avoiding U.S. dumping penalties because their accounting didn't meet U.S. standards. Small companies didn't even keep double entry books and were unable to show Department of Commerce officials what their overhead costs were. So Commerce accepted the figures supplied by U.S. industry.

Even large Korean companies had this problem for a time, but they learned quickly after they hired American accountants and lawyers. These professionals have developed ways to allocate overhead between exports and domestic sales to minimize a finding of dumping.

American exporters now will have to learn to take similar steps in order to avoid being penalized in foreign markets. It will become more and more expensive to comply with the different laws and practices evolving around the world. And it will become extremely difficult to set up accounts that will satisfy all jurisdictions.

For years, U.S. companies have relied upon dumping laws to stifle the foreign competition. They have, by their example, created a monster. Now, recognizing the costs of anti-dumping measures, some American exporters have begun to rethink their support for such laws. Unfortunately, they remain a minority.

John T. Bennett is a consulting ecooomist in Alexandria, Va.

JOURNAL OF COMMERCE, November 2, 1990

US Must Rebuild Asian Ties

By ERIC HOTUNG

While President Bush looks for fresh initiatives in the Middle East and wonders just how much the United Nations can be made to do, it might be worth his turning attention to the Pacific. There, his policy initiatives have been stalemated.

America's policies toward Asia and the Pacific Rim, influenced by congressmen who kowtow to public opinion in the hinterlands, seriously undermine the country's economic clout. The most damaging mistake is Congress' refusal to acknowledge the changes that are taking place in China and Vietnam.

In August, when Mr. Bush needed a friend in the United Nations Security Council to support the U.S.-led blockade of Iraq following the invasion of Kuwait, it found one in China. China's endorsement at the United Nations contrasted rather sharply with the stance of some well-known U.S. allies — Germany and Japan, for example — which were reluctant to lend full support to the United States.

The same can be said of China's stance on resolving the problems in Cambodia. China supports the U.S. position, calling for a swift settlement so the devastated and divided country can get on with the arduous task of rebuilding itself.

In Vietnam, which is going through its own traumas, the lack of American recognition is hurting U.S. business interests more than the Vietnamese.

At fault, I believe, is the continual congressional shadow-boxing with Asian realities.

Whoever said that "the sins of the father should be visited on the son" did the world a major disservice. This is evident today in Vietnam, besieged by investors from every country but the United States. Those investors are, in American words, "making hay while the sun shines."

The situation in China is not dissimilar.

China's ties to the United States in the past have been based on mutual aspirations. In looking to America as a big brother, China reconstructed its own economy. That the incidents last year in Tiananmen Square cast a continuing pall over the process of liberalization has yet to be satisfactorily explained.

However, changes are apparent and worth noting. The recent successful conclusion of the Asian Games in Beijing, with all the colorful pageantry that accompanied them, demonstrated China's willingness to leave its self-imposed cocoon of reactionary isolationism. By reaching out to the countries in the region, China has expressed its desire to share in the responsibility for Asia's political, economic, social and cultural future.

That China has found itself on comfortable ground with its Asian neighbors at last is all to the good. Even Singapore's Lee Kuan Yew, following his farewell visit, can testify to this. More recently, Britain and other European countries have moved to lift the sanctions they imposed against China.

But in the United States, the House of Representatives recently voted to suspend China's most-favored-nation status.

Within the past 12 months, there has been a considerable amelioration in the conduct of the Chinese. Physicist Fang Lizhi has been released, and the recent public appearance of former Communist Party General Secretary Zhao Ziyang indicates that his political fall was not followed by any social condemnation.

Mr. Bush has been much criticized for refusing to cancel China's most-favored-nation trading status. Instead, he should be applauded for his political acumen and courage. More than likely, that is what won him China's support in the Security Council.

It is now more necessary than ever for the United States to reconsider its political, economic and social objectives in Asia and the Pacific. If this is to be what the pundits herald as the Pacific Century, then America must come face to face with certain realities. The need to maintain stability in the Pacific is Number One. And for this, China's help is of the utmost urgency.

America, if it takes its responsibilities seriously, must do what it can to raise the region's standard of living. U.S. dollars and cents should prevail. Markets for American goods, American technology and American know-how are shrinking. The specter of a united Europe and, in the near future, a single market in Asia is there for them to contemplate.

It would be better for America to make amends with China now, while the impetus is there. It should rebuild the economic bridges that will prove so vital in the years ahead.

Sanctimoniousness has no place in foreign affairs. It is wiser to adopt the kind of pragmatism exposed by the British statesman, Lord Henry Palmerston, long ago. "Britain," he said, "has no permanent friends; she has only permanent interests." The same should be said of the United States.

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IMF WORKING PAPER

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INTERNATIONAL MONETARY FUND

European Department

Transitional Arrangements for Trade and Payments Among the CMEA Countries

Prepared by Peter B. Kenen*

Authorized for Distribution by Massimo Russo

September 1990

Abstract

Trade among the CMEA countries will soon be conducted at world prices and in convertible currencies. These are crucial steps in economic reform but will worsen Eastern Europe's terms of trade and drive it into current account deficit with the USSR. Proposals have been made for a payments union, resembling the European Payments Union of 1950-1958, to ease the transition. But it would not be very helpful if confined to the countries of Eastern Europe and would not function well if it included the USSR, which would be a persistent creditor. Other ways must be found to deal with the transition.

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*The author is a Professor of Economics and Director of the International Finance Section at Princeton University and was a consultant in the European Department when this paper was prepared. The author is indebted to the staff of the European Department, especially to Thomas Wolf, for advice and comments on earlier drafts, and to papers by Peter Bofinger (1990) and Constantine Michalopoulos (1990), which examine the same subject. The views expressed here are the author's sole responsibility and do not necessarily represent those of the International Monetary Fund.

JOURNAL OF COMMERCE, December 21, 1990

How to Prevent a Collapse

By DANIEL BOND
and ANTHONY SOLOMON

Soviet and Central European economists have predicted that their countries' intra-regional trade will decline by 30% this year, and another 30% in 1991. This contraction is forcing a loss of output and employment far beyond that caused by market-oriented restructuring. Further declines inevitably will become an impediment to economic reform in the region.

It is in the interest of the West to prevent such a collapse. This could be done by helping those countries to establish adequate export credit facilities.

For the past four decades, Central Europe and the Soviet Union have been locked into an archaic, barter-based trading system. This system is now being dissolved.

As the old trading system breaks up, Soviet and Central European exporters are cutting back sales to their traditional customers, who are unable to pay in convertible currency. Buyers in the region find it easier to purchase goods and services from Western suppliers than from their close neighbors. While Western firms can offer attractive medium-term financing in convertible currencies, regional suppliers demand immediate cash payment.

Western export credit agencies are providing $6 billion a year in financing for exports to Central Europe and the Soviet Union. Without comparable financing for their own sales, Central European exporters have a difficult time winning orders — even if their products are competitive on the basis of price, quality, delivery and service.

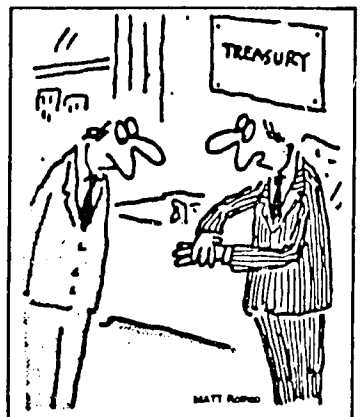
By helping the Central European countries set up their own export financing facilities, the West could "level the playing field" for the region's exports.

Central European governments cannot now secure foreign bank financing for large amounts of export credits. Commercial lenders question their creditworthiness and are not interested in their payment guarantees.

The West could assist by providing a reinsurance facility for Central European export credit agencies. National agencies in Central Europe could provide trade credit insurance and financial guarantees in support of their country's exports. They could reinsure eligible transactions through a facility backed by Western governments. This reinsurance facility should be managed by a multinational institution, such as the European Investment Bank or the newly created European Bank for Reconstruction and Development.

Reinsurance would not require immediate cash outlays, since commercial banks would fund the export credits, as they do under existing Western export credit programs. Future outlays would be called for only if the importers fail to pay their bank creditors and the Central European export credit agencies fail to pay the resulting claims.

We estimate that the annual demand for Central European export credit reinsurance would be $4 billion. To cover claims, the reinsurance facility would need to be backed by reserves equal to about one-tenth of outstanding guarantees. Given a five-year average repayment term, reserves of $2 billion may eventually be required.



"OK, heads we're in favor of a single European currency, tails we're against."

Reserves would be funded partially from premiums charged by participating export credit agencies. The premiums should initially be low, increasing gradually over time as the export credit agencies' need for such support declines.

While the West may be willing to provide a level playing field for Central European exports, they should not expect their own exporters to be placed at a disadvantage. The terms of reinsured export credits should be no more generous than the terms offered by Western nations for their own exports.

Western export credit agencies, working through the Organization for Economic Cooperation and Development, have reached agreements designed to keep their cover policies in line with one another. To be eligible for reinsurance, Central European export credit agencies should agree to adhere to the terms of these agreements.

Western reinsurance should also not cover uncreditworthy transactions. Central European agencies' credit decisions should be reviewed before reinsurance is approved. Transactions involving creditworthy, private sector firms should be favored.

The reinsurance program could be tailored to each country's performance and needs. Western support in trade financing could be conditioned on the pursuit of market-oriented economic reforms. And the reinsurance program could be phased out as Central European governments become able to finance their trade operations on their own.

This initial Western assistance will help Central Europe move quickly into the normal multilateral practice of world trade and finance.

Daniel Bond is vice president and chief economist of the Export-Import Bank of the United States. Anthony Solomon is the former president of the New York Federal Reserve Bank and chairman of the Institute for East-West Security Studies Program for Soviet and East-Central European Economic Transition. The views expressed here are their own.

Policy Analysis

No. 143 November 30, 1990

Routing

WHY TRADE RETALIATION CLOSES MARKETS AND IMPOVERISHES PEOPLE

by Jim Powell

This analysis challenges the prevailing fashion in U.S. trade policy, the so-called crowbar theory that predicts that foreign markets will open if we close our markets, or at least threaten to. The crowbar theory is enshrined in the "super-301" section of the 1988 trade law.

The primary target now, of course, is Japan. James Fallows, Atlantic Washington editor, attracted international attention with a May 1989 article contending that the United States must "contain Japan."[1] Fallows's cold war language, of course, suggested that Japanese companies pose a threat comparable to that of Soviet weapons. He made it clear that Japanese containment called for "outside pressure" from a nation "unchallengeably strong," such as the United States was when it occupied postwar Japan.

In The Enigma of Japanese Power, Dutch journalist Karel Van Wolferen insisted that the Japanese play by fundamentally different rules than we do. He concluded that only "therapeutic economic sanctions" are likely to bring significant changes in Japanese trade policy.[2] In Trading Places, former Commerce Department trade negotiator Clyde V. Prestowitz promoted the idea of "managed" trade: the United States should close its market if Japan does not give us a satisfactory share of its market.[3]

Yet despite frequently repeated claims, it is hard to find a single significant case in which trade retaliation or retaliatory threats have forced open a foreign market.

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Examination of a large number of recent and historical cases of trade retaliation reveals that when retaliation-related market openings did occur, they were small. In many cases, countries responded to retaliation by further closing their markets--surely the opposite of what crowbar theorists intend. Consequently, the history of trade retaliation looks like a bad investment portfolio: small gains dwarfed by huge losses.

The crowbar theory has backfired so many times that a study of it, like the study of warfare, inevitably becomes a study of failure. Trade retaliation has failed to produce significant market openings for five principal reasons.

First, retaliation tends to inspire nationalism and xenophobia in the target country. "The theory of economic sanctions is that they will cause a split within the leadership and the masses of people," says political scientist Robert Gilpin of Princeton University. "But in almost all cases, it's been the opposite. What you have is really a rally-around-the-flag response in these countries."[4]

Second, retaliation forces a country to reorient its economy toward alternative suppliers and markets. Sometimes that means expanding business with previously unimportant trading partners. The target country may develop brand-new trading partners. It may raise crops or produce goods that other countries want so much that they will disregard retaliatory sanctions. The target country may pay premiums for its imports. One way or another, it is almost sure to get along.

Third, retaliation commonly expands the role of government in the target country, much as warfare does. The target government may increase its use of price controls, import quotas, exchange controls, "administrative guidance," and other restrictions, which become very hard to get rid of because they are defended by local lobbyists. That is why, in more than one case, retaliation has had the presumably unintended consequence of promoting fascism. Thus, retaliation may indeed hurt the people in the target country without helping the country that imposed the sanctions.

Fourth, the "tougher" the sanctions, the more they harm people in the retaliating country. Import restrictions trigger shortages and higher prices for consumers, and export restrictions wipe out business for exporters. Sanctions probably inflict as much harm at home as they do on the target country. That is why tough sanctions are seldom adopted, despite continuing objectionable practices in a target country. When such measures are adopted, they lead to losses, black markets, and corruption.

Fifth, retaliation cannot do anything about the worst cases, nations whose economies are already closed. Since there is little trade with such countries, threats to cut off trade are meaningless.

To be sure, retaliation may inflict considerable harm on a target country with whom a lot of trade is taking place, but such retaliation rarely causes the target country to change its policies. In many cases, people have patriotically endured hardship rather than do the bidding of a hostile foreign government. If Washington prevented American consumers from buying any Japanese products, Japanese companies as well as American consumers would lose, but past experience suggests that it is unlikely that the Japanese government would respond with a significant market opening.

Since the crowbar theory has failed in practice, we should not be surprised to discover that its underlying premises are false. Crowbar theorists assume that it is somehow easier for Washington to get other governments, thousands of miles away, to make significant policy changes than it is to achieve changes, such as abolishing agricultural import restrictions, here at home. Also false is the premise that markets open only when subjected to external pressure such as trade retaliation. That is as false as the ancient delusion that genuine reforms can be imposed by conquest.

As is shown below, significant market openings tend to occur for domestic, not external, reasons, and the precondition is almost always an economic crisis. When enough people in a stagnant, closed society fear falling behind prosperous open-market economies, it becomes politically possible to overcome entrenched interests and abolish border restrictions. Equally important, there must be prosperous open-market economies in the world--standard-bearers if you will--so people in closed societies can see for themselves that they will really be better off after they go through the short-term pain of allowing long-protected, backward enterprises to close and make their resources available to new entrepreneurs.

The most dramatic way we can promote more open markets abroad is to unilaterally repeal our own border restrictions. Although that is a formidable task, it is far more likely to succeed than is a policy of bludgeoning foreigners thousands of miles away. By repealing our border restrictions, we will make it possible for our people to get what they need more easily and cheaply. Companies will become more competitive, and living standards will go up. We will provide a much-needed affirmation that peaceful contact with the outside world is perhaps the most powerful, persistent stimulus for human progress.

JOURNAL OF COMMERCE, December 3, 1990

Bush Erred on Weapons Trade

By BARRY KELLMAN

When U.S. legislators recently considered the usually humdrum subject of export reform, they sparked off a heated controversy over the question of who should regulate weapons trade.

Earlier this year Congress enacted the Omnibus Exports Amendments Act of 1990, including mandatory trade sanctions against countries and companies that use or supply chemical or nuclear weapons. President Bush vetoed that law because, he alleged, it restricted the president's free hand in foreign affairs.

Mr. Bush's veto drew the line of battle between the legislative and the executive branch over separation of powers. The president is commander-in-chief and historically has been the principal representative of the United States in foreign diplomacy. But the Constitution authorizes Congress to regulate commerce with foreign nations.

The constitutionality of the mandatory sanctions all depends upon whether U.S. efforts to control international weapons trade falls into the province of foreign policy or foreign trade.

Congress decided, quite rationally, that use of its express power to regulate foreign commerce would best achieve the national interest in stopping proliferation.

The Reagan and Bush administrations have scuttled congressional sanctions against Iraq for its possession and use of chemical weapons. Instead, they have favored inadequate diplomatic efforts to discourage proliferation.

Not only has weaponry escalated, but failure to impose sanctions has announced to the world community that chemical weapons development will not have serious consequences, at least short of war.

U.S. export policy strictly controls American firms' participation in the weapons trade by restricting the export of U.S.-made products. But the market is open for foreign companies not within U.S. jurisdiction. A European company, for example, that supplies Iraq or Libya with chemical weapons components doesn't face much of a consequence — the U.S. government would deny any U.S. companies' requests to export to that European company.

Indeed, in a number of cases, Europeans have contributed to the proliferation of weapons in the Middle East. The French aided the Iraqi construction and operation of its main chemical weapons facility at Samarra. German and Japanese firms helped Libya build its chemical plant near Rabta. And German companies helped Iraq develop the Sa'ad 16 missile project. According to Central Intelligence Agency Director William Webster, the Middle Eastern countries would have been unable to obtain these dangerous weapons of mass destruction without this assistance.

The new export act would have brought U.S. policy up to date because it identifies the proliferation of mass destruction weaponry as the primary strategic threat in the Cold War era. While trade with the nations of Eastern Europe was substantially relaxed, the 1990 act strengthened sanctions against foreign nations and companies that use or supply chemical or ballistic weapons.

Mr. Bush was wrong to veto the Omnibus Export Act because mandatory sanctions are vital to a policy designed to control the spread of chemical and nuclear weapons. The president did not take issue with the possible value of sanctions, he vetoed the legislation because the imposition of mandatory sanctions limits the bottom line discretion he claims is necessary to effectively manage foreign policy.

The administration prefers the freedom to use diplomatic overtures — to offer carrots, instead of sticks — to encourage the cooperation of foreign states and the international chemical and ballistic industries that supply them.

To declare mandatory sanctions, by contrast, sends a clear message that the pursuit of a weapons capability will invoke inescapable penalties far worse than a mere diplomatic rebuke. Mandatory sanctions can thus deter the development of chemical or ballistic weapons.

In the wake of the Cold War, a host of adversaries lacking the capability to wage all-out war against the United States are nevertheless rapidly gaining the ability to inflict serious damage. To cope with these threats demands tight oversight of trade in militarily critical materials and punishment of violators. The United States can help restrict access to weapons by initiating legal sanctions against these modern masters of war.

While the Cold War's bipolar conflict called for a unitary executive, capable, through the adroit use of diplomacy, of protecting the United States and its interests from rapid and massive destruction, the coming era requires the regulation of trade to prevent weapons proliferation.

This task is closer to the domestic regulation of industrial and commercial conduct than to the task of influencing foreign heads of state. It is appropriate, therefore, that Congress should both determine which conduct contravenes its anti-proliferation policy and prescribe the punishment for violators.

Put starkly, the worldwide proliferation of weapons threatens consequences too horrifying to leave the job of its control to diplomacy. Sooner or later, mandatory export sanctions will be enacted because international security demands it. Hopefully, legislators will be allowed to implement rigorous enforcement laws before the lack thereof leads to disaster.

Barry Kellman is a professor of law at DePaul University in Chicago.

NEW YORK TIMES, November 4, 1990

Stop Arming the Third World

By Edward N. Luttwak

WASHINGTON

Now that the cold war has ended, we should try to end one of its most evil side effects: the reckless arming of third-world countries with modern weapons.

Once a vital tool of the Soviet Union's global influence-seeking strategy, and sometimes profitable too, weapons sales no longer serve Moscow's drastically recast ambitions. Nor are they particularly profitable — almost all hard-currency buyers prefer Western products.

For the U.S. the gift or sale of weapons was a strategic imperative only as long as friendly countries faced regional enemies armed by Moscow. The economic benefits are illusory. To keep U.S. military production lines going by third world sales only delays the release of capital and skilled labor to civilian industries now struggling to compete internationally.

Thus a U.S.-Soviet agreement to end arms sales to the third world, once a chimera, is now a practical prospect. It is also an urgent necessity, to avoid a fire sale of the huge NATO and Warsaw Pact inventories that have become redundant.

Because Britain, France, Germany, Italy and a dozen other countries also export weapons, it might seem that any agreement would have to be multilateral. But that would result in endless and futile debate, while an accord between Washington and Moscow (but left open to other signatories) might be concluded rapidly.

That would in itself immediately stop much of the flow of weapons to the third world, and it would *not* merely set the stage for greater sales by all other suppliers. An American-Soviet ban would inevitably establish a new international standard, stigmatizing arms sales to the third world just as the transfer of nuclear weapons was stigmatized long ago.

As it is, arms sales are already very controversial in most Western democracies except for France. Even the French Government would face overwhelming domestic opposition if it tried to keep selling weapons in sordid isolation. In practice, Britain, France, Germany and Italy would be shamed out of the arms business in short order — and they are still the only sources of first-class combat aircraft, tanks and warships except for the Soviet Union and the U.S.

True, lesser exporters such as Brazil, which may have strong cash needs, might have to be bribed, perhaps by debt concessions. China might have to be appeased once again, and both Koreas might have to be pressured. If civilian exports are made hostage to full compliance, most weapons sales would soon stop.

In any case, whether by shame, bribes, appeasement or pressure, all significant arms exporters are likely to fall into line. Paying customers have become quite rare in any case, and it is the U.S. itself that has most of those, including the premium market of the oil-rich of Arabia.

Some sales would no doubt continue by subterfuge. But there is a world of difference between odd lots of mortars or outdated tanks and the great flood of advanced weapons that has made Iraq, with its oil-and-dates economy, and Syria with its sesame-seed-and-chickpea economy, into dangerous powers capable of modern war on a large scale.

Throughout history, the military power of nations could not exceed their own abilities in governance and technology. The cold war suspended such proportionality, for it induced each side to arm its clients as heavily as possible. But now this historical aberration, which makes Iraq better armed than highly industrialized Belgium, and Saudi Arabia more heavily armed than Italy, now the world's fifth largest industrial power, can be ended.

A U.S.-Soviet pact could end all sales.

Only a sweeping prohibition can succeed — a total ban on all arms sales to all countries in the "violent zone" from Morocco to Bangladesh. That would of course leave the more self-sufficient at an advantage, but no remedy can be faulted because it fails to nullify the natural scientific-industrial superiority of India over Pakistan, or of Israel over Jordan, or Iraq for that matter.

No self-sufficiency is complete, of course, and a ban on weapons exports would immediately raise the question of weapon-making machinery exports, and then of plain machinery exports and so on. That difficulty too is manageable. After all, that very problem is already being confronted by all the countries that are enforcing the long-established controls on the spread of nuclear-weapon and ballistic-missile technology.

The alternative to a new paradigm is now before us in the Persian Gulf, where U.S.-made Hawk antiaircraft missiles recently sold to Kuwait are being fielded by Iraq, which can only use them because the U.S. trained hundreds of Jordanians in their operation.

American pilots might also be killed by the 100 French-German Roland missiles, once upgraded with almost $1 billion of American money when the U.S. Army was planning their purchase. Iraq, moreover, would certainly use its U.S.-made helicopters to kill Americans if there is a war — and Iraq, it should be recalled, is unusual precisely because it has so few U.S.-made weapons.

When the Hawks were sold to Kuwait their capture by Iraq was not anticipated. When those other Hawks were earlier sold to Jordan, King Hussein's sympathy for an enemy of the U.S. was not anticipated. Now that many more weapons are being sold in the Middle East, no unfortunate results are being anticipated either.

Plausible strategic justifications are of course offered for each sale. But these are worthless when the recipients are fragile autocracies whose policies can change overnight.

As long as the Soviet Union armed its clients, the U.S. had to do likewise. Now there is a choice, and it should be exercised to end this most dangerous residue of the cold war. □

Edward N. Luttwak holds the chair in strategy at the Center for Strategic and International Studies.

Congressional Research Service
September 12, 1990

U.S.-CANADA FREE TRADE AGREEMENT: ASSESSMENT AND IMPLICATIONS FOR A U.S.-MEXICO FREE TRADE AGREEMENT

SUMMARY

By Arlene Wilson

The historic U.S.-Canada free trade agreement (FTA), which became effective January 1, 1989, is a long-term, evolving agreement which will probably increase trade and investment flows considerably, as well as stimulate economic growth in both countries, in the years to come. But no large surge in trade or investment flows is evident in the year and a half that the agreement has been in effect.

The FTA is unique in many ways. It covers a wide range of issues, such as energy trade, government procurement, automotive trade, border crossing procedures and some nontariff barriers in agriculture and wine. The FTA's provision of rules for future trade in investment and services provided a model for the Uruguay Round of GATT negotiations currently underway. The temporary dispute settlement procedure for countervailing duty (CVD) and antidumping (AD) cases represents a compromise between the U.S. goal of achieving more rules on subsidies and the Canadian goal of obtaining exemption from U.S. CVD and AD cases.

By phasing out tariffs over a 10-year period and removing some nontariff barriers, the FTA immediately liberalized some trade. But, in terms of magnitude, the FTA's main thrust was to provide a better environment for trade in the future, not immediate trade liberalization. A better environment for trade is difficult to assess, however, because it is not easily quantifiable and the FTA has been in effect for less than two years.

As in the case of the FTA with Canada, an agreement with Mexico would likely yield negligible economic benefits to the United States in the short-run. In the long-run, however, U.S. trade and investment might increase considerably as the Mexican economy grows. Furthermore, with both agreements, the improved environment for trade would be a major benefit.

The United States did not extensively study the potential effects of an FTA with Canada on the U.S. economy before the negotiations began (although Canada evaluated the potential effect on the Canadian economy for several years before requesting negotiations). An agreement with Mexico would raise many concerns, such as the effect of the difference in U.S.-Mexico wage levels and labor standards on movement of U.S. industry to Mexico. An objective, comprehensive, analysis of the potential effects of a U.S.-Mexico agreement on the U.S. economy, industry sectors and U.S. workers could be very valuable in determining any negotiating agenda.

OTA Report Brief

September 1990

Worker Training: Competing in the New International Economy

Workers' skills are critical to U.S. industrial productivity and competitiveness, and to maintaining living standards. Today's international economy requires flexible workers who can adapt to new technology and the work reorganization needed to make effective use of new technology. Employees need to take more responsibility, cooperate more closely with one another, and understand their roles in the production system. Training is the key.

Good training pays—for workers whose skills are upgraded, for companies seeking a competitive edge, and for the Nation in overall productivity. For a slowly increasing number of businesses, training is becoming an integral part of competitive strategy. Too often, however, American firms seek to improve their production systems by focusing on investments in hardware—equipment and physical plant—rather than on the people who will make the hardware perform. When managers treat workers as adjuncts to technology, they fail to capitalize on employee skills and to reap the rewards that can come from blue-collar and gray-collar innovation.

When measured by international standards, most American workers are *not* well trained. Our major trade competitors provide more training, offer government support for training, and train workers to higher standards. More than ever before, the international economy pits the U.S. workforce against those in other countries.

Many American firms have found training employees for new technology more difficult than anticipated. Traditional approaches are proving too narrow. Also, many workers—20 percent or more in some firms—need better basic skills (reading, writing, arithmetic, and oral communication) before they can handle broader training. Increasingly, firms need to deliver training in basic skills, task-specific skills, plus broader problem-solving and group skills.

The quality of training also needs to improve. Training must be focused on workplace problems and delivered effectively. Following instructional design principles and using training technology can improve training and increase its chances of transferring back to the job.

Over the long term, improving education and helping young people make the transition from school to work will be crucial to the Nation's continued economic success. In the near term, training for those already at work will have the greatest influence on competitiveness.

Greater Federal involvement may be required to develop the highly skilled, flexible workers needed today. American firms and workers do not place enough emphasis on training. Some look to State programs to fill the gap, but States can provide only modest direct support to corporate training in economic development programs, plus important, but limited, indirect support through community colleges.

Options for increased Federal involvement range from providing better information about training, to support for new apprenticeship programs, to payroll levies. Incremental strategies that build on current Federal assistance for training research and demonstrations, program evaluation, and best practice dissemination would have low initial implementation costs. However, they would do little to change companies' fundamental training practices.

To encourage widespread corporate action, Congress would have to choose more far-reaching initiatives. A payroll-based levy would have the largest potential impact on corporate training with no direct effect on Federal revenues. Requiring employers either to invest a percentage of payroll in training or contribute the same amount to a Federal training trust fund would increase training among *all* employers.

New institutional structures also will be needed to make affordable training available to small businesses. Approaches such as industry training consortia, involvement of employer organizations in training, and joint labor-management training programs show promise in reaching those currently underserved by the training system.

The Office of Technology Assessment (OTA) is an analytical arm of the U.S. Congress. OTA's basic function is to help legislators anticipate and plan for the positive and negative impacts of technological changes.

Summary of Selected Policy Options

OTA's report analyzes 16 policy options for encouraging more and better training of employed workers, grouped in 4 broad issue areas. The advantages and disadvantages of 10 of these options are listed below.

Issue area/options	Advantages/disadvantages
A. Reducing barriers to firm-based training:	
• Help firms set up training consortia	—could help firms with limited training funds or expertise (e.g., most small firms) share resources, and thus expand training activities —firms outside a training consortium might poach trained workers from members
• Consider limited tax credit for private-sector training	—firms favor tax credits over more prescriptive approaches —unless targeted, a credit might simply substitute for industry funds; if targeted, paperwork would increase and employer interest would decline
• Phase-in a payroll-based "National Training Levy" obliging firms to spend a specified amount on training or forfeit that amount to a training fund	—could raise skill levels throughout the employed workforce at little or no public cost —at least initially, the approach could result in training-for-training's sake
B. Retraining for individual career advancement	
• Support, expand apprenticeship	—would help give workers transferable skills and firms highly skilled workers —few workers are now enrolled in apprenticeships; even if tripled, only about 1 percent of the workforce would be served at any given time
• Provide programmatic (not just demonstration) support for workplace basic skills projects	—only programmatic support is likely to reach a meaningful number of firms and workers —turning a demonstration program into a program of regular assistance to firms and their employees could create competition for limited Federal adult basic education funds
• Make favorable tax treatment for employer-provided education assistance permanent	—would assure that workers would not discontinue employer-supported training due to tax concerns —if the objective is to encourage low-wage workers to participate in training, other, more direct approaches might be a better use for the foregone Federal tax revenues
C. Linking training and technology assistance to firms	
• Help States expand industrial services, combined with training	—expansion of technology services, coupled with training assistance, would help firms make decisions about modernizing their equipment and upgrading worker skills —unless well-balanced, Federal assistance might exacerbate competition among States for new business, to the detriment of other States
• Support creation of an employer institute for work-based learning	—a private-sector institution would be more likely than government to win the ear of employers —the danger exists that the institution's agenda could be dominated by parochial concerns too narrow to merit public support
D. Improving the quality and effectiveness of training	
• Fund the Federal Training Technology Transfer Program	—initial funding would: 1) help determine how much federally sponsored training technology is relevant to the private sector, and 2) allow procedures to be developed to transfer promising training approaches and technologies to the private sector —transfer activities could divert staff and resources from primary agency training missions
• Fund learning research/technologies by, for example, earmarking a small percentage of Federal education and training program funds to research	—the resulting program-related research might easily pay for itself many times over through more effective training —earmarking funds would be resisted by program managers worried about micromanagement

Copies of the report for congressional use are available by calling 4-9241.

Copies of the report for non-congressional use can be ordered from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402-9325 (202) 783-3238. The GPO stock number for the OTA report, "Worker Training: Competing in the New International Economy," is 052-003-01214-6. The price is $12.00. Summaries of reports are available at no charge from the Office of Technology Assessment.

For further information contact OTA's Publications Office. Address: OTA, U.S. Congress, Washington, DC 20510-8025 (202) 224-8996.

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INTERNATIONAL MONETARY FUND

PRESS RELEASE NO. 90/57

FOR IMMEDIATE RELEASE
November 15, 1990

In response to recommendations from the IMF Interim Committee at its September 1990 meeting, the Executive Board of the Fund has unanimously adopted a series of decisions to provide emergency financial relief to member countries seriously affected by the Gulf crisis. Recent developments in the Middle East have increased the vulnerability of the world economy and exacerbated the difficulties facing many of the Fund's members. In accordance with its mandate, the IMF has a central role to play in helping its members to overcome such unexpected shocks. Notwithstanding the difficulties and uncertainties, Executive Directors consider that the overall situation is manageable through the use and adaptation of the existing instruments available to the IMF. Such an approach is considered appropriate since--contrary to earlier times of major oil price increases--a large number of members presently have IMF arrangements in place. Also, the lessons of past experience suggest strongly that the provision of added financing by the IMF be primarily in the context of comprehensive adjustment programs.

In view of this, the core of IMF's support will be provided within the stand-by, extended, structural adjustment facility (SAF)/enhanced structural adjustment facility (ESAF) arrangements, and the compensatory and contingency financing facility (CCFF). Suitable modifications in adjustment measures and IMF financing within the context of IMF arrangements could be introduced relatively quickly, in keeping with the need for a rapid response. Specifically, the IMF's Executive Board decided to:

1. Modify or rephase the amount of financing available to members, as appropriate, to take into account the effects of developments in the Middle East.

2. Suspend, until the end of 1991, the present lower annual, three-year, and cumulative borrowing limits 1/. The upper limits of 110, 330, and 440 percent of each member's quota and the clause which allows the IMF to provide financing in excess of these limits in exceptional circumstances, remain unchanged.

1/ 90 percent of quota, 270 percent of quota, and 400 percent of quota respectively.

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3. Allow the IMF to increase the total ESAF financing 1/ for a member at the time of mid-term reviews of such arrangements.

4. Allow the IMF to add a fourth year of ESAF support for countries that would complete their current ESAF arrangements prior to November 1992. This will enable them to benefit from a further year of concessional financing when undertaking strong programs of structural adjustment.

5. Until now, the IMF has not had the ability specifically to compensate for economic shocks caused by sharp increases in the price of oil imports. Consequently, the Executive Board agreed to introduce, for a temporary period, to the end of 1991, an oil import element into the compensatory and contingency financing facility to cover excess costs of imports of crude petroleum, petroleum products, and natural gas. Prior to such a drawing, a member will be required to undertake satisfactory energy policy actions.

Access under the oil import element will be up to 82 percent of quota. In certain cases, the financing will be disbursed in two amounts: 65 percent of the total will be available on approval by the Executive Board, and the remainder at a later date in conformity with specified requirements.

6. The Executive Board also decided to expand the coverage of IMF's compensatory financing. Whereas previously only workers' remittances and travel receipts could be included in the calculation of export shortfalls under compensatory financing, under the new policy losses resulting from shortfalls in other services, such as receipts from pipelines, canals, shipping, transportation, construction, and insurance, will also be included.

7. In view of the present uncertain global economic situation, the Executive Board agreed that an external contingency mechanism could be attached to IMF arrangements at the time of a review, provided it is done at least six months before the expiration of the underlying arrangement. Such mechanisms allow the member to be protected against external developments that could harm the implementation of their economic program. Previously, such contingency mechanisms could only be attached to an arrangement at the time of approval of the arrangement or at the beginning of any annual program.

1/ ESAF is the IMF's concessional window for assisting its poorest members undertaking macroeconomic and structural programs to strengthen substantially and in a sustainable manner their balance of payments positions.

These significant adaptations of the IMF's instruments leave unchanged, nevertheless, the basic principle governing IMF assistance and, in particular, the criteria of balance of payments need the strength of the adjustment program and capacity to repay, as well as catalytic role of the IMF calling for consideration of the contribution that can reasonably be expected from other institutions and bilateral lenders or donors.

Executive Directors have emphasized that the present situation, and the Fund's responsibilities in managing it, underscore the need for the earliest possible implementation of the quota increase and the associated amendment to the Articles of Agreement. They also stressed the view that while temporary forms of relief are important, the impact of the Middle East crisis, and the broader economic changes sweeping the world, call for bold and comprehensive growth-oriented structural adjustment programs that would reinforce the member countries' capacity to react to such unexpected shocks. The IMF stands ready to assist its members in the design, financing, and implementation of such programs.

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release December 12, 19

FACT SHEET

THE USSR AND THE INTERNATIONAL FINANCIAL INSTITUTIONS:
A SPECIAL ASSOCIATION

President Bush has proposed a Special Association of the Soviet Union with the International Monetary Fund (IMF) and the World Bank that will give Moscow access to the economic and financial expertise in those institutions. He has asked Secretary of the Treasury Brady, as U.S. Governor of the IMF and World Bank to pursue this proposal with the institutions and other countries and to develop with them the necessary new arrangements.

We believe it is best for the USSR to establish such a relationship with these institutions before addressing the issue of full membership.

A "Special Associate" status could include the following elements:

- The IMF providing technical assistance to the Soviets on macroeconomic, financial and exchange rate policies, as well as advice on other issues such as fiscal policy, tax reform and central banking issues.

- The World Bank providing technical advice on specific structural issues, such as changes in the transportation, energy and financial sectors, as well as on critical microeconomic issues, such as development of markets.

- The Fund conducting an Annual Review of the Soviet economy, similar to the Article IV consultation process, now done for all IMF member countries.

- The institutions placing technical experts in Moscow to provide ongoing assistance and coordination of activities.

- The Soviets continuing to attend Annual Meetings, as they did in 1990.

- The Bank and the Fund inviting the Soviets to participate in courses offered by their respective training institutes.

The IMF and World Bank, along with the Organization for Economic Cooperation and Development (OECD) and the President-designate of the European Bank for Reconstruction and Development (EBRD), are now completing a study of the Soviet economy that was requested at the Houston Economic Summit. A new Special Association could allow the IMF and World Bank to build on that work and to advance the process of economic reform and liberalization in the Soviet Union.

Speakers Debate Policy Challenges Posed by Trade and Capital Flows

Emerging problems and challenges in international trade policy, changes in global capital flows and their implications for U.S. policy, and risks and opportunities in Eastern and Central Europe were the main themes discussed by speakers at the Tenth International Monetary and Trade Conference held in Philadelphia on September 26–28. The conference, which was organized by the Global Interdependence Center, a forum for the discussion of international economic issues, brought together some one hundred economists, bankers, corporate executives, and government officials from many countries. It was cosponsored by the Overseas Development Council, a Washington-based research organization, and the University of Pennsylvania's Fels Center of Government.

Trade Policy. The conference opened with a presentation by Sylvia Ostry, Chairman of the Center for International Studies at the University of Toronto, who focused on the challenges for trade policy during the 1990's.

The most pressing concern now, according to Ostry, is the Uruguay Round of multilateral trade negotiations, which is due to be concluded by the end of 1990. She saw the outlook for the Uruguay Round as "pretty foggy." The most crucial issue is agriculture, where a major sticking point is the European Community's (EC's) refusal "to confront head on the export subsidy question, essentially because it cannot politically confront a real reform of the CAP [Common Agricultural Policy]." She added that "unless there is a significant change in the EC position, which strikes me as highly unlikely, the rest of the Round hangs in the balance." Other issues also remain gridlocked, she said, including trade in clothing and textiles and in services.

In addition, institutional questions have come to the fore. One of these, according to Ostry, is that of dispute settlement procedures in the GATT (General Agreement on Tariffs and Trade). For many countries, the objective now is to establish mechanisms "to curb the aggressive unilateralism of U.S. trade policy in section 301 of the 1988 Trade and Competitiveness Act." But even stronger dispute settlement procedures "would not be enough to sustain the GATT system over the longer run." A "more fundamental" institutional reform, along the lines of the Canadian proposal for a World Trade Organization (WTO), will be necessary for the effective implementation of key parts of the Uruguay package and for the full integration of the former centrally planned economies into the world trading system. Looking to the future, Ostry noted that the nature of trade—particularly among the industrial countries—is changing. An increasing proportion of it involves high-technology goods produced by large firms in imperfectly competitive markets. This trend has begun to create new frictions, notably asymmetries in investment and technology access. For example, she noted, the fact that Japanese investment in the United States in 1989 was $32.5 billion, while U.S. investment in Japan was only $1.64 billion has already heightened perceptions of unequal investment access. And in technology, there are moves to retain domestic control of "strategic" technologies—as evidenced by EC and U.S. initiatives to block foreign subsidiaries from joining government-industry research consortia. Ostry saw "an obvious and potentially damaging conflict" between this "technonationalism" and the "technoglobalism" of multinational enterprises. She said that, at present, the only forum in which such issues can be handled multilaterally is the Organization for Economic Cooperation and Development (OECD). But, over time, it might be possible to develop a set of codes that could be transferred to the WTO.

Irving Kravis, Professor of Economics Emeritus at the University of Pennsylvania, focused on the "growing trend toward managed trade." He noted that governments are increasingly seeking to determine both prices and quantities of traded goods through negotiations rather than leaving them to the markets. And multinational enterprises are showing a growing tendency to enter into technology- and market-sharing agreements. The motivation behind such pacts may not be anticompetitive, but the result is assuredly so—at least in certain markets. Kravis stressed the need for a world trade organization or some other international body to "systematically exercise surveillance of the sorts of arrangements being made."

Sylvia Ostry of the University of Toronto: the outlook for the Uruguay Round of multilateral trade negotiations is "pretty foggy."

Regional free trade arrangements are other manifestations of managed trade, according to Kravis. He noted that the result of such agreements—which involve giving special entitlements to some countries while denying them to others—could well be to reduce trade overall rather than increase it. In addition, such arrangements could lead to the establishment of blocs. "One can imagine a world divided into three or four trading blocs," he said, which "is bound to create more hostility in trade relations."

In comments from the floor, Arthur Dunkel, Director-General of the GATT, stressed that free trade arrangements or customs unions are not intrinsically undesirable. The issue is whether they create trade or divert it. By that yardstick, the evolution of the EC, the U.S.-Canada Free Trade Agreement, and the arrangement proposed between the United states and Mexico are positive developments. Customs unions also have other advantages: they are able to speak with a single voice, and "cooperation is easier if you have one spokesman for 12 states than if you have 12 spokesmen." He added that, in a sense, the United States is itself a customs union, consisting of many states, which sometimes differ on issues even more than do EC members.

Later, in a luncheon address, Dunkel pointed out that the Uruguay Round "is our only chance to nail down the worldwide process of reform and prevent it from unravelling or dissipating itself . . . ." He stressed that the December deadline for the conclusion of the Round "must be kept," first, to avoid a loss of momentum "which could delay results not for months but for years"; and, second, because the economic implications of the Middle East crisis underline the need for urgency.

According to Dunkel, some positive results have already emerged: a wave of recent accessions to the GATT has been accompanied by substantial market-opening measures; dispute settlement procedures have been strengthened; and there is greater acceptance of multilateral surveillance of national trade policies. But "major issues remain open."

Global Capital Flows and U.S. Policy. This session focused on various aspects of global capital flows, their effects, and their policy implications, particularly for the United States. David Lomax, Group Economic Adviser, National Westminster Bank PLC, London, examined the putative linkage between global saving and investment policy and the U.S. budget and external deficit. This debate is "seriously misconceived," he said, suggesting that by OECD standards, the U.S. budget deficit is "not large"; it amounts to 1.8 percent of GNP, compared with 9.9 percent of GNP for Italy, 5 percent of GNP for the Netherlands, and 2.7 percent of GNP for Canada. He also noted that the U.S. trade deficit is improving steadily: in the first six months of 1990, it averaged $7.6 billion a month, compared with $9.1 billion a month in 1989. Partly as a result, the U.S. current account deficit is declining. Higher oil prices will set it back, but "the trend was clearly in the right direction." Lomax pointed out that an improvement in the current account would, by definition, increase domestic savings. Lomax disputed the view that the United States is vulnerable because it relies on foreign, particularly Japanese, savings to finance its deficit. "How many dollars foreigners hold depends primarily on the U.S. trade position," he said. For example, "if any country . . . is willing to sell the United States a motor car and to receive dollars in exchange, then the seller of the car will hold dollars. Foreign attitudes toward trade may thus influence a country's current account and thus its total savings." Lomax pointed out that the debt of the U.S. Government "is bound to be bought, and the only issue, which is determined by the financial markets, is the interest rate at which that paper will be held." He cautioned that "the increasing paranoia and nervousness" surrounding U.S. budget and trade deficit issues "create the risk of significant policy mistakes." The United States "needs to adopt a more sanguine attitude toward domestic savings and investment," he concluded.

David Hale, Chief Economist and First Vice-President of Kemper Financial Services Inc., considered the consequences and policy implications of the rapid globalization of securities markets in the 1980s. He attributed this globalization to three major forces: the elimination, by most industrial countries, of capital controls; the development of modern computer and communications systems, which has reduced the cost of international investing; and the divergences in national economic policies in the 1980s, which created large imbalances between savings and investment among the United States, Japan, and Europe.

Hale pointed out that global financial liberalization has had many positive effects. Notably, it has enabled the United States to import capital relatively easily and so sustain many years of moderate economic growth despite large government deficits and declining rates of private saving. But it has also had some unintended side effects, "which could be less positive for the world economy of the 1990s." In particular:

- There is an "overconcentration" of capital flows in English-speaking countries, both because of divergences in macroeconomic policies and microeconomic and institutional considerations, such as the faster financial liberalization in these countries relative to Japan and continental Europe.
- Because the global capital market liberalization occurred within a floating exchange rate system, it generated considerable exchange rate instability. Notably, there was a sharp rise in the value of the U.S. dollar in the mid-1980s, which fueled protectionism and demands for a more interventionist industrial policy.
- Concern about trade friction prompted attempts by the major industrial countries to exercise more official control over exchange rates through ad hoc targetry via central bank intervention, moral suasion, and greater coordination of monetary policies. These attempts were not altogether successful. For example, Japan's efforts to control the yen/dollar rate through an easy monetary policy in the late 1980s helped inflate Japanese asset prices, which prompted large capital outflows as Japanese investors stepped up their purchases of foreign assets. These outflows, together with a weakening yen, set the stage for increases in Japanese interest rates, which, in turn, helped bring on the 1990 Tokyo stock market crash.

The EC Commission's Corrado Pirzio-Biroli: reforms in Eastern Europe will eventually boost economic growth in Western Europe too.

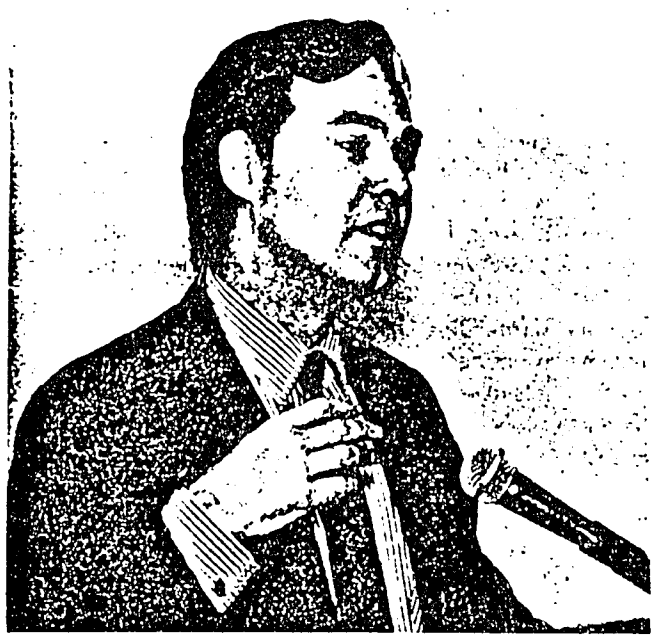
Hale noted that controlling the effects of increased capital mobility on exchange rates and trade policy will not be easy. But the experience of the 1980s "makes it

clear that monetary policy coordination alone will produce sub-optimal outcomes . . . . If one country pursues an easy monetary policy to prop up another country's currency, it will be difficult to avoid speculative excesses in asset markets or a general rise in inflation." Hale suggested that the major industrial countries focus more attention on the role of fiscal policy as well as on microeconomic and institutional forces that drive private capital flows. He pointed out that Japan and the United States have set a useful precedent for such cooperation through the yen/dollar talks of 1985 and the Structural Impediments Initiative agreement of 1990.

In the same session, Michael Moran, Chief Economist at Daiwa Securities, New York, discussed the interest rate implications of the slowdown of capital inflows into the United States. He noted that both purchases of private securities and direct investment by foreign—particularly Japanese—investors have fallen dramatically in the first half of 1990 relative to the same period in 1989. Many forces have contributed to this decline, he said, including falling U.S. real estate values, forecasts of recession, problems in the thrift industry, and more attractive investment opportunities in other countries.

Moran argued that the slowdown in foreign investment into the United States is unlikely to precipitate a rise in domestic interest rates as some have suggested. What is often overlooked, he said, is that the demand for funds in the United States has also slowed down. For example, private nonfinancial debt increased by an annual rate of 8 percent in the first half of 1990—about the same pace as in the recession years of 1975 and 1982. Federal government borrowing is also growing slowly, and much of this borrowing—for example, part of the borrowing arising from the savings and loan crisis—is substituting for private liabilities rather than adding to them. Moran was therefore "not surprised" that, despite a large outflow of funds from the United States this year, U.S. interest rates have fallen relative to those in other major countries. Looking ahead, he suggested that the demand for funds in the United States would continue to be weak in the short term, while that in Germany and Japan, in particular, would be strong.

The latest oil shock also suggests a sanguine outlook for U.S. interest rates, according to Moran. One of its likely consequences is a substantial transfer of external surpluses from Japan to members of the Organization of Petroleum Exporting Countries (OPEC). He contended that much OPEC investment, which has traditionally been "conservative," might flow into the United States and further relieve upward pressure on U.S. interest rates.



David Hale of Kemper Financial Services, Inc.: monetary policy coordination alone will produce suboptimal outcomes; the industrial countries should also consider fiscal, microeconomic and institutional issues.

Opportunities and Risks in Europe. Speakers in this session focused on the progress in—and prospects for—economic reforms in Eastern European countries.

Corrado Pirzio-Biroli, Deputy Head of Delegation of the Commission of the European Communities in Washington, argued that the movement toward economic and political reform in Eastern Europe will eventually boost economic growth not only in that region but also in Western Europe. He added that the establishment of market economies in Eastern Europe would "pave the way for a European economic space" encompassing the countries of Eastern Europe, the EC, and the European Free Trade Association, which would have a combined population of 500 million and a combined GNP of about $6 trillion.

Pirzio-Biroli pointed out that the EC has already done much to support Eastern Europe's efforts toward reform and closer integration with the rest of the continent. Notably, it has entered into a number of trade and economic cooperation agreements, agreed to provide substantial grant aid, and cosponsored the European Bank for Reconstruction and Development. In addition, the EC is negotiating "association agreements" with Eastern Europe. These agreements would include provisions for freer trading arrangements—under which Western European countries would liberalize their markets faster than Eastern European countries—technical and financial assistance, and common institutions.

Turning to the extent of financial assistance needed by Eastern European countries, Pirzio-Biroli suggested that a real growth rate of 5 percent a year in these countries would imply a balance of payments financing gap of about $20–25 billion over 1990–92. This amount is roughly equivalent to the extent of EC aid to its poorest members, he said, and is only a fraction of the aid provided to Western Europe under the Marshall Plan of 1948–52, which would be about $150–200 billion at today's prices. He added that, if another $30 billion in aid were to be provided to the U.S.S.R. "because one cannot help Eastern Europe without helping the Soviet Union," the total aid requirements would be less than 10 percent of the OECD countries' annual expenditures on defense and less than ½ of 1 percent of their GNP.

A more sobering perspective on the prospects for Eastern European countries came from J. Paul Horne, Managing Director of Smith Barney, Harris Upham & Co., Inc., an international brokerage firm, who discussed the impact of the recent oil price increase on these countries' balance of payments. He suggested that this increase would create "a double oil shock" for Eastern European countries, which already face higher energy bills from the U.S.S.R., their main oil supplier. The U.S.S.R. has announced that from January 1991, all members of the Council for Mutual Economic Assistance (CMEA or COMECON) will be required to pay mar-

ket prices for Soviet oil and gas. Horne estimated that assuming Bulgaria, Czechoslovakia, Hungary, Poland, and Romania maintain their oil consumption in 1991 at approximately the same level as in 1988, their total oil bill, given average oil prices of $35 a barrel, would be $23 billion, roughly four times what they had been paying the U.S.S.R.

Horne pointed out that Eastern European economies are particularly vulnerable to high oil costs because of their energy intensity, which ranges from 1.5 to 2.7 times the average for OECD economies. From the standpoint of trade, the double oil shock "could not have come at a worse time," he said. Except for Hungary and Czechoslovakia, Eastern European countries "simply have not had enough time to restructure their economies sufficiently" to reorient their exports away from COMECON barter toward OECD countries and so boost hard currency earnings. In fact, the reverse has been happening. The international economic environment will be "very important" in determining how easily and rapidly the necessary corrective reforms can be implemented. He saw this environment as likely to be difficult, noting that the two major sources of excess savings for international borrowers—Germany and Japan—are reducing their capital outflows. Moreover, monetary policies in Europe and Japan are likely to remain tight. New credits and the servicing of existing floating-rate debt are likely to be more costly for Eastern Europe.

In the medium and long term, however, the prospects for foreign direct investment in Eastern European countries appear to be good, according to Horne. "If and when [such] investment starts to accelerate—presumably after the present oil crisis ends and economic-financial confidence is restored—the shift to democracy and free markets in these countries will be speeded up and in turn attract still more capital," he said.

Stanislaw Soltysinski, Professor of Law at A. Mickiewicz University in Poznan, Poland, reviewed the results thus far of Poland's nine-month-old economic reform program. The program emphasizes monetary and fiscal discipline, drastic cutbacks in subsidies and price controls, privatization, tax reforms, and measures to attract foreign investment. On the plus side, Soltysinski pointed out that hyperinflation has been eliminated, although at a much higher cost than planned; the zloty, has stabilized vis-à-vis the U.S. dollar; a trade surplus is expected by the end of the year, although this is partly due to import cutbacks, which portend lower exports in the near future; and the number of joint ventures with foreign participation has increased. However, in many respects, the reforms have fallen far short of expectations. Most worrisome of all, according to Soltysinski, is the "dramatic recession"; he pointed out that the decline in output since March has been about seven times as large as forecast at the start of the program. The private sector has been particularly hard hit: tens of thousands of small firms have closed down, often because they could not afford to pay deregulated rents. The only fast-growing part of the private sector comprises shops, wholesale traders, and import-export firms.

David Lomax of National Westminster Bank PLC, London: the "increasing paranoia and nervousness" surrounding U.S. budget and trade issues "create the risk of significant policy mistakes."

By contrast, state enterprises occupying dominant positions in some manufacturing sectors are doing relatively well. This is because, first, they can afford to wait until the recession ends or policies change; second, because they are often protected by tariffs; and third, because the Government is loath to allow bankruptcies among such enterprises.

Noting that "the public trust and willingness to tolerate austerity measures [are] quickly disappearing," Soltysinski was "rather skeptical" about the strategy of rapid economic transformation involving short-term shock therapy. He added that even today's newly industrializing economies, such as Korea and Taiwan Province of China, "went through long periods of sacrifices and painful transformations before they reached relative affluence and stability."

Soltysinski suggested that the lack of a capitalist class and the weakness of the managerial establishment are "the two main factors that have been underestimated by the proponents of rapid transformation strategies in Eastern Europe." Pointing out that the pace of privatization in Poland has been slow, he added that "today, the streets of big Polish cities resemble bazaars in developing countries." He was not surprised, "because it must take time before street vendors and 'hit-and-run' importers are transformed into investors and taxpayers."

With regard to trade policy, Soltysinski argued that bilateral trade agreements between Eastern European countries and major industrial countries "often require the former to introduce rapid liberalization . . .without paying due attention to the economic and political costs of such openness." He was especially critical of some of the provisions of the 1990 trade agreement between Poland and the United States, notably those relating to local content requirements and the protection of intellectual property rights. "U.S. negotiators have succeeded in imposing upon Poland tougher trade-related investment measures than those negotiated with Canada" under the U.S.-Canada Free Trade Agreement, he said.

Soltysinski suggested that Eastern European countries should "gradually adopt new, onerous rules of international trade" only when they join the EC. "Only then will the required 'openness' be sufficiently protected by Community institutions . . . and these countries be able to exploit fully their comparative advantages," he said.

Vikram Khanna,
Editorial Officer, *IMF Survey*

Whither the Brady Plan?

By Shafiqul Islam

The irrelevance of the Brady Plan is rooted in a simple fact: It came too late, is built on too little economics, with too little relief to offer

THE WORLD BANK'S LATEST COUNT identifies 70 troubled debtors in the Third World. Forty-six of them are classified as severely indebted countries; the remaining 24 are labeled moderately indebted. While the low-income countries have mostly official debt (their creditors are largely governments and multilateral institutions), the middle-income debtors are a mixed lot: Some are burdened by large commercial bank debt, some by largely official debt and some by both.

The Brady Plan seeks to achieve reduction of bank debt, and is thus potentially relevant for a small group of debtors—those middle-income countries indebted primarily to banks. Nevertheless, when Secretary Brady launched the plan in March 1989, the Treasury claimed 39 countries were eligible to benefit within a three-year period. More than half of the time is gone, and yet so far only three countries—Mexico, the Philippines and Costa Rica—have received bank debt reduction, and one country—Venezuela—has reached agreement in principle. Morocco went some distance with the banks, but it is getting nowhere with the Fund.

Two mega-debtors—Brazil and Argentina—have yet to enter into negotiations, let alone receive any Brady-benefits. Banks don't want to negotiate with Argentina until it clears its arrears; and Brazil doesn't want to negotiate with the banks unless they come one by one.

The U.S. Treasury is now courting Uruguay to go to the banks and breathe new life into the Brady Plan squeezed between the banks' "pay first, talk later" approach to Argentina, and Brazil's "bank-by-bank" approach to debt settlement. That leaves 33 Brady debtors whose chances of getting debt reduction is becoming increasingly remote. The shortcomings of the overall debt strategy—in terms of its scope, goal, implementation and ultimate effectiveness—are, however, even more wide-ranging and serious. Here are three of the shortcomings.

First, the plan to deal with the bilateral official debt problem—the 1988 Toronto Initiative—covers only the severely indebted low-income countries (SILICS, as the World Bank calls them) of Africa, and among them only those not in arrears to the Bank and the Fund are eligible for relief. Even though the creditor governments are taking new steps to cancel debts of all poor countries under the 1978 UNCTAD resolution, three groups of debtors are being more or less ignored:

- severely indebted middle-income countries (SIMICS) that owe the bulk of their debts to official creditors;
- SILICS—mostly African—in arrears to the Bank and the Fund; and,
- SILICS with substantial multilateral debt.

These debtors have simply fallen through the crack created by the two-track approach of the Brady-Toronto debt strategy. The Houston summit's promise to review the Toronto terms, and President Bush's "Enterprise for the Americas' Initiative" announced on June 27, however, offer opportunities for new initiatives toward helping these "orphan debtors."

Second, for the debtors lucky enough to be on the short list, the debt strategy is being implemented at a snail's pace with the debtors ultimately getting bread crumbs as relief. The progress in implementing the Toronto Initiative has been painfully slow and highly inadequate, bordering on irrelevant. The story is similar for the Brady debtors. The Mexico deal took about 10 months to complete. Venezuela—where bloody riots put the final nail in the coffin of the Baker Plan—is still waiting to receive relief. With the exception of Costa Rica, the Brady Plan is also delivering inadequate debt reduction. For the Philippines, the debt relief menu included two appetizers, but no main course: a Brady-appetizer of a mini-debt-buyback was followed by a Baker appetizer of mini-new-money.

The much-celebrated Mexican accord reduced Mexico's net annual interest bill by about $1 billion (equivalent to a one percentage point reduction in interest rates), relieved it from repaying $7 billion of principal due in 2019 and promised bank loans of $500 million a year on average for three years. All this, however, could not bring Mexico's

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interest/export ratio below 20%, and Mexico was poised to move from being "a severely indebted country" to a less "severely indebted country."

But thanks to the mysterious ways of Almighty God, President Saddam Hussein is doing much more for Mexico through higher oil prices than what Secretary Nicholas Brady had done through lower bank debts; even taking into account a U.S. recession, Mexico may at least temporarily transform into a "moderately indebted" country.

The benefit that President Salinas extracted from the accord was not adequate financial relief, but increased business confidence. But the oft-repeated claim that the July 1989 announcement of the agreement induced a sharp fall in short-term interest rates and return of flight capital is misleading and disingenuous. Most of the flight capital returned before the July announcement, attracted by high interest rates; the inflow slowed down as interest rates fell after the agreement. Also, it is not so much the invisible hand of market confidence, but the visible hand of the Mexican monetary authorities that led to the fall in interest rates. Much of that decline was reversed by the time the debt accord was finally signed in early February. In sum, contrary to claims by some, Mexico's improved economic performance reflects not so much the debt accord, but sounder policies, kinder markets (higher oil prices) and gentler nature (no earthquake or other natural disaster). Indeed, it is disappointing that the Brady Plan missed the opportunity to give the Mexicans a bit of room for absorbing the consequences of policy slippage or unanticipated shocks.

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Finally, debt reduction is being carried out without systematic management and coordination within and between the two tracks (Brady and Toronto) of the current two-track approach to debt management. A major goal of eliminating the debt overhang is the reduction of uncertainty—a force that destabilizes the economy, discourages capital formation and damages business confidence. The effective way to eliminate the debt overhang thus requires a coordinated one-shot approach. Disjointed and unpredictable nibbling at the edges of the debt stock carried out over a protracted period of time only adds to prevailing uncertainty. And yet the adherence to "ad hocery" is precisely doing so for the troubled debtors, in particular, those who owe substantial debts to both private and official creditors.

But even for those big debtors burdened with massive bank debts, the Brady Plan in its original form is becoming increasingly irrelevant. The reasons are two-fold. First, almost all of them are running growing arrears on their long-term public-sector debts. This means that the Brady Plan must transform itself from a scheme for debt reduction to one of debt settlement. It can no longer provide cash-flow relief through reduction of debt service; most debtors have already helped themselves with such relief by not servicing their bank debts. What it can do is help settle the defaulted debts. The settlement will actually aggravate the cash-flow problem as part of the defaulted debts have to be serviced again; the benefits will involve restoration of confidence as the relationship with the banks is normalized, thus encouraging private investors (including domestic investors managing their flight capital) and official creditors to finance the debtors' investment needs.

Second—and here is the rub—years of misguided policies of the debtors and the creditors have now created a seemingly unbreakable vicious cycle of hyperinflation, hyperstagnation and hypergrowth of domestic public debt. This vicious cycle is shredding into irrelevance conventional policy prescriptions flowing from the two sides of 19th Street. No one disputes the Brady Plan's stress on sound economic policies. The problem is that there is little agreement on what sound economic policies exactly mean in a country like Argentina or Brazil: .

This increasing irrelevance of the Brady Plan is rooted in a simple fact: It came too late built on too little economics with too little relief to offer. While the debt crisis resulted from sins committed by consenting adults, the ultimate responsibility lies with the debtors—they could have neutralized the external shocks more effectively if they had pursued sound policies, resisted the temptation to overborrow and took decisive actions when all hell broke loose. But one cannot also ignore that it took six years of economic crisis, arrears, moratoria and defaults by major debtors to make the official creditor community admit that when countries have too much debt, they do not need more "new money," but less "old debt." By the time the reality was recognized, many of the debtors were already engulfed by the vicious cycle of hyperstagflation. Also, while the focus shifted from new money to debt reduction, the overall approach remained one of "muddling-through," thus allowing the vicious cycle to gather force and ultimately paralyze the Brady Plan itself. ♦

The Myths and Fallacies of the Brady Plan

Myth 1: The Brady Plan's emphasis on debt (principal and interest) reduction discourages banks from providing new loans to the debtor countries, thus depriving them of much-needed resources for financing their growth and development.

This argument is wrong on two counts. First, a major force behind replacing the Baker Plan—which encouraged banks to provide fresh loans—with the Brady Plan, was the banks' dogged refusal to provide new loans to the debtors.

In 1986, nothing short of a threat of default from Mexico and persistent arm-twisting was required to get the banks to negotiate a new package for the "model debtor."

During 1987 and 1988, only two other countries—Brazil and Argentina—of the 70 troubled debtors received any long-term new money from the banks as the market value of the LDC loans was dropping and the banks themselves were coming up with schemes for debt reduction. It is this failure of "forced lending" that forced Washington in 1989 to embrace "voluntary debt reduction," not the other way around.

Second, during the 1970s, private banks were not meeting the debtor countries' resource needs for sustainable development; they were financing their twin—budget and current account—unsustainable deficits. Too much new money from the money-making banks to the adjustment-averse countries is what largely caused the debt problem in the first place. Then the tables turned, and it was the debtors that began to transfer resources to the banks to support their profits.

Thus it is sheer nonsense to lament that "no new money" from the banks is going to hurt the debtors' development prospects. The little new money that banks involuntarily provided since 1982 came right back to them as it helped ensure an uninterrupted flow of payments from the debtors.

Myth 2: There are simply not enough official resources to support significant debt reduction.

This is one myth on which there is complete consensus between the bankers, the debtors and the international official community. The World Bank, in its 1989 Debt Tables, tells us: "...funds to support debt reduction are limited...$30 billion to $35 billion in official resources could lead to an average reduction in annual contractual debt service over the period 1990-1993 of approximately $6 billion." Recently, the Economic Commission for Latin America and the Caribbean called for $90 billion of taxpayer's money to support bank debt deduction arguing that the Brady Plan is "underfunded" as the current "pool of US$30 billion of public funds could finance only a marginal 13% to 14% net reduction of debt and debt service in Latin America and the Caribbean."

This line of reasoning starts from a flawed premise, and thus gets the arithmetic wrong. Common sense says that the deeper the discount, the smaller the amount of the remaining debt, and thus the lower the need for official resources for collaterizing it.

That is, fewer resources can support a deeper debt reduction. By the same token, shallow discounts will require large amounts of resources to collaterize the remaining debts. The real source of concern is not the lack of taxpayers' money to support deep and adequate debt reduction; the concern is over the lack of money to support shallow and inadequate debt reduction.

This rejection of adequate debt reduction (deep discount) compounds the need for official resources in another way. As the IMF, the World Bank and the major creditor governments refuse to be guided by the principle of adequate debt reduction, they remain unsure that the restructured debts will be fully serviceable, and hence make the prudential assumption that there is high probability that the country will default even on its reduced stock of bank debts. This leads to the demand that the principal of the debts as well as interest payments over a one to two year period will have to be fully collaterized.

It seems odd that the same officials who insisted earlier that the middle-income debtors with poor policies can fully service their debts and thus need no debt relief now assume with equal insistence that countries pursuing sound policies and debt reduction will likely fail to fully service their remaining debts. Thus they put up taxpayers' money to support bank debt reduction that they publicly claim as adequate; but the principle they follow for collaterization reveals that they do not believe in what they say. This schizophrenia can be avoided with an alternative approach where the IMF and the World Bank staffs, in consultation with the debtor country, prepare an estimate of adequate debt reduction. Debt reduction is deemed adequate if it meets three conditions simultaneously: recovery of growth and investment to sustainable levels; the full serviceability of the restructured debts; and complete elimination of the need for "new money" from banks for refinancing interest payments. Calculations of this nature are highly sensitive to various assumptions, and an estimate of adequate debt reduction for a particular country will be no exception. Still, it will be an effective basis for negotiations between debtors and banks.

According to the World Bank, 19 severely indebted middle-income countries (SIMICSs) and 27 severely indebted low-income countries (SILICSs) owe about $220 billion long-term public-sector debts to the commercial banks. If adequate debt reduction for these requires an average discount of 50% (the estimated discount may turn out to be much higher, perhaps 70% or more), a fund with a 20% capitalization can offer full guarantee to the banks; and $22 billion of official

resources can finance this operation. That is much less than the $30 billion to $35 billion available now which almost everyone considers highly inadequate. If adequate debt reduction required a 65% discount on Mexico's long-term public-sector loans, banks could have been offered full guarantee on the new bonds with $3.4 billion of official money—half of what has actually been used to leave both Mexico and the banks insecure and unhappy.

The IMF is restricted by its charter from using its resources to directly provide guarantees, and consideration of financial integrity and credit rating constrain the World Bank from taking this burden alone. But if the principle of deep discount in exchange for full guarantee is accepted, there are practical and politically feasible ways of establishing a guarantee fund. For example, one option is modest new appropriation from the major creditor governments disbursed over the five-year period with Japan playing a more active role. Another option is innovative use of the newly established Multilateral Investment Guarantee Agency (MIGA), perhaps with the financial support from the IMF's gold holdings.

The Fallacies

The refusal to accept the concept of adequate debt reduction has also led to two fallacies which greatly complicated the Mexican negotiations, and will do the same in future negotiations.

Fallacy one: Banks must provide new money, as debt reduction can't possibly meet debtors' financing needs.

With the possibility of deep discount ruled out, debt managers see little cash flow relief coming from debt reduction, and hence sing the virtues of combining debt reduction with new money. Most bankers reject such a suggestion, and rightly so, as wholly unsound banking practice. They find it difficult to explain to their board members and shareholders why they should write down their bad loans with one hand and extend good loans with the other. Many European bankers refuse to provide new loans to the troubled debtors because they are required to set aside additional loan-loss reserves for any new money they provide to the debtor countries.

With adequate debt reduction, the debtor country should not need any new bank money to refinance interest payments. But the failure to clearly define the concept of adequate debt reduction drives the official debt managers into pushing new money and pressuring banks to continue to do what created the debt problems in the first place. The goal of a new debt strategy should be to revive growth by cutting debt service burden substantially, and not to encourage large-scale lending for refinancing interest on loans that have long gone sour.

As steps are taken to resolve the current crisis, efforts should be made to return development finance to the traditional division of labor. Banks should limit themselves to transactional finance (trade credit and interbank loans) and low-risk project finance; the IMF should provide temporary balance-of-payments financing; and, the World Bank, the regional development banks and the creditor governments should provide various types of development finance.

Fallacy two: The use of official resources to support debt reduction transfers risk from the private to the public sector.

While treasury secretary, James Baker used to reject offical support for debt reduction with the argument that it will transfer private risk to the public sector. Now some Americans and many Europeans use Baker's argument to attack the Brady Plan.

Such criticism is both misleading and misguided. To begin with, the debt strategy has been transferring risk to the public sector from day one of the crisis by having the Bretton Woods institutions pulled in as the panic-stricken private banks have been pulling out. The share of bank debt in the Baker 15 countries fell from 67% in 1982 to 56% by 1988, while the share of IMF and multilateral development banks more than doubled from 7% to 18%. At the same time, the strategy of giving banks the breathing time and keeping pressure on the debtors to fully service the debt with prolonged hyper-austerity has damaged those debtors' productive capacity, thus turning the multilaterals' LDC exposure increasingly risky.

So, the truth is that the policy of no debt reduction has already jeopardized the taxpayer's pocketbook. And, if anything, the Brady Plan has the potential to eventually stop this risk transfer process. The use of official resources to support adequate debt reduction can actually upgrade the quality of the loan portfolio of the Bretton Woods twins. Needless to say, official resources used to support inadequate debt reduction will not reduce the systemic risk, and instead only perpetuate the process of risk transfer. So once again whether official funds to support debt reduction will cut down the risk of the public sector's LDC loan portfolio critically depend on whether debt reduction is adequate or not.

Indeed, to protect their financial integrity, it would be in the self-interest of the Bretton Woods institutions to ensure that the banks provide deep discount—in exchange for full guarantee—to the debtor countries. Having contaminated their own portfolios to help the banks to collect interest from the debtors over the last seven years through stepped-up balance-of-payments and structural-adjustment loans, the Bretton Woods institutions should by now have all the incentive to upgrade the quality of their exposure by making sure that they do not support debt accords where the extent of debt reduction is not adequate enough.

—Shafiqul Islam

U.S. Banks Steering Clear of Eastern Europe

By Richard Phillips

BURDENED BY large portfolios of developing country debt, mostly in Latin America, U.S. banks are shying away from Eastern Europe. Aggregate Central and East European exposure for the U.S. banking industry is under $3.5 billion, substantially less than the total lending of banks in most industrialized countries.

The official position of most U.S. money center banks is that they have no plans to increase exposure in Central and Eastern Europe, in spite of the various political and economic changes. Although the U.S. banks are not anxious to increase their lending exposure in Central and Eastern Europe, they are interested in establishing a presence to facilitate trade and operational services for their clients.

In spite of major political and economic restructurings in Central and Eastern Europe, U.S. banks are hesitant to extend their financial involvement in the region beyond current levels. This apparent lack of interest is consistent with the longstanding posture of U.S. banks.

As of year-end, U.S. exposure in the region totaled over $3 billion, compared to more than $14 billion each for Germany, Japan and France.

Several reasons can be cited for banks' reluctance to expand in Central and Eastern Europe. First, these banks are just ending a painful period involving LDC lending, and are hesitant to engage in fresh lending to sovereign borrowers, several of which are currently rescheduling.

Second, large U.S. banks are now confronting new credit problems involving HLT loans and commercial real estate lending. Significant reserves were required in these sectors during the first quarter, and analysts believe that these problems will get worse before getting better. These two factors are creating a "credit crunch."

Problems in existing credit portfolios notwithstanding, U.S. banks perceive a number of structural problems in dealing with newly democratized countries. In most of these countries, the political climate is still viewed as highly unstable.

In addition to political risk, plans for economic reform, even in the most progressive Central and East European countries, have so far been viewed as incomplete or inconclusive. After a decade of dealing with the often compromised attempts at economic reform undertaken by a large number of developing countries, U.S. banks seem unwilling to endorse anything but comprehensive approaches aimed at far-reaching economic change.

Finally, U.S. financial institutions have found it extremely difficult to get the information on Central and East European government agencies or business entities they need to make informed credit decisions.

From a business (rather than credit) standpoint, currencies are not yet fully convertible, and issues of foreign ownership and repatriation of profits have yet to be resolved.

Following are some of the positions on investment taken by specific banks:

• **BankAmerica.** BankAmerica is watching the situation in Central and Eastern Europe carefully to see what develops. There is potential interest in some of these economies, but a "wait and see" attitude prevails. The bank will, however, finance projects by U.S. and other Western companies in Central and Eastern Europe. Currently, BofA's only involvement in the region is a representative office in Moscow.

• **Bankers Trust.** Bankers Trust currently has no offices in Central and Eastern Europe. Bankers has the issue under review, however, and intends to "investigate and make the most of these markets."

• **Chase Manhattan.** Chase has a representative office in Moscow, but no further involvement in the region. Chase is "assessing the situation in light of recent events," but there is nothing of consequence to report.

• **Chemical Bank.** Chemical will not publicly discuss its plans for Central and Eastern Europe except to say that its involvement is *de minimus*. Walter Shipley, Chemical's chairman, was recently quoted as saying, "Chemical Bank is not interested in lending to Central and Eastern Europe."

• **Citicorp.** Citicorp is extremely cautious about lending in Central and Eastern Europe and has been reducing its cross-border exposure everywhere, including this region. The bank remains actively interested in opportunities there, however, and is seriously involved in discussions with several governments about participating in the local economies and capital markets. Citicorp currently places bonds for Central and East European sovereign issuers with international investors.

• **First Chicago.** First Chicago currently works with a Soviet bank to supply financial advisory services to multinational corporations investing in the USSR. It remains extremely cautious about lending.

• **Manufacturers Hanover.** Manny Hanny has had a branch in Bucharest for over 10 years, one of the few Western banks to do so. The branch only handles trade services, which is in line with the bank's philosophy for the region as a whole. Although not formalized, the bank's general strategy for the future is to stay small and participate only in fee-based activities such as trade and operational services.

• **J.P. Morgan.** J.P. Morgan has no operations in Central and Eastern Europe and currently has no plans to change this situation, although it is active in debt/equity swaps through its London office.

Mr. Phillips is an analyst with H.P. Corporate Communications in New York City. This was adapted from a study produced for HPCC clients entitled "U.S. Banks Show Little Interest in Eastern Europe."

INTERNATIONAL POLICY UPDATE

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November 7, 1990

THE IMF AND EL SALVADOR

It took the administration and Congress all summer to agonize over cutting military aid to El Salvador by $42.5 million. It took the executive directors of the IMF just two hours to restore this cut on August 27, and add another $7 million for good measure.

It is fully legitimate to speak of such economic-aid funds as restoring the congressional cut. Here is President Cristiani last May 3, when questioned by Tom Gibb about the effects of the military-aid cut:

> Obviously the government has the responsibility to defend the democratic institutions of the country and will not stand by with a weakened defense. Therefore, this means reallocating resources that might be used for other types of programs — such as social programs, economic, or political programs that the government can have access to — to obviously use for defense purposes.[1]

President Cristiani's defense minister confirmed this intention. "As for the U.S. cut in military aid," Col. Rene Emilio Ponce said on October 13, "the government will seek alternative means of financing the military so as not to affect the military budget, and thus the Armed Forces' actions."[2]

According to the IMF, this loan could be the first of a series. No amount of further loans is given, but the IMF says El Salvador is interested in a loan from the compensatory-financing facility and that it would likely qualify. The possibility of a further standby is also suggested.[3]

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[1]Press conference broadcast by San Salvador Radio Domestic Service as transcribed and published by U.S. [Central Intelligence Agency], Foreign Broadcast Information Service, Daily Report: Latin America (May 4, 1990, FBIS-LAT-90-087, National Technical Information Service, Springfield, Va.), p. 28.

[2]San Salvador Radio Cadena YSU in ibid. (October 15, 1990, FBIS-LAT-90-199), p. 18.

[3]IMF, "El Salvador — Staff Report for the 1990 Article IV Consultation and Request for Stand-By Arrangement" (mimeo, EBS/90/145, August 8, 1990), pp. 1, 27.

In the absence of an IMF estimate, the Center calculates that El Salvador, based on the size of its quota and its borrowing pattern from the IMF in 1981-82, could get another $157 million:

Type of loan	Percentage of quota	Amount (U.S. dollars)
Compensatory financing	100	123.7
Standby	67	82.5
Less: standby already received	40	49.5
Total		156.7

Source: IMF, "El Salvador — Staff Report for the 1990 Article IV Consultation and Request for Stand-By Arrangement" (mimeo, EBS/90/145, August 8, 1990), p. 32 and ibid., International Financial Statistics (vol. 42, no. 1, January 1989), pp. 216-7.

The $50 million loan is also helping to spring loose other funds. In September, 1990 El Salvador received a debt-rescheduling agreement with the Paris Club worth over $100 million (a rescheduling is tantamount to a new loan; the Paris Club is a meeting of creditor governments to reschedule a Third World country's loans). The IMF says that in addition to U.S. and other bilateral aid, El Salvador expects to receive about $60 million from multilateral sources in 1990 and $100 million in 1991. These figures do not include IMF loans. They do include an expected World Bank structural-adjustment loan of $40 million.[4]

Controversial history

When the United States first tried to involve the IMF in the Salvadoran maelstrom in 1981, the fund's staff balked. The Reagan administration made the IMF break its own rules which it had followed invariably. One IMF official from a West European country privately termed the loan "scandalous."

With U.S. backing, El Salvador applied for a loan of $36 million from the IMF's compensatory-financing facility in July, 1981. (The facility was set up to help countries through temporary fluctuations in their export receipts.) J.J. Polak, executive director for the Netherlands, addressed the executive board behind closed doors on July 27, 1981.

He noted that the IMF's technical staff had refused to recommend the loan for adoption, and never had the IMF approved any loan without the concurrence of the staff. The particular loan facility to which El Salvador was applying had very clear technical rules which the IMF had scrupulously adhered to in all cases, he said. There had to be a forecast of a country's future export earnings showing a shortfall that was temporary. The staff had concluded that conditions were too unsettled in El Salvador to permit a realistic projection of future exports, and rather than gin up imaginary numbers had declined to make any projection at all. But access to the facility was not allowed without the forecast. "Even a single

[4]Ibid., p. 19.

deviation from that principle would set a serious precedent," Polak said.[5]

Polak was formerly director of research for the IMF in charge of preparing the commodity forecasts for the compensatory-financing facility. No one was better schooled in the rules and precedents.

Nevertheless Richard Erb, formerly of the conservative American Enterprise Institute and recently appointed to the Treasury Department by President Reagan, argued for the loan, saying the staff should have made the projections and denying that the United States sought to politicize the fund.

All the other representative of Western Europe except Italy opposed the loan. Lionel Price for Great Britain: "The request had been presented to the Executive Board without essential information." Gerhard Laske for West Germany called it a "precedent with undesirable effects for the future." Jacques de Groote for Belgium said, "The equal-treatment principle might be jeopardized."[6]

Erb overrode this opposition and the loan was approved. It was the greatest show of opposition to an IMF loan in the organization's history to that point. When a researcher from the Center for International Policy began to report this episode in testimony before the House Banking Committee in August, 1982, the Reagan administration attempted to stop his testimony. The chairman of the subcommittee, Rep. Stephen Neal of North Carolina, rebuffed the administration, saying witnesses before his committee would have the freedom to speak.

IMF policy toward Duarte

After this controversial 1981 loan and another worth $85 million in 1982, the IMF made no loans until August 1990. The IMF was dissatisfied with the expansionary financial policies of the Christian Democratic government of President Napoleon Duarte; also, increased U.S. bilateral economic aid made up the gap. The IMF reacted warmly to the conservative Cristiani government.

"In early 1989," an IMF study complains, "a 23 percent increase in public sector wages without compensating fiscal measures was granted."[7] This was a reference to the Christian Democrats' use of the public purse to increase their popularity on the eve of the presidential elections.

Under Duarte after 1985, said the IMF, the public-sector deficit widened as tax revenue fell and the Christian Democrats resisted raising the price of electricity and water. Balance of payments problems increased, reserves were exhausted, and arrears in debt servicing built up.

IMF and Cristiani policies

"Upon taking office in June 1989, the present Government adopted policies aimed at correcting the external and internal imbalances faced by El Salvador in

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[5]Jim Morrell and William Jesse Biddle, "Central America: The Financial War," International Policy Report (Center for International Policy, Washington, D.C., March 1983), p. 2.

[6]Ibid., pp. 2-3.

[7]IMF, "El Salvador — Recent Economic Developments (mimeo; SM/90/171, August 21, 1990), p. 1.

the framework of a strategy based on increased reliance on market forces," the IMF said. "Despite the guerrilla offensive in November 1989, the prospects for peace in El Salvador appear to have improved following an agreement between the Government and the guerrilla factions to resume peace negotiations under the auspices of the United Nations and more generally as a consequence of the improvement of the political climate in the Central American region."

IMF policy contrasts with that of the European Economic Community. While EEC aid may increase, the EEC has linked it to advances in the peace process. In this way, the effect of EEC is to strengthen the peace negotiators; the effect of IMF aid is to undercut them.

Negotiations between the IMF and El Salvador on the loan began in November 1989 but were interrupted by the guerrillas' offensive, and only resumed in the middle of March.

Disbursement of 1990 loan

El Salvador has already received $32 million of the $50 million standby arrangement approved August 27, 1990 and if it fulfills the economic-performance criteria will get the rest according to the following schedule:

November 15, 1990	$6.2 million
February 15, 1991	$3.7 million
May 15, 1991	$3.7 million
August 15, 1991	$3.7 million

Source: International Monetary Fund, "El Salvador — Stand-By Arrangement" (mimeo, EBS/90/145, Supplement 1, September 6, 1990), p. 1.

Reason to Vote for the IMF

WASHINGTON — Not in recent memory has a World Bank-International Monetary Fund meeting been as dogged by uncertainty as the one just concluded here.

J.B. Sumarlin, Indonesia's finance minister, listed the uncertainties as well as anyone: the cost of Germany's reunification, the Soviet Union's and Eastern Europe's economic rehabilitation, the sudden

TRADE SCENE

Richard Lawrence

shakiness of the United States and other key financial markets and the still-severe Third World debt crisis.

Topping it all was the Persian Gulf crisis, which dominated the meeting's discussions.

Finance ministers from India, Pakistan and other countries gave their own estimates of what the gulf crisis portends for them. Their concerns ranged from higher oil prices to higher interest rates, reduced foreign exchange earnings and the expenses of caring for workers leaving the gulf area.

Perhaps the most poignant appeals for help came from East European finance ministers. In addition to higher oil prices, they must pay for Soviet crude in hard currency and deal with imminent losses in exports to both the Soviet Union and what was East Germany.

Their multi-billion-dollar hit comes just as the East Europeans are trying to press ahead with wrenching economic reforms.

"We are very apprehensive," said Leszek Balcerowicz, Poland's deputy prime minister. The impact, said Vaclav Klaus, the Czechoslovak finance minister, "far exceeds our . . . capacity to absorb."

In sharp contrast, Gunes Taner, Turkey's minister of state, almost seemed to belie the economic stress his country is undergoing. Turkey is one of the three "front line" nations supposedly most hurt by the gulf crisis.

Nevertheless, Turkey's tax boosts, a higher rediscount rate, the sale of state enterprises and more foreign aid, he said, will "enable Turkey in 1991 to continue to have a viable balance of payments position, reduce inflation, and maintain relatively high real income growth."

The meeting disabused anyone of the idea that the debt crisis was over.

Cote d'Ivoire's finance minister reminded his colleagues that Africa is in desperate straits, with many countries suffering "the longest period of economic decline on record." Sub-Saharan Africa's debt now equates to more than two-thirds of the region's annual output.

He outlined a "more imaginative, forward-looking strategy," which, however, appeared little different from past prescriptions.

Still, the meeting had positive overtones.

Most striking was the embrace by struggling developing countries of market-oriented reforms. Countries as diverse as Vietnam, Iran, Bangladesh, Romania and Peru trumpeted their commitment to "market forces."

And Peru, despite its $10 billion in debt payment arrears, appears to be attracting the international financial support that may help it get IMF-World Bank credits sooner than expected.

Meanwhile, a consensus is forming among industrial countries for further debt relief not only for the least advanced nations, primarily in Africa, but also for "lower middle-income" nations in Asia and Latin America.

France, Britain, the Netherlands, Belgium, the Scandinavian countries and even the United States (although it so far has focused mainly on the Caribbean basin) are increasingly endorsing debt forgiveness.

The meeting also made clearer the World Bank's future focus — a growing emphasis on overcoming extreme Third World poverty through more loans for education, health, family planning and nutrition.

The environment also will get bigger play. A $1 billion Third World environmental fund may be put together by early next year.

Even the gulf crisis seemed to generate at least one "plus," prompting greater coordination among the industrial and oil exporting nations to help the global economy and the less advanced nations in particular.

The Bush administration, whose commitment to the IMF had been questioned, now appears more supportive of the agency. Nicholas Brady, the Treasury secretary, proposed that both the IMF and World Bank back up U.S. and other emergency aid for Turkey, Jordan, Egypt and possibly other countries hurt by the gulf crisis.

This is good news for the IMF, seeking a $60 billion funding next year. Mr. Brady indicated the administration will push Congress hard for the U.S. contribution.

A year ago, Rep. Charles Schumer, D-N.Y., came close to scoffing at the IMF's chances of a large U.S. contribution. When he visited folks in neighborhood taverns, the Brooklyn congressman related, nobody ever asked about the IMF.

Even with the gulf crisis, they are still unlikely to inquire. But the congressman, after a round or two, now might feel less awkward about explaining the IMF request and voting for it.

Richard Lawrence is senior correspondent in the Washington bureau of The Journal of Commerce.

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Rapporteur's Report
By Delia M. Boylan

A NEW FINANCIAL FRONTIER: DEVELOPING COUNTRY STOCK MARKETS

Thursday, December 13, 1990
The IMF Visitor's Center
The National Economist's Club

Speaker: Peter Tropper, Manager, Emerging Markets Data Base

In 1989, stock markets in many developing countries outperformed those of developed countries. This was largely a result of:

a. A dramatic increase in private investment in LDCs throughout the 1980s

b. Increased access to global markets and information

1. Equity Market Data

In the 1970s and 80s, LDC governments were statist oriented and paid little attention to the private sector. The onset of the debt crisis changed this debt over equity focus, and foreign investors began to see exciting things in LDC markets:

A. good returns on investments

B. Diversified portfolios

1. Why diversify?

a. Higher level of return for lesser risk

b. Correlation coefficients indicate that when the US market goes down, LDC markets go up (this correlation is not found between the US and other developed countries such as UK, Japan); diversification benefit to investing in LDCs

c. Indeed, in 1990, the 5 best performing stock markets were all developing, including Venezuela (+437%), Greece (+84%), India, Colombia and Mexico. Corresponding 5 "worst" were Brazil (-64%), the Philippines, Taiwan, Japan (39%), and Thailand

2. Volatility--By examining the volatility of a particular country's stock market, the investor can assess the risks of investing in a changing new market

a. Volatility tends to be much more flagrant in developing countries; for example, Venezuela's market went up 5 times in 1990, versus the US which stayed relatively stable--in this case such change is due to dramatic economic policy changes since January which have "opened up" the economy, the windfall profits derived from the oil crisis, and exchange rate adjustment, etc. In Taiwan, however, extraordinary activity

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resulted from an inability to invest outside the country. The resulting liqudity forced investment in stock and property.

b. These figures can also be misleading--for example, in Venezuela there are only 13 companies making up 90% of trading--this suggests a very thinly traded market which is quite unlike that found in the US

c. Volatility can also be negative--in Argentina, for example, the market was at 45% of its level in January and it is now 65% of what it was--this looks bad initially, but when compared to Japan, there is actually not much difference--one must put all of these factors in balance.

C. Performance Indicators--Are these developing country stock market successes a fluke of 1990?

1. If one looks at stock markets performances over a 5 year span ending in 1989, we see that this has been a steady trend:

market performance:

a. Japan--504%
b. Asia NICs--339%
c.EAFE (industrialized cos. excluding US)--335%
d. IFC composite (LDCs total)--206%
e. UK--174%
f. LA--131%
g. US--111%

2. The reason for such tremendous growth is that, finding itself shut out of the international financial system, the private sector was forced to export in order to survive. Many small companies in LDCs acquired assets and reserves in dollars which served as a shields for them when the recession of the 1980s hit.

D. Access to LDC Stock Markets:

1. Until this year, it was very difficult to LDC stock markets; but recently many have opened up

2. Moreover, trading values have changed; in China and Taiwan, the average daily turnover went as high as $3.4 billion a day and in Korea, this was $270 billion. If you can get in, it is thus well worth the effort.

E. Country Funds:

1. Some investors worry that they do not know enough about individual private companies in LDC markets to invest wisely.

2. Beginning in 1984, investors began to invest in "country funds"--These stocks can be purchased through a broker

for almost any LDC and are an important way for private investors to break into these otherwise difficult markets

3. The problem with country funds is that they are close ended; this means that the underlying share value does not necessarily equal its value on the market. In many cases, investors may need to pay a premium in order to purchase shares. This has led to trading on premiums. (In the case of Korea, for example, the mark-up was in the order of over 250%, while in Latin America investors were trading on discounts, paying 90 cents on $1 worth of stock)

2. Conclusions:

Two Trends:

A. Increased Flotation-State owned shares sold to individuals both inside and outside of the country will augment (privatization)--Closely held shares will open up (this means that privately owned companies will be listed on stock exchanges and open to foreign investors, such as occured with Pemex and Argentina's telephone company)

B. Eastern Europe--Far from being the investment "haven" that investors expected it to be, much of this is hype.

1.In actuality, these economies are inefficient, uncompetitive, lack regulatory regimes, have an aging capital stock with no replacement mechanism, low productivity, high external debt, no institutional base for market-based economies, not to mention political problems. There is also an acute lack of managing class capable of running business in Eastern Europe

2. Moreover, because the laws for private ownership are virtually non-existent, state-owned enterprise is a disaster, and there are no accounting systems nor SEC regulatory mechanism, stockmarkets are virtually non-existent. Indeed, in the only two active stock markets current, Hungary has 6 shares and Yugoslavia has but 1 equity share listed and is only open 1 hour a week for trading.

3. Nonetheless, Eastern Europe is not hopeless. Poland, Czecholslovakia want to open stock exchanges, and the USSR has announced that it will climb to 1500 shares by the end of next year, plans for privatization go through.

<u>Question and Answer:</u>

In 1989, developing countries added up to over 600 billion dollars in market capitalization, versus 2.5 trillion for the US (approximately one quarter).

Debt/equity stocks have helped countries like Chile and Mexico get rid of a substantial portion of their national debts.

Obviously, in many of these countries, stocks are owned by a very small ownership base, though the privatization process is requiring this basis to gradually be diversified.

To guard against the exchange rate risk, some companies are issuing deposit receipts in local currency which are gathered up and sold as an "ADR basket" in the US, from which one can accrue dividends in dollars. This is one way of getting around hyperinflation and exchange rate difficulties.

"A Hot Market Emerges for the Third World's Bad Loans", THE NEW YORK TIMES

December 23, 1990

The trading of debt has grown into a $70 billion global business.

By JONATHAN FUERBRINGER

BEHIND the third world debt crisis, a market is bubbling.

The trading of the debt — the swapping of often steeply discounted loans for cash, other loans or equities — has grown in less than a decade into a $70 billion-a-year global market. While that is not big by the standards of foreign exchange, bond or stock trading, it is not bad either for a lot of paper that until this year was declining in value.

But this year, trading prices for the loans of most of the biggest debtors have been rising with a vengeance. The debt market has even been strong enough to rebound from the impact of the Persian Gulf crisis, a feat unmatched by the world's bond and stock markets and the dollar. Mexican debt is now trading at 45.625 cents per dollar of face value, up 30 percent for the year, and Argentina's debt, long one of the poorest performers, is up 70 percent, to 20 cents on the dollar. Of the major debtors, only Brazil has seen a decline.

"If you threw darts at the beginning of the year, you could not have lost money," said Giacomo de Filippis, one of the originators of debt trading while working for an Argentine bank and now head of his own firm in New York, Giadefi Inc.

Giving the market its lift are a number of ongoing economic restructurings that seem to augur a turning point for much of Latin America, which holds about 29 percent of the $1.3 trillion in third world debt.

The market has also gotten a boost from the debt-relief program initiated by Treasury Secretary Nicholas F. Brady. Under the Brady plan, several countries have had their debt burden reduced and have converted old loans into new bonds that are more attractive to investors because they are backed by international guarantees. As a sign of the growing acceptance of the debt-trading market, Mexico's so-called Brady bonds last week got their first rating from Moody's Investors Service Inc.

Besides causing debt prices to rise, the economic restructurings are altering the market's character and scope, offering new opportunities not only for some of the debtor countries but also for the big Western lenders who wrote off billions of dollars of loans in recent years when it became clear they would never be repaid.

Until recently, the debt has largely been the medium for a traditional trading market, a place in which Citibank, Manufacturers Hanover Trust, Morgan Guaranty, Bankers Trust, Chase Manhattan, Bank of America and hundreds of other banks could try to improve the value of their bulging debt portfolios or just shed them. These trading operations, along with those at some investment banks, have also been used to speculate on the movement in debt prices, producing enough income so that some institutions, like Morgan Guaranty Trust Company, have highlighted the profits in their earnings reports.

Now, because of the economic turnabouts that have begun in Chile, Mexico and Venezuela, commercial and investment bankers are opening up a traditional corporate finance business in a debtor's setting, a move that could well spread to Eastern Europe. Two venerable investment banks, Morgan Stanley Group and Goldman, Sachs & Company, have been lured into the business this year.

IN some cases, the bankers are packaging the debt held by a number of lenders — including themselves, at times — and swapping it for shares in state-owned companies being sold to the public, like Entel, the

The New York Times

telephone company in Argentina. As part of the deal, the new owners often infuse the privatized company with cash to modernize or expand.

In other cases, the bankers capitalize on their ties to the third world to be hired as traditional advisers in raising new capital. MG-First Boston Asset Trading acted in this capacity when Mexico's state-owned development bank went to the Eurobond market this year to raise $100 million.

While privatizations have buoyed the debt market in the past, they have never been conducted on such a scale or with such commercial appeal. In the last two years, privatizations and traditional corporate finance deals have brought $16.4 billion to the five major debtors in Latin America, according to Salomon Brothers's John F. H. Purcell.

"This is the transition year," said Peter R. Geraghty, senior vice president in New York of NMB Postbank Groep N.V., a Dutch bank that is one of the major debt traders. "The market evolves. The trading market is not the be-all and the end-all. It is now M & A and corporate finance."

The move away from trading for trading's sake and toward corporate finance is a logical one, banking experts say. The deals provide attractive fees for the bankers. They are also less risky than playing the debt market and, for the large debt holders, provide another avenue for getting rid of debt.

"If Mexico and Brazil and other countries turn around, then this market becomes the old, traditional, humdrum capital-raising business," said Peter Woika, a managing director at J. P. Morgan & Company, the parent of Morgan Guaranty.

The success of the business depends, of course, on the success of the economic restructurings that are going on. As long as the programs, like those in Mexico and Venezuela, move ahead, there will be a market for raising cash or doing privatizations.

But if they are set back — and Brazil is having new problems less than a year after the start of its austerity program — then the business could dry up.

DEBT trading is a product of the debt crisis that began in 1982, when it became obvious that many third world countries would not be able to pay back the huge loans that Western banks had made to the governments.

At first, the trading took the form of simple swaps. A bank would consolidate its debt portfolio, trading off debt from Chile, for example, for that of Mexico, a country in which it had more confidence. Some banks, especially smaller ones, then decided to get rid of the risk entirely, and sold debt for a portion of its face value.

Some privatization deals in Brazil, Chile and Mexico helped give the market another rationale in the mid-80's, but these debt-for-equity deals came and went.

The biggest boost for the market came in May 1987, when Citibank bowed to reality and became the first big bank to set aside reserves for anticipated losses from third world loans. Other banks followed, making the trading of debt at less than face value much easier.

By the end of the 80's it was obvious that banks were unwilling to lend new money to the debtors. It was also obvious that some reduction of the existing debt level would have to be accepted as part of a solution to the crisis. To this end, the Bush Administration in March 1989 announced the Brady plan, which offered debt reduction to countries that were restructuring their economies to reduce inflation and lift trade barriers.

In July of that year, Mexico reached an initial agreement on a proposal for a 35 percent reduction in its debt and the exchanging of the old loans for the Brady bonds. This deal was finalized last March, at the same time that Venezuela reached its own debt reduction agreement. Other deals have been reached with the Philippines, Costa Rica and Morocco.

Dealers in third world debt are hoping that the Brady bonds will make the market attractive to larger numbers of investors, even retail customers. The bonds come with guarantees on interest and principal and can be repackaged into a number of financial products with broad appeal.

New bond and debt funds, like the Latin American Investment Fund Inc. at Salomon Brothers, are trying to attract such business but most dealers think the wider appeal of this still-risky market will take more time to develop.

make the market attractive to larger numbers of investors, even retail customers. The bonds come with guarantees on interest and principal and can be repackaged into a number of financial products with broad appeal.

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DEBT traders have many of the accouterments found in big-league trading rooms. There are computers on their desks and prices on the computers. They have the toys that traders collect, like the baseball bat and hand weights on Stephen W. Dizard's desk at Salomon Brothers and the joke doll stuck to the window of the trading room at Bankers Trust Company. Last week, they even formed their own trading association, a sure sign of arrival.

The market is a product of the debt crisis that began in 1982.

The market is maturing in other ways, too. Prices for buying or selling debt are getting easier to obtain.

But the market still does not have the pace or the size of its bigger cousins that deal in equities and bonds. When Henry Ansbacher & Company, a merchant banker involved in debt trading had its Christmas party this year in London, the market there ground to a halt. And debt trading is far from a 24-hour game, even though traders are based around the world.

Indeed, debt trading is far from a full-fledged market. Prices may be easier to obtain, but there are no guarantees a quote will be available when a trader needs one. And traders must be prepared to negotiate even when they see a broker's quote on a computer screen, because those prices are not firm, as they are in the stock and bond markets.

Traders must also be aware of potential conflicts of interest, since some of the big banks that trade debt also are involved in negotiating debt reductions under the Brady plan.

"A market has wide distribution of assets and information and a complete network of market makers and brokers," said Nicolas Rohatyn, a managing director of J. P. Morgan and head of the firm's loan transaction unit. "None of that exists here."

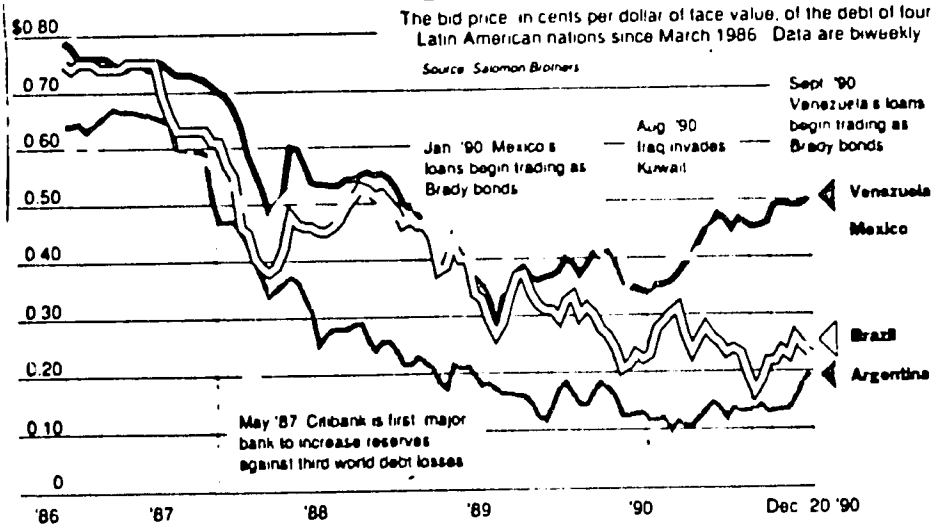
But now that the action in third world debt is turning more toward corporate finance, those shortcomings may be less glaring.

"You're looking at finite issues to finite people, one-of-a-kind deals," Mr. Rohatyn said. "This is more of a business than a market."

A Changing Attitude Toward Third World Debt

The bid price, in cents per dollar of face value, of the debt of four Latin American nations since March 1986. Data are biweekly.

Source: Salomon Brothers



Fair Exchange: Debt for Drugs

By HOWARD M. LIEBMAN

Swaps are all the rage. In the sixties, one swapped spouses. Later, barter clubs were formed across the United States and members swapped goods of all kinds. Time-sharing in effect grew out of the swapping of vacation homes.

The concept was not lost on the financial wizards in New York and London. Currency swaps, hedging and interest rate swaps, all innovative techniques in their day, became de rigeur. Then came debt-for-equity swaps as part of the financial restructuring of major corporations.

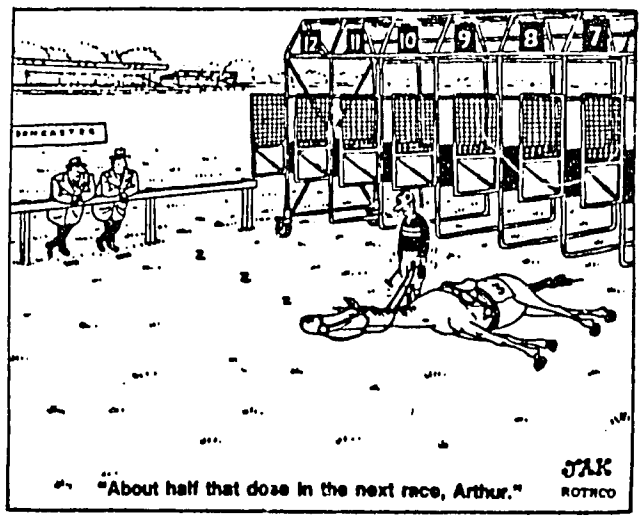
Most recently, a number of debtor nations, particularly in Latin America, have instituted debt-for-nature swaps. Under this concept, a certain amount of a country's foreign debt is waived in exchange for the country's commitment to acquire land to be conserved in its natural state, utilizing local currency. Debt-for-nature swaps have had some notable impact in Costa Rica, in particular.

Debt-for-nature swaps are being played out in connection with one of the most pressing problems presently facing us — the environment (and all it implies in terms of acid rain, global warming and the death of the world's forests). Why not then take the concept one step further and use it against another pressing problem constantly in the news: the drug trade?

Why not devise a system that could swap a country's international debt overhang for a reduction of that country's production, refining or exports of drugs?

Such an approach might work not only in the heavily debt-laden countries of Latin America, but in other drug-producing and drug-exporting countries, such as those in Southeast Asia.

The basic idea would be to develop a basket of tests indicative of a country's efforts to combat its drug "industry." The basket might include the following factors, weighted in some way: the increased number of drug arrests in the United States attributable to increased information from the exporting country; the increase in the number or size of drug caches found thanks to the supplying nation's help; increases in proven destruction of poppy fields, marijuana plants, drug laboratories and other drug production facilities in the foreign country; the increase in local arrests; and the increase in extraditions of drug traffickers to the United States. No doubt other factors could be considered as well.



"About half that dose in the next race, Arthur."

The basket of test indicators should be designed to provide an adequate and targeted incentive for the major drug-exporting countries and intermediary countries to take affirmative action. Nor should the wrong signals be sent. If the formula is too closely linked only to increases in drug "busts" or the like, it might be perceived as an incentive for the debtor countries to step up exports, not to shut them down.

The American public is now much more keenly aware of the insidious influence of drugs. There is a greater political will behind the fight. Nonetheless, the current problem in finding sufficient budgetary resources to support Colombia's brave stand against drug traffickers indicates that the political will may not be strong enough for direct financial support. That is why indirect support, in the form of a debt-for-drugs swap, might be useful.

Some might object that this proposal would only shift the burden of supporting foreign anti-drug efforts from taxpayers in general to banks and financial institutions. The banks, however, already acknowledge that much of their outstanding "third world" loan portfolio is, in fact, bad debt. The banks already have written off large amounts of sovereign debt in belated recognition of their knowledge that it will not be recovered in any event.

Of course, there is clearly a limit to what any one bank will do without a good business reason. Perhaps a debt-for-drugs swap will provide just such a reason. Any prudent banker will concur that the drug scourge is increasingly harmful to business. It even may share the blame for some domestic loan defaults by individuals whose lives have been ruined by drugs. Thus, fighting the drug war could make good business sense.

If banks respond that they should not be alone in bearing this burden, some form of tax credits might be considered for a proportion of debt swapped. This would bring the taxpayers indirectly into the plan as co-venturers, albeit in a relatively less painful fashion than if there were a direct tax increase to fund anti-drug measures.

For the foreign countries involved, release from substantial portions of their national debt (and the interest thereon) could free up important sums of money that otherwise would be paid overseas. Those funds could be used both to fight their domestic drug "industry" and to remedy the underlying socio-economic conditions that often lead local farmers to cultivate drug crops. If properly monitored, and conditioned with built-in safeguards, this seemingly "off the wall" proposal might be usefully refined.

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CHRISTIAN SCIENCE MONITOR, December 26, 1990

PERSPECTIVES ON EASTERN EUROPE

Foreign Debt, Lack of Aid Hinder East Europe's Progress

By Eric Bourne

VIENNA

BETWEEN them, the East European countries' foreign debts add up to at least $80 billion to $85 billion.

Poland owes almost half of this total, Yugoslavia nearly $20 billion, Hungary and Bulgaria at least $10 billion apiece, and Czechoslovakia $6 billion.

Romania has no debt. Repayment was Nicolae Ceausescu's solitary service to his unfortunate country, although at immense human cost. The other five countries are falling deeper in the red, unable to repay on time Western government or bank creditors the principal and meet interest payments.

Western rescheduling and "writing off" of some of the debt can only delay the ultimate reckoning. Meanwhile, East Europeans must live very close to economic collapse – unless there is a radical change in Western thinking on aid.

Not long ago, Poland, Czechoslovakia, and Hungary appeared headed toward effective reform. Romania, Bulgaria, and Yugoslavia were too troubled by political and ethnic conflict to find a direction. But now, even the front-runners share the latter's uncertainty and confusion.

- In Poland, a populist presidential election unseated a government that made a promising start toward stabilization and a market-oriented economy.
- Czechoslovakia got into a constitutional bind with Czechs and Slovaks that threatened to split the federation.
- Hungary's much-acclaimed center-right coalition faces acute social unrest.
- In Bulgaria, such unrest has just brought down an elected government. The same seems likely in Romania.
- In Yugoslavia, election victory for an orthodox and extreme nationalistic Serbian Communist Party at odds with the nation's liberalized republics makes federal survival still more doubtful.

Such confusion in the region can only fuel the uncertainty that the West feels about how far financially to back the switch to capitalist economies.

Support thus far is small and tentative, with minor trade concessions and the provision of business know-how. Only Germany and France favor rapid, comprehensive help as a mark of confidence, which they say will encourage boldness in reform.

New uncertainties will prompt others to continue to "wait and see." Western banks will be even more wary of putting new money after old. Governments will prefer to go on thinking long-term, with debt repayment, for example, stretched far into the next century.

Not surprisingly, East Europeans ask: "How can we rebuild our industries with new technologies without your immediate help to acquire them?" As an economist told this writer, "We just haven't got that kind of time."

Poland is an immediate example. It has made radical changes, but only on a scale a visiting American expert called "petty capitalism." A full market system remains far off, and the likely social dislocations are only beginning.

A kind of second Marshall Plan, as some in the West earlier suggested, cannot be the answer. That was devised for a prostrate postwar Europe, not for a complex change of system.

Western criteria are largely "to help those who help themselves." No Marshall Plan, therefore. But maybe another example from the past is applicable.

In the early 1950s, the United States, Britain, and France proceeded from initial emergency food aid to Yugoslavia to financing of a full-blown economic development program.

Tripartite aid began with some "open checks," which often were misapplied. Then a canny British civil servant urged that aid be absolutely conditional on it being used on priorities selected by the three donor nations.

Agriculture – converting backward farming (just like Poland's today) to modern technology – was a top priority. It worked extraordinarily well.

Why not apply similarly conditional aid criteria both to industry and agriculture in Eastern Europe? It would meet doubts about the wisdom of aid. It might even encourage the politically timid reformers to get on with it faster, as the West requires.

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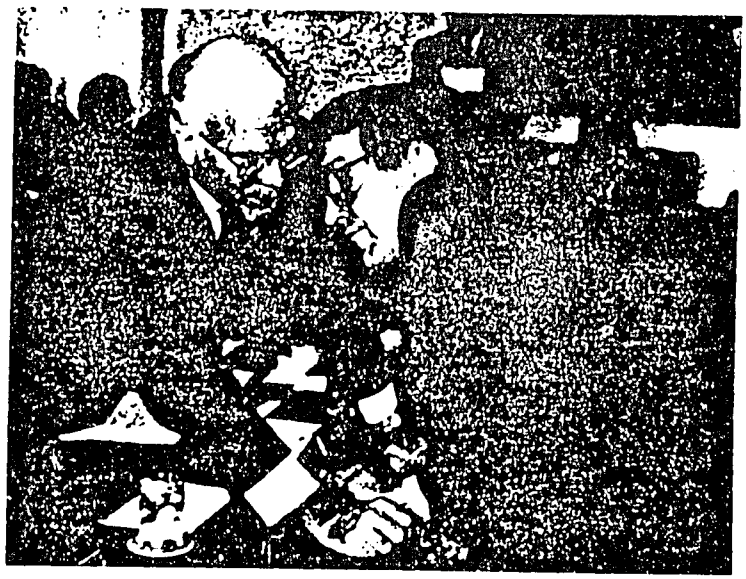
FOREIGN AID

Subcommittee Focuses on Gulf In Making Funding Decisions

Panel OKs Egyptian debt-relief, revisits dispute over military aid to El Salvador

In its June report on the fiscal 1991 foreign aid appropriations bill, the House Appropriations Committee took note of the "dramatic political, military and economic changes" that have "swept the world."

For the Senate Appropriations Committee to offer a similar capsule of recent world events, its staff will have to come up with new adjectives to convey the concept of rapid change. In the three months since the House passed its foreign aid bill, Germany has reunified, centrally planned economies have continued their march toward capitalism — and the United States has moved to the brink of war.



R. MICHAEL JENKINS

Sens. Patrick J. Leahy, D-Vt., and Tom Harkin, D-Iowa, discuss foreign aid appropriations bill during subcommittee markup Oct. 2.

The Appropriations Foreign Operations Subcommittee focused much of its attention on U.S. policy in the Persian Gulf when it marked up its $15.3 billion foreign aid bill (HR 5114) Oct. 2. The subcommittee approved an administration plan to forgive Egypt's $6.7 billion military debt, a proposal that was scrapped by the House after intense criticism.

The panel also backed an amendment offered by Frank R. Lautenberg, D-N.J., which would cut off assistance to any country that violates the global embargo against Iraq.

Despite those responses to the crisis of the moment, the issues that have the greatest potential for dividing the full committee, as well as the full Senate, are familiar. The Foreign Operations Subcommittee deferred many controversial issues, ensuring that the Senate will be revisiting some old battles when it takes up foreign aid.

By Carroll J. Doherty

The subcommittee followed the lead of the House and placed heavy conditions on the $85 million military-assistance program for El Salvador. The panel also included $15 million in support for the United Nations population fund. Both provisions are contentious enough to produce battles on the Senate floor, and both could trigger a presidential veto

One other aspect of the subcommittee's deliberations has remained unchanged in recent years: There is not enough money to fulfill all the foreign aid wishes of senators. In fact, the Foreign Operations panel was given an especially low allocation for outlays — $574 million below the House-passed legislation — when the full Appropriations Committee set spending limits in July.

The tight allocation reflected the view of Appropriations Committee chairman Robert C. Byrd, D-W.Va., never a staunch proponent of foreign assistance.

The allocation could be increased if a budget agreement is constructed. In fact, one factor behind the decision to delay the full committee markup until the week of Oct. 8 was the hope that the budget agreement between President Bush and congressional leaders — which included some $200 million more in outlays for foreign aid — would succeed.

But in lieu of a new, higher allocation, the subcommittee chairman, Sen. Patrick J. Leahy, D-Vt., felt compelled to warn members who had amendments to offer, "If it costs money, you will have to identify specifically what you propose to cut to pay for your amendment and ensure that there are sufficient outlays."

Desert Shield

At a news briefing before the markup, Leahy ruminated over how uncomfortable it would be for lawmakers to support debt forgiveness for Egypt during a time of tight budgets in this country. "You don't have to be a political genius to design the political spots" a campaign opponent could air on television attacking a pro-forgiveness stance, he said.

Many House members evidently saw that possibility as well. As part of the supplemental appropriation legislation for Desert Shield, the U.S. action in the Middle East, the House voted on Sept. 30 to grant Egypt a temporary debt-payment waiver, but deferred the broader question of debt forgiveness. *(Weekly Report, p. 3140)*

But the administration apparently has had some success since then in convincing senators that the fate of Egyptian

Rethinking the Pakistan Alliance

The scenario sounds familiar: an unpredictable military regime with the capability to deploy nuclear weapons in a region torn by ancient disputes over religion and culture.

The country in question is not Iraq but Pakistan. And relations with the United States are distinctly different. While more than 150,000 U.S. troops have been dispatched to the Middle East to contain Iraqi aggression, Pakistan has been, in the words of one House member, "a good friend and a valued partner" of the United States.

Nonetheless, the future of the U.S.-Pakistan alliance has come into question because of its emerging nuclear potential, as well as recent antidemocratic moves by Pakistan's military rulers. President Bush has declined to certify that Pakistan has refrained from developing nuclear weapons, a step that is required for the continuation of $500 million a year in U.S. assistance to Islamabad.

A 1985 amendment to the Foreign Assistance Act, sponsored by Sen. Larry Pressler, R-S.D., states that aid must be cut off automatically unless the president certifies before the start of each fiscal year that Pakistan "does not possess a nuclear explosive device."

In recent years, the Reagan and Bush administrations have provided the certification despite serious reservations about Pakistan's emerging nuclear potential. In 1989, CIA Director William H. Webster told the Senate Governmental Affairs Committee that "clearly, Pakistan is engaged in developing a nuclear capability." But such concerns were set aside, largely because of Islamabad's activities in support of the U.S.-backed Afghan rebels.

Until this year, that is. With Soviet troops being withdrawn from Afghanistan, Pakistan's role in that conflict became less important. At the same time, experts say that Pakistan has developed the ability to launch a nuclear strike, despite pledges to slow its weapons program.

In an interview, Leonard S. Spector, a senior associate at the Carnegie Endowment For International Peace, said Pakistan is able to deploy 10 to 12 nuclear bombs, probably by aircraft. "As a result of the crisis this year over Kashmir, [territory along the Indian border that is claimed by both countries], any restraints that were on the program have been removed," he said.

Short-Term Waiver

The administration has initiated an intensive lobbying campaign on Capitol Hill for a temporary waiver of the Pressler amendment, even though officials have indirectly acknowledged Pakistan's nuclear capability.

Bhutto

Thus far, the idea of a short-term waiver that would allow aid to flow to Pakistan has received a cool response in Congress. Stephen J. Solarz, D-N.Y., chairman of the House Foreign Affairs Subcommittee on Asian and Pacific Affairs, told a hearing of his panel Oct. 2, "We cannot continue to warn Pakistan of adverse consequences if it takes certain actions and then fail to follow through on our warnings when Pakistan persists in taking these actions."

In the Senate, where the foreign aid appropriations bill would be an appropriate vehicle for such a waiver, there also has been little support for the proposal. Patrick J. Leahy, D-Vt., chairman of the Senate Appropriations Subcommittee on Foreign Operations, did not include language authorizing a waiver in the bill his subcommittee considered, although it might be amended for that purpose, either in the full committee or on the Senate floor.

The administration has asked for the waiver, said one official, in order to leave all of its options open at least until Pakistan holds elections Oct. 24. Prime Minister Benazir Bhutto was dismissed from office in August, and there is widespread concern throughout official Washington that the caretaker military government could delay the balloting or, even worse, hold sham elections.

If the military is defeated in free elections, the administration will try to exert influence on the new government, the official said. But if the elections are tainted, he added, "it is difficult to see how the aid program can be rescued."

In recent weeks, the president has become personally engaged in the issue, informing Islamabad of his concerns. In a letter, Bush reportedly pressed for free elections, a commitment by Pakistan to reduce tensions with India and a termination of the nuclear program. Islamabad responded favorably to the first two matters, according to administration and congressional sources, but failed to offer assurances on the nuclear issue.

Yet for Congress, that may prove the most important issue of all. Suspicions that Iraq might be in the early stage of developing such weapons has increased sensitivity on Capitol Hill to the threat of nuclear proliferation.

"Both the integrity of U.S. law and the credibility of our global non-proliferation policy is at stake here," Solarz said.

—Carroll J. Doherty

President Hosni Mubarak might depend on debt relief. According to Leahy, who originally was critical of debt forgiveness, "If we were to renege now, I would not want to be a political oddsmaker on Mubarak's future."

Still, the proposal faces a difficult road, even if approved by the Senate. It would then have to survive a conference committee, and it is in the House Appropriations Committee that most of the opposition lies.

When told recently that the president was still committed to debt forgiveness, Mickey Edwards of Oklahoma, the ranking Republican on the House Appropriations Foreign Operations Subcommittee, said, "That's fine. I'm still opposed to it."

The subcommittee also took a different tack than the House on military assistance for Turkey.

The subcommittee earmarked $545 million in military aid for Turkey, primarily in recognition of that government's contribution to Operation Desert Shield. The House had capped military aid for Turkey at $430 million.

Because military assistance for

Greece has been fixed for several years at a 7-10 ratio with Turkey, aid to Athens was increased as well, from a House-passed ceiling of $301 million to $375 million.

The subcommittee approved another amendment intended to bolster U.S. policy in the Middle East, language offered by Lautenberg to punish nations for trading with Iraq. If approved, the measure could require a cutoff of aid to Jordan, which has continued to trade with Iraq.

Although Jordan has not always been a reliable U.S. ally, it is strategically located and could yet play an important role in a diplomatic resolution of the gulf crisis.

The administration, which has chosen mostly to overlook Jordan's violations of the Iraq embargo, has not expressed its views on the Lautenberg amendment. But the legislation includes a provision for a waiver for national security considerations.

Israel was singled out for favorable recognition by the subcommittee. Leahy cited recent estimates that Israel has spent up to $1 billion on increased air patrols because of the threat from Iraq.

Partly to defray those costs, the panel approved an amendment that would give the Israeli government greater latitude in the expenditure of approximately $200 million from the Economic Support Fund. The full committee is expected to consider several other amendments to aid Israel, although the assistance is not likely to involve new expenditures.

According to Leahy, "We are not going to open the floodgates for Israel or anyone else."

El Salvador

The Cold War might be over, but the rhetoric and lobbying activity surrounding aid to El Salvador are reminiscent of the ideologically charged debates of the mid-1980s.

Opponents of the aid program feel that they have their best opportunity yet to place meaningful restrictions on the program, but supporters of the government of President Alfredo Cristiani are pulling out all stops to prevent that.

A turning point in the Senate's consideration of the issue came in August, when Christopher J. Dodd, D-Conn., agreed to back a Leahy plan, which is similar in intent to House-passed language, for restrictions on fiscal 1991 military aid to El Salvador. Dodd had opposed previous attempts to restrict aid to the Cristiani government.

The Dodd-Leahy proposal would tie military assistance to a U.N.-drafted plan for settling the conflict in El Salvador. The $85 million in aid would depend on three major conditions:

- Aid would be cut off completely if the president determined that El Salvador's government had rejected the peace plan but the country's leftist guerillas (the FMLN) had accepted it.
- It would also be eliminated if the president reported that El Salvador's government "has failed to conduct a thorough and professional" investigation into the murders of six Jesuit priests last November. Leahy described the progress in the case to this point as a "fiasco."
- It would be cut in half if the leftists cooperate in peace talks. The full $85 million would be provided if the president determined that the FMLN has rejected a U.N.-drafted peace settlement that the government accepts, or if the rebels began a major offensive.

"If we were to renege now, I would not want to be a political oddsmaker on Mubarak's future."

—Sen. Patrick J. Leahy, D-Vt.

The restrictive language is anathema to the White House, which stakes its hopes for a resolution of the conflict on continued support for the Cristiani government.

But Republicans held fire on the proposal in the subcommittee and could well do so again in the full committee, preferring to take their chances with an amendment of the Dodd-Leahy proposal on the floor.

The Republicans, along with a handful of conservative Democrats who back administration policy, are constructing amendments that would elaborate on an alternative set of conditions floated by Cristiani when he visited Washington the week of Sept. 24. *(Weekly Report, p. 3143)*

The Republican strategy appears to be to tie full funding of the program to the government's acceptance of a U.N.-monitored, but not necessarily U.N.-drafted, peace plan, which the FMLN rejects.

The problem with this approach, according to Democrats like Leahy, is that it puts the onus on the rebels to agree to a cease-fire "basically on the government's terms." And what that will mean, said one Democratic source, "is that the reform of the Salvadoran military, which is a prerequisite for any real cease-fire, will not take place."

But Democrats concede that any Republican proposal that incorporates a cease-fire provision will draw significant support. "On initial inspection, it looks good, because it looks like you're voting for peace," said the source.

Other Battles

Like the Salvadoran aid issue, other controversial issues, such as funding for the U.N. population fund, are likely to be resolved on the Senate floor. Leahy chose to include $15 million in support for the agency, even though Deputy Secretary of State Lawrence S. Eagleburger informed panel members that the president will veto the foreign aid bill — as he did last year — if the legislation contains the provision.

The administration, like the Reagan administration before it, opposes aid for the U.N. agency because it supports family planning programs in China. Conservatives say the Chinese government coerces women to have abortions. *(Weekly Report, p. 1979)*

While the subcommittee-passed legislation requires that no U.S. funds be used in China, that is not likely to go far enough to satisfy the administration.

The subcommittee struck a provision for aid to the non-communist rebels in Cambodia, which was passed by the full House in June only after fierce debate.

Democratic senators were particularly divided over aid to the resistance because of its alleged ties to the murderous Khmer Rouge. *(Weekly Report, p. 2078)*

The situation in Cambodia has changed considerably since the House vote. The five permanent members of the U.N. Security Council approved a framework for a Cambodian peace agreement in August, and the administration has begun direct talks with Vietnam over the Cambodian war. *(Weekly Report, p. 2839)*

The administration has argued that to cut off aid now would jeopardize ongoing diplomatic progress toward resolving the conflict.

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FOREIGN AID

A Reluctant Congress Passes $15 Billion Assistance Bill

Package is $129 million less than administration asked; amendment increases amount of 'tied aid'

For a brief period early this year, as it became apparent that the Soviet bloc was about to fade into memory, foreign aid became popular on Capitol Hill. Lawmakers scrambled to support new assistance for the fledgling democracies in Eastern Europe.

But that was before the summer budget crunch, which renewed the customary skepticism toward spending abroad the dollars of U.S. taxpayers. With a conspicuous lack of enthusiasm, both houses of Congress on Oct. 27 approved the conference report accompanying the $15.4 billion fiscal 1991 foreign aid appropriations bill (HR 5114).

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The bill includes $369.7 million in aid for Eastern Europe, along with new help for Israel and other favored aid recipients. Most lawmakers welcomed those provisions. But the overall mood was perhaps best expressed by Rep. Clarence E. Miller, R-Ohio, who said during the House floor debate on the bill, "We simply do not have the resources to devote to other nations to the extent we have in the past."

That attitude was reflected in the total amount of aid provided in the bill, which is $129 million less than the administration request for fiscal 1991, and nearly $300 million below the figure approved by the House in June. It also was demonstrated by the approval of an amendment offered by Senate Appropriations Committee Chairman Robert C. Byrd, D-W.Va., raising the amount of tied-aid credits — funds that must be spent on U.S. goods and services — from $50 million to $300 million. *(House bill, Weekly Report, p. 2077)*

Rep. Matthew F. McHugh, D-N.Y., noted that the legislation is "substantially less" than the 1985 bill, which allocated $20.9 billion for foreign aid. Yet even a 20 percent reduction over the past five years has not been enough for many lawmakers. Miller called this year's allocation "a far too modest effort at spending restraint."

By Carroll J. Doherty

Hosni Mubarak

The administration may have underestimated the depth of opposition to generosity abroad when it pressed for an amendment that would forgive Egypt's $6.7 billion military debt. Although the measure was moderated in a House-Senate conference, many lawmakers said it accounted for the relatively narrow margin by which the conference report passed the House (188-162). *(Vote 531, p. 3766)*

The Senate cleared the report the same day without a recorded vote.

President Bush has argued that a grant of debt relief is necessary to reward Egypt's President Hosni Mubarak, who has been a linchpin of Arab support for Operation Desert Shield, the response to Iraq's invasion of Kuwait. But lawmakers, especially in the House, strongly objected to forgiving the debt outright, rather than restructuring payment terms. *(Weekly Report, p. 3627)*

Rep. David R. Obey, D-Wis., who chaired the House-Senate conference on the bill and fought hard to alter the terms of the forgiveness plan, said after the vote, "If this bill had come up any other day than the last day [of the session], it would have been defeated."

In the conference, Obey added language that provides for a six-month payment moratorium, although the president also would get the power he sought to forgive the debt. In addition, Obey won approval for a provision granting similar presidential authority to adjust Poland's debt, which he called the most important provision in the bill. It is authority that "I am certain that the president will use," said Obey, who chairs the House Appropriations Subcommittee on Foreign Operations.

Rep. Mickey Edwards, Okla., the senior Republican on Obey's subcommittee, was also exercised over the Egyptian debt proposal, especially over its timing. Speaking just hours after the budget package was approved, he said it was difficult to justify debt forgiveness "when we have just made a substantial increase in the taxes on the American people."

A second controversial provision, requiring the administration to withhold half of the $85 million military aid package for El Salvador in fiscal 1991, triggered broad Republican opposition. That provision also was softened in conference but, in Edwards' view, not nearly enough.

Edwards complained that the measure does not allow the president to restore aid quickly, should the Salvadoran government make promised reforms. The House-Senate conference retained a provision ensuring that Congress would have final say about resuming the assistance.

Edwards said there is little incentive for the government to comply with the conditions included in the bill. "It is a carrot and a stick without a carrot," he said.

Changing Times

While the foreign aid bill represents

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a concession to budget realities in the United States, it also is an acknowledgement of the changes in the geopolitical landscape during the past year.

With the passing of the Cold War, Congress has grown increasingly dubious of the need for foreign military grants, aside from those provided to allies in the Middle East. Excluding the $3.1 billion specified for Israel and Egypt, the bill would cut the administration request for grants by nearly 25 percent. The bill would replace some of the grants with low-interest loans.

Perhaps more important, the legislation would reduce by $400 million the administration request for Economic Support Fund (ESF) aid. Such aid has been widely used, especially by the Reagan and Bush administrations, to bolster the economies of U.S. military allies. Aside from the slightly more than $2 billion in ESF funds earmarked for Israel and Egypt, the State Department would have only about $1 billion to spread among other countries.

"It's clear that ESF has been hit the hardest," said one administration official.

The official said that a current prohibition on aid to Pakistan could work to the advantage of other ESF recipients, who otherwise might face a reduction. The administration had requested $210 million in ESF aid for Pakistan, along with $228 million in military grants, but assistance to that country has been suspended because of its emerging nuclear capability. *(Weekly Report, p. 3238)*

Demonstrating the zero-sum nature of foreign aid this year, the official added that ESF aid for countries such as Nicaragua could be jeopardized if the administration certifies that Pakistan is again eligible for assistance.

Having taken money from security-related accounts such as ESF, Congress redirected the money toward a variety of purposes. The $369.7 million in assistance for Eastern Europe represents a compromise between the House- and Senate-passed figures and a $140 million increase over the administration's original request. The $70 million request for a U.S. contribution for the European Development Bank, which provides loans for Eastern European countries, also was fully funded.

Lawmakers substantially increased the assistance earmarked for Sub-Saharan Africa. The bill includes $800 million for the Development Fund for Africa, more than $230 million above the administration's request. The Senate Appropriations panel, in its reports on the foreign aid bill, expressed "growing alarm at the decline in living standards" throughout the region.

Congress also increased funding for a number of international health and welfare programs over the level requested by the administration. The House and Senate agreed to provide $100 million for the Child Survival Fund, aimed at helping poverty-stricken children in less-developed nations; the administration had asked for $74 million to fund the program.

Lawmakers provided $250 million in funding for international population control programs, an increase of more than 25 percent over the administration request.

"We simply do not have the resources to devote to other nations to the extent we have in the past."

—Rep. Clarence E. Miller, R-Ohio

They also targeted $52 million to control the spread of AIDS in the developing world, an increase of nearly $14 million over the administration figure.

Desert Shield Response

Debt forgiveness for Egypt almost carried the foreign aid bill to defeat, but there was little opposition to several amendments aimed at bolstering Israel's military capability in response to heightened tensions in the Middle East.

As they have for several years, the two countries dominate foreign aid spending: The legislation specifies $2.15 billion in military and security-related assistance for Egypt, and $3 billion for Israel.

Israel also will benefit from other provisions, including new authorization for the president to transfer up to $700 million of defense supplies to the country and to pre-position another $300 million worth of U.S. defense stockpiles in Israel.

Congressional sources acknowledge that the amendments also were motivated by a desire to reassure the Israeli government, which was concerned by administration plans to sell $6.7 billion in arms to Saudi Arabia. With adoption of the provisions to aid Israel, critics of the Saudi sale dropped plans to press for a resolution blocking the transfer.

Jordan, another nation caught in the vortex of events in the Middle East, was not as fortunate. The House-Senate conference on the bill dropped a provision, passed by the House, specifying $50 million in military financing for the kingdom. However, $35 million in economic aid for Jordan was retained.

The Senate Appropriations Committee, which opposed all earmarked aid for Jordan, said in its report that it was disturbed by Amman's "unwillingness to comply fully" with the U.N.-approved embargo against Iraq.

In another action taken in response to the gulf crisis, lawmakers waived a ban on sales of Stinger missiles to Qatar, a small, independent state that borders Saudi Arabia.

Congress also dealt with the painful issue of Americans trapped in Kuwait and Iraq, as well as those held hostage for several years in Lebanon. The legislation sets aside $10 million to provide health insurance benefits to the hostages and their families. The detainees also could receive a salary from the government, at an annual rate of up to $32,000, for the period of their captivity.

The bill wraps several proposed anti-Iraq amendments into an "Iraq Sanctions Act of 1990," which grants the president the authority to cut off trade with nations not complying with the global embargo against Baghdad.

Yet the most provocative aspect of the act might be a provision that, for the first time, specifically requires the president to "consult with Congress" on developments in the gulf crisis. The measure fails to define what constitutes consultation, however.

Other Issues

As Obey noted, the House-Senate conference empowers the president to write down Poland's $2.85 billion official debt. In their explanatory statement, the conferees said they provided authority for the president to recognize the "uncollectibility" of the debt.

The legislation also extends the authority of the Export-Import Bank and the Overseas Private Investment Corporation to operate in Eastern Europe.

But Congress stopped short of providing aid to provinces within the So-

Foreign Aid Appropriations . . .

The chart shows major programs requested by President Bush, the amounts approved by the House and by the Senate and the final amounts of budget authority in the fiscal 1991 foreign aid appropriations bill (HR 5114).

Figures in parentheses show program limitations that do not count as new budget authority. The figures for individual development banks include only paid-in capital and direct contributions. Figures, in thousands of dollars, may not add due to rounding.

Program	Bush Request	House Bill	Senate Bill	Final Bill
Inter-American Development Bank	$78,299	$78,299	$78,299	$78,299
Inter-American Investment Corporation	25,500	13,000	0	13,000
World Bank	110,592	50,001	110,592	110,592
International Development Association	1,064,150	1,064,150	1,064,150	1,064,150
International Finance Corporation	40,331	40,331	40,331	40,331
Enhanced Structural Adjustment Facility (International Monetary Fund)	10,602	10,602	10,602	10,602
Asian Development Fund	301,809	243,900	187,882	126,854
African Development Fund	105,452	105,452	105,452	105,452
African Development Bank	10,136	10,136	10,136	10,136
European Development Bank	70,021	70,021	56,820	70,021
Total callable capital for development banks	(5,433,457)	(4,153,540)	(5,433,457)	(5,433,457)
International organizations and programs	218,750	248,750	254,730	254,730
International Fund for Agricultural Development	6,250	20,000	30,000	30,000
Montreal Protocol Facilitation Funds (Aid to Reduce Ozone Depletion)	0	0	10,000	10,000
Subtotal, multilateral aid	**2,041,891**	**1,954,640**	**1,958,994**	**1,924,166**
Agriculture aid	424,520	481,635	481,635	481,635
Population aid	193,191	250,000	250,000	250,000
Health aid	115,465	135,000	135,000	135,000
AIDS prevention	38,200	52,000	52,000	52,000
Child Survival Fund	74,538	100,000	100,000	100,000
Education, human resources aid	134,201	134,201	134,201	134,201
Private sector, energy selected development aid	144,223	152,223	152,223	152,223
Science and technology aid	8,662	8,624	8,624	8,624
Private sector revolving fund, limitation on guaranteed loans	(125,000)	(12,500)	(62,500)	(57,000)
Reappropriation authority	23,000	23,000	23,000	23,000
Section 557 (reallocation of development assistance to other accounts)	0	0	−70,500	−40,000
Sub-Saharan Africa development aid	560,500	800,000	800,000	800,000
American Schools and Hospitals Abroad	23,000	23,000	35,000	29,000
International disaster aid	40,000	40,000	40,000	40,000
Foreign service retirement and disability fund	40,341	40,341	40,341	40,341
Agency for International Development (AID) operating expenses	447,794	435,000	435,000	435,000
AID inspector general	33,884	31,384	33,884	33,884

viet Union that have proclaimed independence from Moscow. The conference rejected a Senate amendment that would have provided $10 million in medical aid and humanitarian assistance to Latvia, Lithuania and Estonia.

The bill also attempts to prod further changes in U.S. policy in Southeast Asia. The administration revised its policy toward Cambodia in July, authorizing the first direct talks with the Vietnam-backed government in Phnom Penh. Congress approved $20 million in aid for Cambodia and pressed the administration to lift the trade embargo on that country's government.

Reflecting congressional skepticism over the administration's prosecution of the international war on drugs, lawmakers reduced a request for $141 million in military aid for three Andean countries to $118 million. In a direct slap at the State De-

. . . Where the Money Will Go

Program	Bush Request	House Bill	Senate Bill	Final Bill
African Development Foundation	11,500	13,000	13,000	13,000
Inter-American Foundation	16,941	25,000	25,000	25,000
Peace Corps	181,061	186,000	186,000	186,000
International narcotics control	150,000	150,000	150,000	150,000
Migration and refugee aid	450,648	485,648	485,648	485,648
Emergency migration aid	25,000	35,000	35,000	35,000
Anti-terrorism aid	12,026	12,026	12,026	12,026
Economic Support Fund (ESF)	3,544,000	3,460,000	3,141,000	3,141,000
ESF reappropriation authority	14,000	14,000	14,000	14,000
ESF rescission	0	0	0	0
ESF transfer to Multilateral Assistance initiative (MAI) for Philippines	0	0	0	−30,000
International Fund for Ireland	0	20,000	0	20,000
Multilateral assistance initiative (Philippines)	200,000	160,000	160,000	160,000
Other Special Assistance (Eastern Europe)	229,979	410,675	320,000	369,675
Development Policy Reform	75,000	0	0	0
Housing Guaranty Program, reserve	48,000	48,000	48,000	48,000
Subtotal, bilateral aid	**7,259,674**	**7,733,757**	**7,241,082**	**7,304,757**
Military aid operating expenses	28,000	27,920	27,920	27,920
Foreign Military Financing (FMF) program grants	4,988,900	4,202,000	4,664,347	4,232,000
FMF concessional loans	0	405,000	0	403,500
FMF deobligation-reobligation authority	0	0	45,000	45,000
International Military Education and Training	50,500	47,196	47,196	47,196
Guarantee Reserve Fund	587,061	587,061	587,061	587,061
Special defense acquisition fund (limitation on obligations)	(325,000)	(278,796)	(350,000)	(350,000)
Peacekeeping operations	32,800	32,800	32,800	32,800
Subtotal, bilateral military aid	**$ 5,687,261**	**$ 5,301,978**	**$ 5,404,325**	**$ 5,375,478**
Housing Guaranty Program, limitation	(100,000)	(150,000)	(150,000)	(100,000)
Overseas Private Investment Corporation (loan limitations)	(208,000)	(290,000)	(290,000)	(290,000)
Export-Import Bank direct loans	500,000	750,000	750,000	750,000
Export-Import Bank total limitations	(11,236,235)	(11,522,235)	(11,522,235)	(11,522,235)
Trade and development	30,000	35,000	35,000	35,000
Central fiscal operations	0	0	-852,000	-852,000
Guarantee reserve fund	0	0	382,639	382,639
Interest payments, foreign military aid	0	0	569,000	569,000
Polish debt restructuring	0	0	44,000	44,000
Benefits for U.S. hostages in Middle East	0	0	(10,000)	(10,000)
General reduction	0	-138,282	0	0
Reconciliation agreement adjustment	0	0	-143,639	-143,639
GRAND TOTAL	**$ 15,518,827**	**$ 15,637,093**	**$ 15,389,411**	**$ 15,389,401**

partment's Bureau of International Narcotics, Congress restricted funding for the agency until it provides a report detailing steps being taken to correct its "management deficiencies."

Despite opposition from the administration, and many in the Senate, the legislation includes a House-passed amendment providing $20 million for the International Fund for Ireland. The fund was established in 1986 to promote economic development in Northern Ireland and nearby parts of the Republic of Ireland.

Opponents to the contribution assert that the primary responsibility for resolving the centuries-old problems of Northern Ireland logically rests with Great Britain and Ireland. In their explanatory statement, the conferees said "disagreement continues" between the House and Senate over future U.S. contributions to the fund. ■

WASHINGTON POST, October 26, 1990

Stephen S. Rosenfeld

Bipartisan To a Fault

Under the clutter of President Bush's foreign policy dealings with his first Congress there is good news: a substantial measure of bipartisan accord that stands in sharp contrast to the tensions of the budget standoff.

Public attention may have been caught up by executive-congressional wrangling over the endgame in the Third World disputes carrying over from the 1980s—Angola, Afghanistan, Cambodia and El Salvador. The matter of aid for the last is perhaps the one place where an '80s-type political bloodying could yet come about.

Eager to move on from the political battlefields of the Reagan years, however, the administration is pleased to identify the Persian Gulf as its foreign-policy priority on Capitol Hill and to report satisfaction on four Gulf items: providing for a supplemental appropriation to pay for Desert Shield, designing an arms package for Saudi Arabia, blunting and deterring congressional initiatives to bind the president's policy flexibility, and writing off Egypt's debt.

Aid to El Salvador and cancellation of the Egyptian debt are both in the pending foreign aid bill. The pairing has encouraged sponsors of congressionally approved conditions on the Salvadoran aid to believe they can prevail. The administration, insisting it's serious about undoing some of those conditions, contends otherwise. Stay tuned.

What is notable about this particular showdown, nonetheless, is that it is untypical. Early on, this Republican administration accepted a pragmatic requirement for some workable form of bipartisanship with the Democratic Congress. The collapse of the Soviet Union as a global power and the rush of Soviet-American détente were dissolving the most serious partisan and ideological differences of the past decade, and making this approach sensible as policy and feasible, even attractive, as politics

The administration didn't at all relish congressional micromanagement of foreign policy, but it was prepared to live with a certain amount of it as the price of advancing its basic policy line. Nor was the lobbying all bad. On a number of contentious Third World issues, deal maker James Baker, the secretary of

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The administration didn't at all relish congressional micromanagement of foreign policy, but it was prepared to live with a certain amount of it as the price of advancing its basic policy line. Nor was the lobbying all bad. On a number of contentious Third World issues, deal maker James Baker, the secretary of state, could fend off harder-line Republican conservatives by citing a practical need to meet a demanding Congress. At the same time, he could hold softer-line Democratic liberals at bay by arguing that he needed a freer hand in the negotiations that they favored but that he had already begun.

There is a frank acknowledgment in official circles that the administration's own internal differences kept Cambodia on the back burner until an impatient Congress forced this issue onto a front burner last summer. The result was the American opening to Hanoi that created the promising international negotiation on Cambodia now in train. On Angola, too, the administration used Democratic pressure to offset the position favored by hard-line Republicans.

To talk to both congressional and administration players in these battles is to realize that most of the jostling and the shadow play have gone on within a context of shared pursuit of a negotiated settlement. The results have been at worst acceptable and at best creditable everywhere except in El Salvador, which is for the Bush administration the successor issue to the take-no-prisoners Nicaragua policy wars of Reagan's time.

There the Salvadoran army's still unpunished murder of the Jesuits shrank the normal possibilities of consensus in Washington, producing a congressional aid formula that is heavy on burdens on the government the United States supports and light on burdens on the guerrillas it opposes. The issue is still in play.

Overall it's been a pretty good day

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Overall it's been a pretty good day

for bipartisanship. That's something to applaud, but not too enthusiastically. The administration's particular success in keeping its Gulf policy hand free has a spongy underside.

The United States is living on the edge of a major presidential war in the Gulf. Congress is leery of conveying hesitation to Saddam Hussein and of accepting responsibility, and it has simply failed to insist on the agreed procedures that would allow it to exercise effectively its war-declaring power under the Constitution. To top it off, at this particularly tense moment it's leaving town. A tiger on the lesser throwaway issues, Congress is a pussycat on this central one. It's bipartisan to a fault.

Tied Aid

In debate on appropriations for foreign assistance for Fiscal Year 1991, Senator Robert Byrd (Democrat of West Virginia) introduced an amendment on behalf of himself and a number of colleagues on the subject of tied aid. Excerpts from his remarks, made October 22 on the Senate floor, follow. The legislation enacted specifies that up to $300 million may be provided for tied aid credits from economic support funds; bilateral development assistance programs, including the Development Fund for Africa, are excluded.

Mr. President, the amendment that I have offered raises the cap in the bill for tied aid credits within the overall economic support fund. The amount in the bill for economic support, which goes to scores of countries around the world, is over $2.4 billion for fiscal year 1991.

The bill places an upper cap on the amount of this large sum that may be used to tie aid, that is to require the recipient of U.S. dollars to spend them on U.S. business and commerical services, to a paltry $50 million. Tied aid, then, in the bill amounts to about 1 percent of the overall economic support fund.

The amendment I have offered would increase this to $300 million, still a somewhat paltry sum, 9 percent of the ESF total. As I say, it is still paltry, but at least a beginning in our effort to make our foreign aid programs more relevant to the international economic health and competitiveness of our Nation.

Without debate, America's priorities in the world are changing their character rather quickly. I believe the overwhelming force now driving a refashioning of our international economic policies should be the need to improve our economic competitiveness, our trade balances, and our budget problems.

Aid which benefits the American economy and is tied to U.S. business and commerical interests should make up a larger and larger share of our aid-giving programs. This is not only because other major donors engage in this practice, but because I believe this kind of aid will be of greatest utility to those countries, but more importantly, to our country.

Such tied aid, I hope, will develop a robust American business and commerical presence in nations, such as in Eastern Europe, that desperately need massive infusions of capital, commercial expertise, technology, and information.

I have come to believe that the foreign aid programs of the United States are crippled by the anchors of special clients whose needs have not been examined and in relationship to the overall size of a limited foreign aid pie, and by our failure to address the changing needs of the United States itself. Such an analysis is badly overdue, and must be ruthlessly made, without the overlay of emotionalism, nostalgia, or special interest pleading. In short, we need to pursue, first and foremost, the interests of the United States, to further our goals in a rapidly changing world, and enhance U.S. economic competitiveness as an integral part of our national security.

The two areas which need urgent work are in the country-by-country distribution of aid, and in the fundamental nature of the aid being given.

Perhaps our single most important contribution to making U.S. foreign aid programs more relevant to our own commercial and economic health is to fundamentally change the philosophy underpinning the ways and conditions by which U.S. dollars are transferred via our aid program. They should be tied to long-term U.S. strategic, and particularly economic interests, if these programs are to regain a modicum of popularity and relevance in the American political system.

If a successful program is to be put into place in Eastern Europe, for instance, then the U.S. taxpayers should be convinced that they are going to get a fair and deserved return on their investment. National security and international influence today need to be gauged in terms of economic leverage and prowess as never before. A brief comparison of how we manage foreign aid with that of our key competitors highlights the fundamental problem. Tied aid and tied-aid receipts are a primary mechanism that West Germany—or Germany now—France, and Japan use as a wedge for economic influence around the world. For example, from 1984 to 1987, those three countries spent 70 percent of their aid on capital-intensive projects to create large markets for capital goods exports from the home country.

During the same years, the United States dedicated a mere 9 percent of its assistance to such projects. Tied aid is locking in markets for our economic competitors. Their foreign aid does give valuable assistance to recipients, but it is also a motor to expand influence and penetrate and create new markets in the recipient countries. Between 1984-87, over 90 percent of U.S. aid was in the form of direct cash grants, no strings attached, no influence affected, no lasting economic relationship generated.

Our aid programs have focused on balance of payments support and direct basic needs to the poorest people. The adverse impact of these practices on the U.S. trade position has been substantial, estimated in a recent report by the Center for Strategic and International Studies to be between $2.4 and $4.8 billion of annual losses to American exports.

Mr. President, last May, the administration proposed a more aggressive program to promote U.S. exports, and announced an initiative to tie aid through our aid and export promotion programs. It proposed that $100 million of AID funds and $400 million of Export-Import Bank funds be dedicated to a new initiative of tied aid. Such a program would not be possible with the cap that is now in the bill.

It is still little enough, but it is better than nothing, and it would at least be a start in implementing reforms in this area which I think are badly overdue.

CONCLUSION

America has always been a generous, responsive nation, and we have used our foreign aid programs to rebuild war-ravaged countries across the globe for half a century. In a new world where there are many other economically wealthy donors who practice aid-giving as another form of wealth creation, it would be running against a long tradition in the United States to simply ape mercantilist practices.

But we have also learned that lasting progress results from the long process of capital creation, and if we are hopeful of implanting democratic free market systems in the desperate economies and societies being evacuated by the Soviet Union, then fundamental restructuring of our priorities and our mechanisms is overdue.

In other words, Mr. President, we cannot keep on as we are in the 1990's pursuing a 1950's foreign policy. Success in the kind of reform that I have been discussing would breathe new popularity and political support for foreign aid, help our own economy, be a win-win game for donor and recipient alike, and probably cause an increase in the popular support of our foreign assistance programs.

(Congressional Record, Vol. 136, No. 145, pp. 16346-7).

FINANCIAL TIMES, December 5, 1990

Commercially-motivated tied aid

Time to discipline a costly trade practice

By John Macomber

With dramatic free market reforms sweeping central Europe and many other parts of the world, it is time to take a fresh look at an ever more costly trade practice - the use of tied aid or mixed credits.

These are mixtures of commercial credits and government-supported "soft" loans or grants. All member nations of the Organisation for Economic Co-operation and Development would gain from a co-operative effort to reduce this trade-distorting and expensive practice. A reduction in tied aid would greatly reduce trade costs - something all industrial countries would appreciate as they face tighter budgets.

The United States supports the use of aid for humanitarian and development purposes, but not for purely profit-oriented capital projects that could be commercially financed.

Recipient country funds are diverted from basic needs to capital-intensive projects that may be lower in priority

Everyone loses in commercially-motivated tied aid. The buyer's price of doing business goes up because procurement is directed according to available credit rather than on the basis of the best price and technology. Recipient country funds are diverted from basic human needs and appropriate development projects to sophisticated, capital-intensive projects that may be far lower in national priority.

Inefficient suppliers are protected, reducing the global competitiveness of the donor country. And although exporters appear to win in the short term, the taxpayers in the exporting country pay the cost of government support for concessionary trade financing.

Moreover, tied aid has become increasingly costly because of the higher grant levels required in mixed credits under the OECD arrangement. Revisions to the arrangement implemented in 1988 raise the minimum grant element from 25 per cent to 35 per cent for most developing countries, and to 50 per cent for the least developed countries. At the same time, the calculation of the grant element was more closely linked to each donor country's domestic interest rates. Britain has felt the effects of this increase since tied aid accounts for an estimated 70 per cent of the country's bilateral aid budget.

Countries that do not use mixed credits in certain target markets are also on the losing end as long as commercially-motivated tied aid exists. American exporters lose an estimated $4bn (£2.07bn) a year in export revenues to tied aid deals by foreign competitors - the bulk of it in the Pacific basin.

With trade driving economic growth, American economic policies must focus sharply on US competitiveness abroad. As a result, the administration and Congress are using more aggressive tools to support US sales overseas in the face of government-backed exports. The Export-Import Bank of the United States, America's export credit agency, has at its disposal a "war chest" that has grown from $110m in fiscal 1991. The fund is being used in co-operation with the US Agency for International Development (AID) to launch a $500m joint programme offering mixed credits in four markets where they are most aggressively used by our competitors for commercial advantage: Indonesia, the Philippines, Thailand and Pakistan.

Eximbank and AID are establishing protocols in these four countries, each supporting $125m in US exports. The funding will combine Eximbank and AID grant money with Eximbank guarantees of commercial financing. The programme will finance projects in sectors heavily targeted by Japan and western European countries: telecommunications, transportation, power and construction equipment. All of the projects will meet strict economic and technical criteria, be of high development priority in the recipient countries and benefit both public and private sectors.

We anticipate operating the tied aid programme even more aggressively this year, given our beefed-up Eximbank 1991 budget with the war chest increased by nearly half. Congress has approved a sharp increase in AID funding authority for tied aid projects with Eximbank - from $5m last year to $300m in fiscal 1991. This stretches our US government grant capacity for mixed credits to as much as $500m which could be leveraged with Eximbank guarantees of commercial financing to support $1.3bn in US exports. The importance of this joint initiative lies not just in dollar export figures, however, but also in the administration's resolve to fight fire with fire, and to trim - if not end - this expensive practice.

The US will press for greater discipline on tied aid. We will be watching how our trade partners react to our initiatives

Backed by this muscle, the United States will press for greater discipline in the use of tied aid by other countries. We will be watching how our trading partners react to our mixed credit initiatives. We hope to find a solution through the negotiating process in the OECD talks which resume next week. However, should the talks not produce results, we will expand our tied aid capacities.

It is to everyone's benefit to deal quickly with this trade-distorting practice. Commercially-motivated mixed credits ultimately hurt everyone - buyers, recipient and exporting countries, all traders. It sabotages the trade liberalisation trend sweeping the developing world, at a time when trade is driving world economic growth. For these reasons, the issue will remain a top priority of the US government.

The author is chairman of the US Export-Import Bank.

Food Notes

A Biannual Publication of the CARE Food Programming Unit, CARE New York

FARM BILL 1990:

SENATE AND HOUSE COMMITTEES FINISH WORK ON NEW FOOD AID AUTHORIZATION BILLS FOR 1991 TO 1995

By Charles Sykes

The Senate and House Agricultural Committees and the House Foreign Affairs Committees have finished their revisions of Public Law 480. There are a number of significant substantive and structural changes in P.L. 480 contained in the Committees' bills:

"The current Food for Peace [P.L. 480] POLICY STATEMENT is revised to focus on the enhancement of FOOD SECURITY in the developing world. That means that foreign policy, trade expansion, economic development and all other purposes must first serve to promote food security.

"Title I concessional credit sales adds a new Title I grant program, reauthorizes the Title II donations, and creates a new "Food For Freedom" Program in Title III. For each of these programs, specific authority and responsibility is

given to a single agency of government, although other agencies may be consulted in the decision-making process. This change reflects widely expressed concerns that the present interagency system known as the D.C.C. has infused the Food for Peace Program with bureaucratic infighting, lengthy delays and muddled lines of authority. Instances of D.C.C. delays are numerous. NGOs, agricultural exporters and many food aid officials have complained about the bureaucratic nature of the interagency process.

"The Department of Agriculture will manage the Title I concessional credit sales program which will be directed at developing countries that have market development potential. The loans have a 10 to 20 year repayment period and a maximum interest rate of 4%. The loan repayment may be made in DOLLARS or LOCAL CURRENCY, at the discretion of the Secretary of Agriculture. SELF-HELP REQUIREMENTS are deleted from the Loan Program because they have basically been ineffective.

"Title I also includes a new DEBT FORGIVENESS program for countries that are least developed or who have a high per capita debt and an IMF, World Bank or other Economic Policy Reform program in place.

"There is a new Title I Grant Program to be administered by AID to promote economic development, specifically targeted toward those countries that are too debt burdened to take on more P.L. 480 loans, but are not in such desperate straits that they need Title II relief aid. In order to be eligible for grant aid, countries must be truly poor and have an identified food deficit.

"Title II remains much the same as current law. AID continues as the oversight agency, working with cooperating sponsors, i.e., NGOs. The legislation sets minimum tonnages that must be made available for Title II. Within that minimum is a subminimum that must be distributed by NGOs. The minimums and subminimums are slightly higher than in current law in order to meet increasing food needs in the world.

"The legislation allows NGOs to monetize 10% of the commodities they receive to assist them in the local cost of distribution and transportation and other purposes.

"A new Title II provision requires that $10 to 13.5 million be made available to NGOs annually to them in specific administration, personnel, transportation and distribution costs, particularly for Sub-Saharan African programs where such costs are inordinately high.

"The legislation also has a section to address the NGOs' desire to have clearer and more specific administration of Title II by AID. Title II will have a new "Food Aid Advisory Group" composed of NGO representatives and AID officials. This is to give the NGOs a regular and official channel in which to discuss Title II projects. The AID Administrator will chair the group.

"Title III-Food for Freedom provides $50 million in agricultural commodities to "emerging democracies that have taken steps to introduce representative government and free market economies."

"Multi-year programming is required of all programs to limit unnecessary bureaucratic intervention.

"The legislation requires that food be distributed in a non-discriminatory way and prohibits military forces from distributing food unless there are no other means of transportation available.

SUPERPOWER RELATIONS

Bush Lifts Soviet Credit Ban To Ease Food Shortage

U.S.S.R. can buy $1 billion in U.S. agricultural goods; February summit on START also announced

There was no attempt to gloss over the crisis in the Soviet Union when President Bush appeared with Soviet Foreign Minister Eduard A. Shevardnadze in the Rose Garden of the White House on Dec. 12.

Bush said the U.S.S.R. "is facing tough times, difficult times." Shevardnadze acknowledged that "there is a certain instability in the Soviet Union, and we are worried about that, that's a fact."

Those hard realities led Bush to take a significant step toward normalizing economic relations with the Soviet Union. He suspended a 15-year-old ban on extending commercial credits to the Soviets, enabling them to buy up to $1 billion worth of U.S. agricultural goods.

The trade break for the hard-pressed Soviet economy was the most tangible reward from the visit to Washington by the Soviet foreign minister. But Bush also announced plans for a summit with Soviet President Mikhail S. Gorbachev in Moscow on Feb. 11-13, anticipating the signing then of a strategic arms reduction treaty.

Members of Congress were generally supportive of the new administration overtures, although some saw the offer of agricultural credits as long overdue.

Bush said he was acting now "to help the Soviet Union stay the course of democratization and to undertake market reforms."

Secretary of Commerce Robert A. Mosbacher, appearing on ABC's "Good Morning America" on Dec. 13, stated flatly: "This administration doesn't want to take the chance of having people starve in the Soviet Union when we can be helpful. And it is real help."

In addition to providing agricultural credits, Bush approved sending technical experts to the Soviet Union to help improve the country's troubled food distribution network. The administration will also financially aid private groups sending medical equipment and pharmaceutical supplies to Moscow.

By Carroll J. Doherty

BONNIE BOWER-DENNIS

Addressing long-term economic needs as well, Bush announced that he will ask the International Monetary Fund (IMF) and the World Bank to grant the Soviet Union "special association," a step that he said will promote "fundamental economic reform" in the country.

The busy day of diplomatic activity did not end there: Shevardnadze and Baker took the unusual step of holding simultaneous talks with proxies from each side in the Angolan civil war.

The Soviet foreign minister then sat down with another former adversary — Prime Minister Yitzhak Shamir of Israel — as their two nations inched closer to establishing full diplomatic relations.

Most analysts of Soviet affairs viewed the president's offer of credits as further evidence of the administration's commitment to buttress Gorbachev's increasingly shaky leadership.

The U.S. eagerness to help has doubtless been bolstered by Soviet backing for the U.S. military buildup in the Persian Gulf, although administration officials explicitly denied that credits were offered as a payback for the support.

The U.S. commitment may be severely tested during the next few months, particularly if Gorbachev takes a hard line toward the rising tide of domestic dissent.

Secretary of State James A. Baker III reportedly expressed concern to Shevardnadze that Gorbachev may use tough tactics. Baker warned that closer ties could be jeopardized by a crackdown, officials said.

According to Michael Mandelbaum of the Council for Foreign Relations, "If a Soviet crackdown on the pro-democracy movement results in a Tiananmen Square situation, the administration will have some hard decisions to make on supporting Gorbachev."

Congress Supportive

Key Republicans, including Senate Minority Leader Bob Dole, R-Kan., had joined with Democrats in urging the administration to lift the 1974 Jackson-Vanik amendment, which prohibits the extension of credits to the Soviet Union. *(Weekly Report, p. 4086)*

Bush waived the law, originally aimed at pressuring communist nations to allow free emigration of their citizens, until June 1991. The president praised the Gorbachev government for its "generally excellent [emigration] practices of the past year."

Despite the waiver — which also qualifies the Soviets to receive up to $300 million in credits from the Export-Import Bank — the White House has no plans to send to Capitol Hill the U.S.-Soviet trade agreement that Bush and Gorbachev signed at their summit in Washington last June.

Administration officials said the agreement, which accords most-favored-nation (MFN) trading status to the Soviets, would not be submitted

until the new emigration practices are codified. Bush had previously insisted that he would not grant agricultural credits until such a law was enacted.

The Soviet foreign minister said, "I have no doubt that very soon there will be a final vote and that legislation will become law."

House Majority Leader Richard A. Gephardt, D-Mo., whose call for direct aid to the Soviet Union was ridiculed by the administration nine months ago, said he "commended the president's action" in extending the credits.

"Today I say to the administration: well done," Gephardt added.

Some lawmakers charged that the administration moved too cautiously, by not extending enough food credits, as well as too late. Dole, a tireless advocate for farmers, wrote the president hours before the Rose Garden ceremony, urging $3 billion in credits.

Following the announcement, Dole issued a statement saying, "Let's just hope that this is the beginning," adding that he "would like to see additional credits, substantial enough to have a market impact."

More substantive criticism came from conservatives who, along with a skeptical Democrat, New Jersey Sen. Bill Bradley, worry that the United States may be moving too quickly to assist its old rival.

Calling the economic aid "ill-advised," Bradley said, "We should all be concerned that our actions will strengthen the forces in the Soviet Union that are opposed to the free market."

He was especially troubled by reports that the KGB, the Soviet secret police and intelligence agency, would be overseeing the distribution of foreign assistance and that the Soviet military had denied a request from the mayor of Leningrad to release food stocks.

"At the least," said Bradley, "we should insist that the Soviet military do as much to feed the Soviet Union as the U.S. or the Germans."

START Progress

The decision to schedule a February summit in Moscow also may have been an indication of U.S. determination to show support for Gorbachev. Although Shevardnadze and Baker insisted that significant progress had been made toward completion of a Strategic Arms Reduction Treaty (START), they were none too eager to get into the vexing details.

Sounding more like old fishing buddies than foreign ministers, they literally laughed off efforts by reporters to inquire about the technical disagreements.

THE ASSOCIATED PRESS

A Soviet woman reaches for butter on the nearly empty shelves of a Moscow store.

"I'm sure you're quite familiar with the perimeter-portal monitoring concept," Baker teased. "It's those kind of issues that we're still struggling with, and we still have quite a few of those to deal with."

The complicated treaty, which has been the subject of negotiations for eight years, would slash U.S. and Soviet arsenals of long-range nuclear weapons by almost one-third.

Although there has been broad agreement over the basic elements of the pact for months, several complex and relatively technical issues remain unsettled.

As a result, Bush's announcement marked an apparent departure from the administration's previous insistence that it would not schedule another Bush-Gorbachev meeting until the treaty's terms were nailed down.

While Baker was belittling the jargon that makes up the nuts and bolts of arms control agreements, other administration officials expressed anxiety over the unresolved issues.

"Things can always come up," said one. "The assumption is we have made progress and are very hopeful we will have a treaty to sign. There are no guarantees."

Mandelbaum believes that, despite the outstanding issues, an agreement is likely to be concluded in time for a February signing. "They are only deal breakers if either side thinks so, and I don't get the sense they do," he said.

At least three START issues remain open:

- U.S. negotiators are resisting Soviet demands to inspect the B-2 stealth bomber to verify claims that the plane is not equipped to carry long-range cruise missles.
- Although the two sides agree that each may observe the other's production of mobile intercontinental missiles, there is a dispute over which of several plants should be the monitored site.
- The two sides also differ over how much data from missile test flights each must make available to the other.

Regional Issues

Included in Shevardnadze's full Washington schedule were visits with some old enemies that provided still more evidence of the passing of the Cold War.

The Soviet official had an amicable, 90-minute meeting with Shamir, and, although the two governments did not establish normal diplomatic relations — as some had anticipated — they took steps in that direction.

In fact, Shamir indicated that he had no objections to the U.S. lifting of the prohibition on credits to the Soviet Union. "I have stated it very clearly that we think this Jackson-Vanik amendment could be dispensed with now for a year or more because of the Soviet's very liberal policy related to the emigration of Jewish people," the prime minister said Dec. 12. *(Shamir visit, p. 4146)*

Following his meeting with Shamir, Shevardnadze said, "We are moving toward [relations]. A process is evolving in normal fashion."

Shevardnadze also met with a man who, during the 1980s, embodied the Reagan administration's commitment to challenge Soviet expansionism in the Third World. The Soviet foreign minister's discussions with Jonas Savimbi, leader of U.S.-backed rebels in Angola, were part of a new U.S.-Soviet effort to resolve the country's 15-year-old civil war.

While Shevardnadze met with Savimbi, Baker talked with Foreign Minister Pedro de Castro van Dunem of Soviet-backed Angola. The two-sided negotiations apparently made progress: On Dec. 14, Savimbi said his organization had reached a tentative agreement with the government over a cease-fire and internationally monitored elections.

A formal accord establishing a cease-fire could be reached during talks between the government and rebels in January, Savimbi said.

LOS ANGELES TIMES, December 16, 1990

COLUMN RIGHT/
PATRICK J. BUCHANAN

The Bear Isn't Starving; Don't Feed It

■ Gorbachev is flush with cash; U.S. aid will only help his strategies of repression.

Had Republicans in 1988 told voters we would be raising taxes to send foreign aid to Moscow, even the Little Duke might have been able to slip around our right end and run to daylight.

Yet, here we are. Six months ago, Majority Leader Richard Gephardt took a fearsome pounding for even suggesting what Mr. Bush has decided to do: send $1 billion in food aid to Mr. Gorbachev.

Kansas Sen. Robert Dole, whose friend and contributor is Dwayne Andreas of the grain giant Archer Daniels Midland, suggests we raise Moscow's food-related loan guarantees to $3 billion. Fine, Bob, but when Moscow welshes, let Andreas and ADM eat the loss.

Astonishing. With the dollar sinking, the deficit exploding, the Fed feverishly pumping cash into a failing Bank of New England, the S&L crisis deepening, the Persian Gulf adventure doubling in cost, Uncle Sam is launching a new foreign-aid initiative—to rescue the last dictator between San Francisco and Vladivostok.

Were the Russian people starving, Americans would be there with food assistance. But they are not starving. They just had the greatest harvest in history, and Gorbachev's gang is flush with cash. Moscow's $4-billion windfall profit from the doubling of oil prices, its $24 billion in credits since June from the Germans and Saudis, plus $10 billion to $14 billion in reserves, give Gorbachev all the cash he needs. Why, then, are we sending him food on credit?

Because Bush wishes to signal to the Soviets that Gorbachev is our man in Moscow, that saving him serves U.S. national interests.

But does it, in December, 1990?

Surely, the Gorbachev who held back the tanks in Central Europe in 1989 was the best Soviet leader of our lifetime. Ronald Reagan was right: Gorbachev was a "different kind" of Communist. Were he to preside over the dismantling of the Soviet strategic rocket force and the opening up of his "prison house of nations," his regime would be as wise a strategic investment as the United States could make. But there is no evidence that Gorbachev intends to preside over the liquidation of the Soviet Empire; there is hard evidence that he is aligning with the imperialist factions determined to save it.

The Soviet military still consumes 20% of GNP. Soviet tanks have been moved east of the Urals to exempt them from U.S. arms-control agreements; Soviet rockets—aimed at the United States—continue to roll off assembly lines. Moreover, Gorbachev has lately declared his intent to use force to keep the Soviet Union together. At the top of the Interior Ministry sits a newly appointed ex-KGB tough from Latvia, Boris Pugo, whose deputy, Gen. Boris Gromov, has the aspect of a Russian Napoleon. There is a good possibility that just as U.S. food aid is pouring into Moscow this winter, Gromov will be conducting a blockade of one or more Baltic republics.

'Like the . . . loans to Poland in the '70s, and to Iraq in the '80s, we will never see the money again.'

In the battle between neo-Stalinists and reform Communists, Gorbachev was with the reformers. We had an investment in his victory. But that fight is over. The battle now is between those who believe in constitutional rights, free markets and independence for the republics, and those prepared to use force to keep Russia's captive nations captive forever. Gorbachev is emerging as the leader and voice of the forces of repression.

His regime—with its huge Marxist bureaucracy—is now the impediment to reform. As former National Security Council aide Roger Robinson of the Center for Security Policy writes, the Soviet Union is referred to by American bankers as "Red Bear S&L." It should be shut down, its managers fired, its assets parceled out. To stuff Moscow full of cash and credit in 1990 is to give this failed regime the same lease on life we gave Lenin in the '20s, Stalin in the '40s, Brezhnev in the '70s. This time, don't bail 'em out, let 'em go under.

Like the Commodity Credit Corporation loans to Poland in the '70s, and to Iraq in the '80s, we will never see the money again, all that subsidized food will have to be paid for by the American people.

By denying aid to Gorbachev, we could force him to act in his own best interest. Without hard currency, he could not pay his bureaucrats, maintain his arsenal, send aid to Cuba and Afghanistan, operate his state farms and factories. Without aid, he must open his country to investment, or go under. You do the alcoholic no favor when you give him a drink; you do him a favor when you put him through cold turkey.

President Bush put America's prestige behind Deng Xiaoping, and, until Aug. 2, behind Saddam Hussein; he was burned by both. With this aid package, he ties himself to a dictator who just may reward him with a crackdown that will cause us to forget Tian An Men Square.

Patrick J. Buchanan writes a syndicated column in Washington.

Competing Needs of Africa and USSR

The President's Opinion

By Peter J. Davies

I am troubled by the prospect of sending thousands of tons of relief food to the Soviet Union this winter. Obviously, if the Soviet people do face famine, we should be concerned. But any food shipments should not be at the expense of those suffering much greater hardship in Ethiopia, Sudan, Liberia, Mozambique and other countries -- children, women and men who are malnourished or face the threat of famine due to protracted civil wars, droughts and ecological devastation.

How does one balance the competing needs?

I recognize the need to help President Gorbachev to keep the situation from becoming more unstable. We must continue to support the Soviet Union and its people -- especially the most vulnerable -- as they make the transition to a more open society. Nevertheless, when I read that food is stored in warehouses, and stacked up in railroad cars but fails to reach the shops of Moscow and Leningrad, I conclude that our policy should be to provide logistical and organizational technical assistance; experience that PVOs handling PL 480 food have developed over many years.

Reports are that the USSR actually has a bumper crop of grain, and the potato crop is not being harvested in some places because distribution has broken down. The problem is not a shortage of food in the countryside, but failure to get food into the shops. There is widespread hoarding as a result.

If the problems are primarily with the distribution system, I would urge that PVOs experienced in food aid form an assessment team, perhaps with representatives of AID's Foreign Disaster Assistance and Food for Peace offices. Such a team could assess the problems; determine where the bottlenecks are; what resources exist already and how best to provide the Soviets assistance to break them. In the past, teams of InterAction members have visited Ethiopia, Angola, Sudan and Mozambique to conduct joint assessments. A similar team to Russia could assess, recommend steps and report back. It might also determine how to strengthen the indigenous voluntary sector and encourage the informal private markets.

Apparently our government, at this writing on December 12, has decided not to send humanitarian food aid. Complicating the problem is the Jackson-Vanik law which prohibits "most favored nation treatment" in the absence of free emigration. However, the National Conference on Soviet Jewry, an umbrella group of American Jewish organizations, has said it would support a waiver of Jackson-Vanik, as has Prime Minister Shamir. A waiver could be granted to allow trade credits. This seems a more appropriate response than massive humanitarian food shipments. Relief food, if sent, should be channeled through PVOs such as CARE to assure that food reaches the neediest people.

In any case, as the media continues to report Soviet food shortages, we as humanitarian agencies should use the opportunity to focus public attention on the fact that the USSR's food shortages are not of the same magnitude as those in famine-affected Africa. And Africa is where the world's attention rightly belongs.

AFRICA REPORT
November/December 1990

U.S.,Soviets Join Efforts in Angola

As famine looms over Angola, threatening 3 million people, and the government is struggling to operate "corridors of peace" to supply food to needy areas, the U.S. and the Soviet Union are making a concerted but as yet unsuccessful effort to break the deadlock in peace talks and put an end to the 15-year civil war that has claimed 200,000 lives. After four rounds of negotiations, the government and the National Union for the Total Independence of Angola (Unita) have agreed to hold elections, but they cannot decide on the logistics of the operation—when to hold them and how.

The U.S.-Soviet joint effort comes at time when the two superpowers are cooperating to resolve conflicts diplomatically in developing countries, including Afghanistan and Cambodia, and in the withdrawal of two-thirds of the Cuban troops in Angola in return for Namibian independence. Both superpowers have played a key role in the conflict: The U.S. supplies $60 milllion worth of covert military assistance to Unita each year, and the Soviet Union furnishes $500 million (down from $1.5 billion in 1987), in military aid annually and over a thousand military advisers. The superpowers expressed their willingness to take part directly in the peace talks for the first time, and to supervise a ceasefire and elections in the fourth round of talks held in Portugal in late September. The State Department has since stated, however, that it is unlikely that U.S. forces will be sent to Angola on a peace-keeping mission with Soviet troops.

The Angolan government and Unita remain adamant on their respective positions: The former claims that Unita cannot be recognized until the constitution has been amended to allow for a multi-party system and elections cannot be held until the country is well on its way to recovery. Unita demands that it be immediately recognized as a political party and that elections be held next year.

The Bush administration is pressing Congress to renew military and technical support for Unita until the peace talks are over and a timetable for elections has been set, prodded by the visit of Unita leader Jonas Savimbi to Washington in early October, who talked of peace, but pleaded for arms. The State Department argument is that Unita's legal status continues to be unresolved, jeopardizing its future political role in Angola. Liberal Democrats are lobbying for the phasing out or termination of aid to Unita, based on the movement's abysmal human rights record documented in minute detail two years ago by the State Department itself, and on Savimbi's questionable politics.

Maintaining covert aid to Unita, a measure adopted during the Cold War, has become anachronistic and should be freshly reconsidered by the Bush administration, argues Democrat Ronald Dellums. In mid-October, the House voted 246 to 175 against ending CIA support to Unita, but approved an amendment by Democrat Stephen Solarz that will suspend CIA aid to the rebels for three months, as soon as dos Santos agrees to a ceasefire, elections within two years, and a political settlement with Unita. CIA aid to Unita can resume, according to the amendment, should the Angolan government not fulfill these conditions. ■

Failures of State

The Bush administration has a sorry record of responding to the turmoil in Liberia and Kenya, two of the U.S.'s traditional African allies. In the former, the American government stood by as Doe's troops and rebel forces ran amok, and in Kenya, the administration failed to use its leverage to press the Moi government on political reforms.

By HOLLY BURKHALTER and RAKIYA OMAAR

Assistant Secretary Herman Cohen recently made the startling observation that rebel leaders Charles Taylor and Prince Johnson are democratically inclined

When he visited Nairobi in August, Herman Cohen, the American assistant secretary of state for African affairs, commented that "while the United States favors a multi-party system, who are we to say it is good for everybody?" Ironically, Cohen's statement appeared in *The New York Times* the same day as a letter from Richard Schifter, the assistant secretary of state for human rights, headlined: "America is still the Lodestar for Democracy"—but perhaps not in Africa, as U.S. policy toward Liberia and Kenya illustrates.

The murder of President Samuel Doe on September 10 rid Liberia of a deeply unpopular dictator. For much of his decade in power, Doe enjoyed strong U.S. support, and Liberia was the largest recipient of American aid in sub-Saharan Africa. Since war broke out in December 1989, the U.S. government has stood back and watched while government and rebel troops slaughtered civilians from rival tribes, displacing virtually half of Liberia's population. The consequences are sadly apparent to anyone who has visited the 500,000 Liberian refugees in Guinea, Côte d'Ivoire, and Sierra Leone, who are running out of food and out of hope.

The U.S. has a special relationship with Liberia, created in 1847 to settle "repatriated" freed American slaves, ensuring close political, economic, and cultural ties between the two countries. As a result, Liberians are looking to the United States to help their country out of its deepening crisis and to assist the victims of the current turmoil. They have been severely disappointed.

After a rebel incursion in late December, two U.S. military personnel were sent to accompany government forces, while soldiers from Doe's Krahn tribe were killing Mano and Gio civilians living in Nimba county, the area where the rebel incursion was launched. The administration argued that the military advisers were there not to provide advice on counter-insurgency tactics, but to minimize abuses by the army.

It is difficult to imagine how two

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advisers could restrain the behavior of an army that had already killed hundreds of civilians. A more compelling motive may have been the desire to verify reports of Libyan involvement with the rebels. Their presence gave the Liberian government the pretext to suggest, without any foundation, that it was making an effort to rein in the military. The advisers were withdrawn after protests by human rights groups.

The State Department's failure to take decisive measures has only prolonged the tragedy in Liberia. It encouraged Doe to stay in office until the bitter end, while his soldiers went on the rampage in Monrovia. By June, rebel forces had gathered enormous strength, largely in reaction to army atrocities and years of pent-up frustration with Doe throughout Liberia. By the time he died, rebel forces had inflicted the same kinds of abuses against members of Doe's tribe as the Doe forces had committed against Gios and Manos.

Today, Krahns are threatened with genocide by victorious rebel troops. Yet at no point did the Bush administration publicly call on Doe to resign, which would have eased Liberia's agony, adopting instead a disastrous "watch and wait" policy as Liberia disintegrated.

The administration's policy has taken a strange turn since President Doe's death. Herman Cohen recently made the startling observation that rebel leaders Charles Taylor and Prince Johnson are democratically inclined. The remark was made in the context of Cohen's effort to achieve a ceasefire—in itself a laudable aim.

But the effect of the statement is to associate the United States with rebel leaders whose forces continue to commit atrocities. Prince Johnson himself executed a civilian relief worker in Monrovia in full view of the international press. This unseemly rush to label brutal rebel leaders as "democratic" is reminiscent of the Reagan administration's embrace of Doe in the early 1980s.

Nor has the U.S. responded generously to the victims of the conflict. There are more than 500,000 refugees in the Côte d'Ivoire, Sierra Leone, and Guinea, and humanitarian assistance has been insufficient. The U.S. announced in late September that it was increasing assistance for the refugees; current levels are said to total approximately $48 million, which is a welcome development. But it falls far short of the need.

The administration's response to the needs of Liberian refugees in the U.S. has been inadequate. Currently, it is almost impossible for Liberian refugees in West Africa to enter the U.S., even if they have close family ties there. Human rights groups and Congress have called upon the State Department to increase the number of refugee slots for Liberians, as was done two years ago for Soviet Jews, and upon the Immigration and Naturalization Service to instruct U.S. embassies abroad that applications for non-immigrant travel visas by Liberian refugees should be favorably reviewed.

On the positive side, the INS announced a program of safe haven for Liberians. However, the program limited the beneficiaries to those who arrived before late July, and only extended protection for six months. Given the continuing level of violence, safe haven should be granted to *all* Liberians in the U.S. until they can return home without fear of violence.

The roots of the administration's failure in Liberia lie in the Reagan years when money was poured into Liberia, and the State Department, for the most part, avoided public criticism of flagrant abuses. The embassy under Ambassador William Swing was appreciated in Liberia for its efforts to influence the government to respect human rights and for reaching out to the opposition. But an embassy cannot override the broader policy decided in Washington.

The Doe regime received $500 million between 1980-85. Congress insisted on a dramatic reduction in aid after Doe used fraud and strong-arm tactics to win the election and after widespread killings and other abuses followed an abortive coup. Unfortunately, this was not accompanied by public condemnation by the executive branch which certified the election as valid.

After Congress prohibited further military assistance in 1985, the U.S. nevertheless maintained military personnel in Monrovia to attend to its interests in the country: the Omega navigation station, a CIA listening post, and the Voice of America's largest transmitting facility in Africa. The failure of the Reagan and Bush administrations to promote human rights in Liberia is particularly unfortunate because there are few countries where the U.S. has comparable influence.

The Case of Kenya

Across the continent, in Kenya, the administration faced a deteriorating human rights situation in mid-1990, but did not take advantage of its leverage to press for significant reforms. Long-standing political and strategic links make Kenya one of America's closest allies; by 1990 it was the largest recipient of foreign aid in sub-Saharan Africa.

The Bush administration requested a total of $53 million for fiscal year 1991, including $8 million in foreign military financing, $1.175 million in military training, and $7 million in economic support funds. Since 1980, a facilities access agreement has allowed the U.S. access to naval facilities in Kenya; it has also been an important base for the rapid deployment force in the Indian Ocean. Kenya's strategic significance has increased in light of the Gulf crisis.

Suppression of political opposition predates the succession to power of President Daniel arap Moi in 1978. However, in the last 12 years, and particularly since an abortive coup in 1982, repression has become more systematic. Power has become increasingly concentrated in the hands of the president and a few close advisers, most of them from his own Kalenjin ethnic group.

The power of Kanu, the only legal party, has made Parliament irrelevant and stifled public debate.

Amendments to the constitution have eroded the independence of the judiciary and the civil service. Executive intervention in the internal affairs of the Law Society typifies the government's efforts to destroy all aspects of an independent civil society, including the churches, academic institutions, the trade union movement, the national women's movement, and special interest lobby groups.

The mysterious murder of Foreign Minister Robert Ouko in February, widely believed in Kenya to implicate senior government officials, and calls for the restoration of a multi-party system following the changes in Eastern Europe, led to anti-government riots. The authorities responded by detaining and harassing churchmen, human rights lawyers, former politicians, and scores of ordinary citizens.

In July, pro-democracy demonstrations called attention to a wide range of grievances. The government itself has acknowledged the deaths of 20 people when police and paramilitary forces fired into crowds and bystanders. The casualty figure is thought to be at least 100. Kenya's leading proponents of multi-party democracy, politicians Charles Rubia and Kenneth Matiba, were jailed, along with dozens of their supporters. The most prominent human rights lawyers were either detained or forced into hiding or exile.

Surprisingly, the U.S. ambassador to Kenya, Smith Hempstone, a former editor of the ultra-conservative *Washington Times*, adopted a policy of outspoken identification with the goal of multi-party democracy. In May, Ambassador Hempstone stated publicly that Washington preferred to give foreign assistance to nations which "nourish democratic institutions, defend human rights, and practice multi-party politics." In July, the embassy gave refuge to Gibson Kamau Kuria, a lawyer critical of government policies and prominent in the defense of politically unpopular clients.

Hempstone's public statements were sharply criticized by President Moi and other senior officials. Herman Cohen visited Nairobi in late July to repair the damage to U.S.-Kenyan relations. He did so primarily by distancing himself from the views of his ambassador. Cohen pointedly refused to meet with the country's leading advocates of democracy, except for a few less prominent individuals who were invited to an embassy function, along with government officials.

Worst of all, Cohen distanced the United States from the aspirations of Kenyans calling for a multi-party democracy. In addition to questioning the universality of the democratic ideal, he told the press that "the people of Kenya, under the leadership of President Moi, are now in the process of making some important decisions about their own political future," an extraordinary remark in a country where a large number of citizens had just been killed or detained for participating in the debate about the political future of their country.

The significance of Cohen's visit cannot be overstated, coming as it did on the heels of brutal measures to contain pro-democracy protests. Finding the balance between vocal and quiet diplomacy is not an easy task. But Cohen's conduct was so extreme that there were serious doubts in Kenya as to whether human rights concerns were raised with a sufficient degree of seriousness even in private discussions. The overall result was to identify the administration with precisely the prejudices that civilian movements for change and human rights in Africa are struggling to overcome.

The administration also attempted to provide an infusion of military aid to Kenya in the midst of the political crackdown. On July 5, one day after Moi's police swept critics into jail, the administration signed an agreement that would have allowed the Kenyan government to draw $5 million in military assistance. Congressional leaders responded angrily, demanding a suspension of foreign aid following the July crackdown, including the $5 million in military assistance which the administration had obligated but not expended. After weeks of bargaining with Congress, Cohen reluctantly agreed to suspend delivery of the military aid, but continued to press Congress to provide portions of non-military aid.

Events were to prove again that an ambassador, even one as outspoken as Hempstone, cannot outweigh a larger policy. On July 30, the ambassador participated in a public signing ceremony of a U.S.-Kenyan aid agreement which was reported as a "landmark in U.S. relations with Kenya." Hempstone noted that the aid agreement (which represented a change by providing $10 million of food aid in grant form instead of loans) "is not only the first time the U.S. has provided such a grant to Kenya, but is also the first time we have made such a commitment to any African country." This was precisely at a time when developments in Kenya highlighted the need for the most stringent conditions.

If present trends continue, President Moi's policies will have disastrous consequences for the future of Kenya. Experience elsewhere shows that when all other avenues for the expression of opposition are closed, an underground movement using violent tactics remains the only conceivable vehicle for the mobilization of public conscience toward the redress of grievances.

To avoid the prospects of bloodshed, pressure must come from major donors. Even judged by narrow self-interest, the failure to issue strong public warnings by close allies is self-defeating. The result will be further upheavals, plunging a country with tremendous potential and an unstable region into further uncertainty.

The administration has lost an important opportunity to advance the pursuit of human rights in Kenya. The current turmoil in Liberia is a lesson about the dangers of supporting the illusion of "stability" at the cost of repression. The administration has yet to show that it has learned that lesson with regard to Kenya.

WORLD ROUND-UP

SUDAN:

AS FAMINE LOOMS, HUNGER CHAIRMAN CALLS FOR COOPERATION

With worsening conditions in the Sudan, experts fear that the current famine could be as disastrous as the one that devastated the country in 1984 and 1985. Chairman Tony P. Hall and a bipartisan group of Select Committee members recently sent letters to both Sudanese President Bashir and rebel leader John Garang asking for their cooperation in famine relief efforts.

A nationwide food crisis in the Sudan threatens the lives of at least eight million people. While Bashir refuses to acknowledge the existence of famine in Sudan, there are reports of the government bombing relief distribution sites, grounding relief flights, and obstructing movement of relief food. Recent reports reveal that government forces forcibly moved thousands of refugees from a camp near Khartoum to a desolate desert location without access to food or water.

Cooperation by the government and rebel forces is essential to avert massive starvation. Private voluntary organizations have been reluctant to operate in Sudan, given the government's attitude. In testimony before a Foreign Affairs Subcommittee on Africa hearing on the situation in Sudan, Hall asserted, "We must not give up on the Sudan, many lives depend on it."

Two other Select Committee members, ranking Republican Rep. Bill Emerson (R-MO), and Rep. **Frank Wolf** (R-VA) testified before the subcommittee. All three signed the letters to Bashir and Garang, as did **Rep. Byron L. Dorgan** (D-ND), Chairman of the Hunger Committee's International Task Force, and **Rep. Bob Smith** (R-OR), Task Force Ranking Republican.

LIBERIA:

DESPITE DIRE CIRCUMSTANCES, FOOD SHIPMENTS ARRIVE IN MONROVIA

Chaos reigns in Liberia as rebel armies struggle for control. As many as 50 to 60 people reportedly die every day from starvation and malnutrition, according to disaster relief workers in Monrovia. There is almost a complete breakdown of social order as a result of a ten-month civil war between the remains of former President Samuel Doe's army, the West African peacekeeping force ECOMOG, which arrived in August, and other warring rebel factions. Because of the intense conflict, commercial vessels had been unable to enter the port of Monrovia and relief workers were forced to evacuate the city for their own safety.

Despite these dire circumstances, the first major shipment of food to reach Monrovia in months arrived on October 25. The food was desperately needed because the mortality rate continues to increase dramatically as a result of starvation and disease. In a briefing with Select Committee Chairman Hall, U.S. AID officials estimated that the lives of 220,000 people in Monrovia are threatened.

However, the basic structure for relief remains in place. According to the AID officials, once a cease-fire is arranged, relief to the at-risk population can begin to move quickly.

ETHIOPIA

CRUCIAL ROUTE HOLDS PROMISE -- U.S. OFFICIALS EXPRESS FRUSTRATION

U.S. Government officials have met with Ethiopian government and rebel forces in a renewed effort to secure a peace agreement in that nation's nearly thirty-year civil war. Fighting between government forces and the Eritrean People's Liberation Front has thwarted efforts to deliver food aid to between 3 and 6 million drought and famine victims. Relief into the northern province of Eritrea currently must be delivered across the border from Sudan, or by caravan from the south. Both routes are expensive. The shortest route for relief, through the Red Sea port of Massawa, is the most promising.

(WORLD ROUND-UP, page 4)

THE SUN NOVEMBER 9, 1990

Opinion • Commentary

Rome.

Helping Africa

By Jonathan Power

THE AIRLINES — those telltale barometers of middle class well-being — loudly complain that the rise in the price of oil is ruining their balance sheets and plunging them into the red.

But where's the splash about the implications for Africa if the recent oil-price rises are compounded by another doubling or tripling when and if the fighting starts in the Gulf? The 12 African countries presently suffering from serious food shortages spent over $1 billion on oil in 1989 — 11 percent of their total import bill. This figure could easily double this year.

Inopportunely, this new tipping of the scales of fortune arrives just when some things had started to go right for Africa. With the awful exceptions of Ethiopia and the Sudan, plentiful rain has now fallen on most of Africa's drought-inflicted countries. Chad, until recently a perpetual desert war zone, is now exporting food to Sudan!

Here in Rome, the United Nations' "food capital," Idrisa Jazairy, president of the International Fund for Agricultural Development, throws up his hands, brings them down again like a knife and with the angry voice of exasperation contemplates the implications of the oil price rise for Africa. "It's been drought, then war and, now again for the third time in a generation, oil prices."

The last seven years Mr. Jazairy has fashioned his organization into a sharp tool for helping the poorest farmers in the Third World. Unlike many U.N. bodies, the International Fund for Agricultural Development is a streamlined business with a small staff working long hours under intense pressure. Yet, argues Mr Jazairy, with the earnest frustration of a thoughtful man who sees his life's work being undone, "with the best will in the world we cannot protect these people against another almighty squeeze on their livelihood."

His fund came into being on the political rebound from the first price hike in 1974. It was the joint progeny of the OPEC countries and the West, an attempt to take care of those most hurt. It was, and still is, unique among international agencies, in concentrating its attention on the small rural farmer and the need for each peasant family to be self-sufficient in food.

In Pakistan it helped fund the "motorbike bank" that takes its loan officers away from the big oak door, the brass rail and the teller's desk with its telephones, and puts them on two wheels and sends them into the remoter regions to offer financial credit and agricultural advice to distant villagers, who don't even know the word for bank.

In Bangladesh it has supported the Grameen bank which gives $100 loans to help men, but mainly women, buy a cow, a rickshaw, a potter's or blacksmith's tools, the equipment to process betel, mustard and spices or for paddy husking, working bamboo, making brooms and weaving cloth — something with which they can begin to make money. In a dozen years it has radically changed the lives of 300,000 people at the bottom of the pile in Bangladesh. Ninety-nine percent of the loans have been repaid.

In Africa it is been the principal funder of the attempt to control a dangerous pest, the mealy bug. Six years ago this tiny insect was winging its way across Africa at the astonishing rate of nearly 500 miles a year, eating and destroying cassava, the root vegetable that is the staple crop for 200 million people.

By means of an inventive system of biological control — using a natural enemy, a wasp, imported from Brazil, that feeds on the mealy bug — the pest has been stopped in its tracks.

Elsewhere in Africa the fund has helped farmers in Burundi grow rice on irrigated land, initiated soil conservation and afforestation on the eroded hill tops of Rwanda, reorganized the agricultural institutions of Sierra Leone, distributed high-quality seeds in Liberia and helped create national research and extension institutions in Zimbabwe.

Over the years I've seen many of these projects with my own eyes. They work. They work well.

For all this success the OPEC countries' contributions to the fund have been decreasing by the year. And if OPEC can't be bothered, why should the Western contributors, is the comment made in Washington, London and Bonn.

The oil producers have given the excuse that oil prices were going down and they had less to spare. They can't talk like this anymore — unless they want to prove the truth of Saddam Hussein's jibes against spoiled rich kings, princes and emirs.

Here in Rome is an organization, of which the oil producers are a major shareholder, that knows how to soften the effects of the tumultuous events of the last three months. They must wake up before this time it really is too late for Africa.

NEW YORK TIMES, November 4, 1990

U.S. Cuts Aid to Zaire, Setting Off a Policy Debate

By CLIFFORD KRAUSS

Special to The New York Times

WASHINGTON, Nov. 3 — Resisting persistent lobbying by the Bush Administration, Congress has cut all military and economic aid to President Mobutu Sese Seko of Zaire, a longtime United States ally in Africa.

As it adjourned last weekend, Congress denied the Administration's request for $4 million in military aid and stipulated that $40 million in economic aid be funneled through humanitarian agencies not affiliated with the Zairian Government. Its decision was based on human rights violations and accusations that Mr. Mobutu's vast wealth was largely stolen.

The Congressional action and the Administration's attempts to control the inevitable damage in American-Zairian relations illustrates a classic foreign-policy problem: What kind of relationship should Washington have with dictators who arguably work to promote American interests? Can friendly dictatorships best be reformed through quiet diplomacy or overt pressure?

Many American conservatives have charged that the ouster of dictators like Anastasio Somoza Debayle of Nicaragua and Ferdinand E. Marcos of the Philippines with Washington's tacit approval ultimately failed to pacify those countries and damaged American strategic interests.

Liberals, however, have countered that such dictators are unworthy allies. They say that American support for dictators inevitably associates Washington with repression and encourages anti-American feelings.

The potential importance of Zaire further complicates the problem. Zaire is as large as the United States east of the Mississippi River and has major untapped reserves of copper, cobalt and uranium. The country has nearly half of Africa's remaining rain forests, as well more than half of the world's hydroelectric potential.

While the Congressional action denying arms aid to Zaire has received little attention outside Washington, it caused great concern in the State Department.

Mr. Mobutu has received hundreds of millions of dollars from the United States since he took power in 1965. But allegations of a massacre of at least 12 students at the University of Lubumbashi in April and reports that he has a fortune estimated at $2.5 billion tipped the scales against him in Congress.

"What jeopardizes the prospects of regional stability is the existence of a cleptocracy in Zaire that has driven the standard of living lower than it was at the time of independence three decades ago," said Representative Stephen J. Solarz, Democrat of Brooklyn.

State Department officials concede that Zaire has a tarnished human rights record, but they worry the opposition in the Central African country will use the aid cutoff as a propaganda tool to undercut what they consider Mr. Mobutu's cautious reform efforts. They say that Mr. Mobutu's lifting of a ban against opposition parties and the appearance of independent newspapers this year should be taken seriously. They say these steps are, in part, the product of Washington's diplomacy.

"Mobutu must be wondering why he's receiving more negative signals than ever before when he's trying to embrace democratization, no matter how flawed and limited that may be," a ranking State Department official said.

Representative Howard Wolpe, Democrat of Michigan and chairman of the House subcommittee on Africa, disputes the notion that improvements can ever come out of the Mobutu Government. "Every six months, we are told Mobutu has seen the light," he said. "Invariably, those announcements are followed by a new wave of arrests, repression and corruption."

State Department officials also argue that Mr. Mobutu has worked to calm tribal tensions in his country and has performed diplomatic and military services. He was the first black African leader to recognize Israel after the 1967 war. He sent troops to Chad to counter a Libyan invasion. He served as a mediator to bring the Angolan Government and guerrillas to the peace table. Last month, he sent troops to bolster the Government of Rwanda against a guerrilla insurgency.

"Mobutu slips into these roles naturally because he's the senior guy in the region," said a State Department official troubled by the aid cutoff. "Other heads of state see him as the big chief."

Liberian Refugees: The Gulf's Other Victims

By Hiram A. Ruiz

THE generosity that a number of countries around the world have shown to the more than 500,000 people uprooted by the Gulf crisis – many of them Asians who had been working in Kuwait and Iraq – has been heartening. Although the suddenness of the crisis caught the international community off guard, the refugees' situation has improved. While those who are still trapped in Kuwait and Iraq remain in a precarious situation, at least much world concern and attention is being focused on them.

There has been no such generous response, concern, or attention for the victims of the brutal civil war in Liberia. Their plight, overshadowed by events in the Gulf, is tragic, and demands urgent action.

There have been difficulties in getting aid to the victims of the Gulf crisis. Many were stranded in the middle of the desert, and no clear international system existed for aiding people in their situation. However, through the combined efforts – and political will – of governments, international organizations, and private relief groups worldwide, high-profile media coverage, and quite substantial amounts of money, the international community is finding ways to respond to their needs.

Difficulties also exist in aiding the civilians affected by the Liberian crisis. If the international community could spare some of its goodwill, creativity, and funds for them too, their suffering could also be alleviated.

At greatest risk in the Liberia are the 100,000 to 150,000 civilians, mostly women and small children and those too old or sick to flee, who are trapped in Monrovia, the besieged capital. Without water for five months, and food for two months, they are slowly starving. Hundreds of thousands of other Liberians have fled to the relative safety of refugee camps in neighboring countries. But they too are short of food, because the international community has been unwilling to respond adequately to their need.

Besides the US contribution, the international community has pledged $200 million to aid the Gulf's uprooted. Yet a United Nations appeal for just $12 million to assist nearly half a million Liberian refugees in Guinea, Ivory Coast, and Sierra Leone has yielded only $4.3 million from nations other than the US.

Even more aid than that already requested is likely to be needed. Assistant Secretary of State for African Affairs Herman J. Cohen, who has just been in Liberia and met with both main rebel leaders, said that the prospects for increased warfare are growing. Another US official who also recently returned from Monrovia described the situation there as the worst he's witnessed in 20 years of relief work. Desperate for water, people literally drink from the sewers. Cholera and other diseases are rampant. Children who are still strong enough fight over scraps of food.

When night falls, armed hooligans, many of them soldiers belonging to what is left of the army of the late president, Samuel Doe, rape, pillage, and murder at will. Virtually all aid workers, including those of the International Committee of the Red Cross (ICRC), the one agency that is often able to assist civilians trapped in war zones, have had to leave because their safety could not be guaranteed.

Protecting and assisting both those in Monrovia and the refugees who have fled to neighboring countries is clearly not an easy matter. There is no internationally agreed-on system for responding to people caught in such situations. The ICRC is experienced in civil conflict and prepared to help, but is unable to go into Monrovia because the warring parties refuse to guarantee ICRC personnel's safety.

A group of West African nations sent a small military force to attempt to restore some order in Monrovia. But not only does it appear not to have the experience or capacity to achieve that goal, the force now seems to be actively participating in the conflict. Clearly, restoring order and protecting the civilians in Monrovia would require a far larger, broader-based effort, such as a UN peace-keeping force.

Getting adequate aid to Liberian refugees in neighboring countries has also been difficult. They settled in regions that are difficult to reach (particularly in Guinea, where the majority have gone); there was no already-established relief network to respond to the emergency; and their plight has generated little international humanitarian response.

Liberians are not sitting atop large oil reserves. The only "hostages" involved in the Liberian crisis have been other West Africans who had been working in Liberia. And, because of Liberia's historical links with the US, Liberia is viewed by many in the international donor community as something of an American dependency. But the "Liberian problem" is not just an "American problem."

■ *Hiram A. Ruiz is a policy analyst at the US Committee for Refugees.*

STRAINS WITH AN OLD ALLY

BY ROCHELLE L. STANFIELD

The once warm U.S.-Pakistani relationship is rapidly cooling because "the United States just doesn't need Pakistan any more." That view—expressed by a Washington-based specialist on Pakistan—is widely held around the capital these days.

"In the last six months, absolutely everything has changed in the relationship," the specialist continued. "The relationship is clearly at a crossroads."

Pakistan received $550 million in U.S. foreign aid for fiscal 1990, the largest allocation after Israel and Egypt. But no one protested vehemently when Congress, for the first time in more than a decade, declined to earmark aid to Pakistan in the fiscal 1991 foreign aid appropriation that was adopted late last month shortly before adjournment.

Whatever funds the State Department allots out of the unearmarked foreign aid pot are unlikely to get to Pakistan anyway because of legal restrictions in separate antinuclear proliferation legislation. To provide aid to Pakistan, the President must certify that Pakistan doesn't have nuclear weapons and that U.S. assistance would discourage Pakistan from developing them. Even though Pakistan has vigorously pursued its nuclear weapons development program for many years, Administrations for the past 10 years have gone to considerable lengths to make those certifications.

Not anymore.

"The United States and Pakistan have had a very artificial relationship, which has not made for friendship," Selig S. Harrison, a senior associate at the Carnegie Endowment for International Peace who specializes in the Asian subcontinent, said in an interview. "We have been providing military assistance to them for reasons of our own, and therefore we've had repeated misunderstandings."

American reasons for assisting Pakistan had much to do with the Cold War. India was friendly with the Soviet Union, and so the United States befriended India's archenemy. More important, Pakistan's location made it a natural ally. That geographic importance intensified in 1979, after the Soviet Union invaded Afghanistan, which borders Pakistan. Much of the rebellion against the Soviet-backed Afghan government of Najibullah has been directed from Pakistan, and covert U.S. aid to the Afghan rebels has been funneled through Pakistan.

There were other, more secret, security reasons. "The basic objective was to use Pakistan as an intelligence base for monitoring missile tests and Soviet antisatellite launches from northern Pakistan," Harrison said. "That's really been the main reason—much more important than Afghanistan or proximity to the Gulf or the other factors usually mentioned."

The end of the Cold War not only reduced Pakistan's strategic importance, it contributed to a shift in the political dynamics of the U.S.-Pakistani relationship. Pakistani politics was also important.

Traditionally, Pakistan's most ardent supporters in Congress were hard-line anti-Communists, such as Rep. Charles Wilson, D-Texas, and Sen. Robert W. Kasten Jr., R-Wis. This was partly because of the Cold War and Afghanistan. It was also because of an affinity for the late Pakistani president, Gen. Mohammed Zia ul-Haq.

In 1988, Zia died in an airplane crash—a bomb has long been suspected as the cause of the crash—and Benazir Bhutto, the daughter of the late president Zulifkan Ali Bhutto, who was ordered hanged by Zia, came to power. Pakistan's old friends in Congress continued to support foreign aid for the country, but their personal zeal diminished somewhat, in part because Bhutto was cooler to them.

Congressional liberals switched to support her and her efforts to implement democracy, however. Bhutto's dismissal in August angered these new friends. Her catastrophic loss in the Oct. 24 national elections further soured the relationship with congressional liberals.

The new government returns power to Zia's Islamic Democratic Alliance. But it's not the same to Zia's old friends in Congress and elsewhere in Washington. The Appropriations Committees in both chambers "were not pushed to earmark Pakistan by anybody," a congressional aide said. "If they had [pushed for an earmark], they would have met with resistance from the Democrats, many of whom felt that what was going on with Ms. Bhutto was unfair."

In addition, public opinion in Pakistan, particularly during the election campaign, has grown stridently anti-American. There have been reports that American support for Bhutto backfired and helped defeat her.

The crisis in the Persian Gulf adds another dimension to the tortured U.S.-Pakistan relationship. Pakistan has sent ground troops to Saudi Arabia to show solidarity with the anti-Iraq coalition. But the crisis has dramatized the urgency of strong nuclear nonproliferation efforts, in the view of many Members of Congress and security analysts, because Iraq is believed to be close to possessing nuclear weapons.

Therefore, both the Administration and Congress are unlikely to wink at Pakistan's nuclear weapons program because that could set a precedent for other countries, such as Iraq.

The cooling of U.S. relations with Pakistan and the withdrawal of the Soviet Union from many of its overseas commitments open new opportunities for the United States in the region, Asia specialists say. "We can begin to move to a more natural policy, which is to pay more attention to India," Harrison said. "It is eight times larger, a much more important country with military reach all over the Indian Ocean and the Persian Gulf."■

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Eastern Europe — Divided It Fails

By Jan Urban

The euphoria in Central and Eastern Europe that has followed the overthrow of Communism may well be replaced by disillusionment and a search for easy solutions. Again we hear voices — mostly in Czechoslovakia, Hungary, Rumania, Yugoslavia — proclaiming that nationalities are more important than state borders. We hear it in parliaments and in government.

Even today, in a region where nearly a dozen nationalities are crammed together in a relatively small area, this can have dangerous consequences. Democracy in Eastern Europe can lose unless it can prove economically and and politically more profitable than dictatorship.

Central and Eastern Europe have arrived at an extremely difficult and risky moment — a period when much depends upon the political wisdom of Western democratic countries.

Recently, rising oil prices have emphasized the poor survival potential of Eastern and Central Europe's long centrally managed economies. The countries' economic isolation along with their inability to produce saleable goods was only underscored by the collapse of Comecon, the Communists' trade organization.

Jan Urban, a former dissident, is an editorial writer for Lidove Noviny, a Prague daily.

For this reason, Western governments should quickly prepare and institutionalize a common strategy for helping democratize and develop the whole post-Communist area.

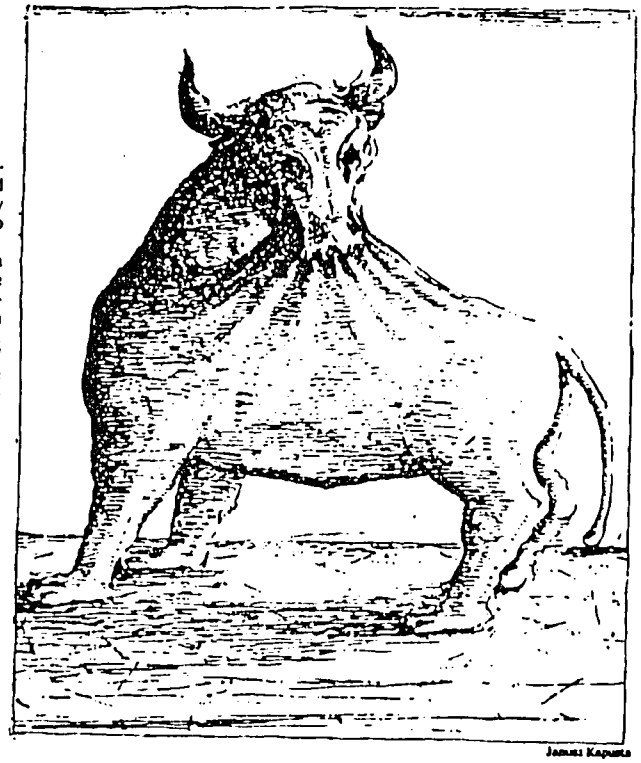
First, the strategy should approach the region's needs as those of a single unit and treat them as a single systemic problem through the promotion of supranational economic systems. This would help avoid the growth of political nationalism, which must be shown to harm the economic interests of all, and of political tensions in today's period of economic insufficiency.

Congress has committed $370 million for Eastern and Central Europe for the coming year. While in Prague last weekend, President Bush pledged to ask Congress to use $60 million of that to help embryonic businesses in Czechoslovakia. That money should be spent regionally.

Second, the region should be helped to help itself. Before asking for economic aid from abroad, Central and Eastern European countries must prove to themselves and the rest of the world that they are able to mobilize all of their domestic resources as well as the resources that can be organized regionally.

Help should not be given to individual governments. The U.S. has known since the 1970's that a well-tested technique for losing money while solving nothing is to pump financial aid into governments of centrally managed, bureaucratized economies.

Instead, concrete regional development projects should be financed through international banking institutions like the European Bank for Development and Reconstruction, with priorities set for the development of infrastructure and education.



James Kapusta

Central Europe and Eastern Europe possess nearly all the basic conditions for economic growth and prosperity: raw materials, short distances for transportation, energy, arable land and a relatively skilled and educated pool of manpower. What it needs is capital for revitalization, general technical know-how and a comprehensive blueprint. These lacks can be remedied.

The West can politically convince Central and Eastern Europe of the need for, and profitability of, regional cooperation — even in conditions of economic recession and even without available capital — by helping to build civil service and democratic political institutions, by providing know-how and by training experts in a whole spectrum of fields.

Of course, there is another possible and unfortunately more probable scenario. The West can continue selectively supporting individual countries. But by doing so, it will only increase their mutual isolation and the envy others feel. If this happens, we might witness the collapse of national economies and a free-for-all sellout to private foreign capital (principally German), along with the survival of nationalist environments and nondemocratic behavior.

The experience of the Marshall Plan speaks to a joint collective strategy and speedy action. The stakes are high. The West is gambling on the democratic or nondemocratic future of that part of Europe where, in this century, two world wars began. □

LOS ANGELES TIMES, December 3, 1990

PERSPECTIVE ON THE SOVIET UNION

Europe Braces for Hungry Hordes

We must be a prompt and generous partner in the attempt to prevent mass migration on a scale unseen since WWII.

By ROBERT E. HUNTER

BRUSSELS—As winter approaches, fears of invasion are reemerging in Western Europe. This time, the specter is not of Soviet shock troops advancing across the North German plain, but of hordes of civilians fleeing what could become the worst famine in the Soviet Union since the 1930s.

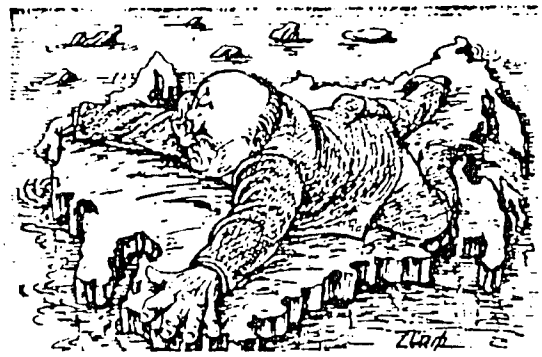
The prospect of Soviet refugees flooding westward is the inevitable result of the breakdown of order and the economy. The discipline fostered by reasonable certainty about the future is vanishing. Republics within the Soviet empire are engaging in self-serving practices that are producing the penalties of decentralization without the benefits. Communist *apparatchiks*, whose jobs are threatened by change, are engaging in sabotage. And the erosion of the system for distributing goods is presenting the irony of want in a year of bumper crops.

Within the next several months, therefore, millions of Soviet citizens, already cast adrift in their own country, are likely to press on the borders of neighboring countries, in many cases aided and abetted by Soviet authorities. Top Moscow officials are talking about the "export" next year of between 2 million and 7 million people. In response, Finland, the Western country with the longest border with the Soviet Union, is seeking ways to contain an extraordinary onslaught of migrants. The stimulus to migrate toward the promised land of the European Community will be compounded for Germany if, as expected, significant numbers of Soviet soldiers in former East Germany refuse repatriation.

Even West European countries buffered by Eastern neighbors from a direct flow of Soviet refugees cannot escape migration pressures from a similar human crisis in Central and Eastern Europe. There, the bloom is off the rose of revolution, as 1989's euphoria has been replaced by the rigors of building pluralistic societies and market economies. In January, East European states will receive another economic blow, when they will be required to pay hard currency for Soviet oil—and at prices inflated by the Persian Gulf crisis.

Western Europe is thus facing the prospect of the most massive refugee influx since the 1940s. Yet simply closing borders would create a moral dilemma after years of Western efforts to tear down Cold War barriers. And the thought of forcing Soviet soldiers to go home recalls memories of American and British repatriation of Soviet soldiers to Josef Stalin's slave camps in 1945.

In response to this unprecedented challenge, the European Community has decided to pursue the most humane and efficient remedy: to try providing incentives for people to stay at home. In Eastern Europe, the EC has taken the lead in beginning to provide the slow—but so far deficient—supply of capital, training and ideas needed to reform economies. The EC also has agreed to provide an extra $1 billion in aid to the Soviet Union, and Germany—most concerned about the Soviet future—has begun a major dispatch of food. Even so, these contributions will be inadequate in the face of the enormous requirements of feeding the Soviet people. It is also not clear how effective European food will be in reaching those who need it most, when so much Soviet-grown food is already going to waste.



ZLATOVSKY / Krokodil, Moscow

As much politics as human concern is involved in European efforts. Since the collapse of Soviet power in Central Europe, the West's basic strategy has been to avoid the historic mistake of 1919, when the victors of World War I exacted reparations from defeated Germany and paved the way for Adolf Hitler.

But this political strategy of forestalling Soviet isolation and revanchism will be more effective if it is backed up by genuine expressions of concern for the plight of the Soviet people—an attitude that can be recalled years hence when a successor state assumes a major role in Europe.

Unfortunately, West European wisdom and humanity are unmatched by the United States. Just as the Bush Administration is playing a secondary role in the reconstruction of Eastern Europe—a detachment that could prove to be a major strategic folly—it is absent from efforts to help the Soviet Union weather the prospect of famine. This country's preoccupation with the federal budget and the Persian Gulf have inhibited American generosity and diverted the government's attention from events in the Soviet Union and Eastern Europe that have no rival today for historic importance.

In 1921-23, Herbert Hoover led a $60-million U.S. famine relief program in Russia that reflected America's moral sense; Franklin Roosevelt's Lend-Lease program in World War II reflected strategic sense. President Bush must recognize today's moral and strategic interests by making good now his vague promises of future food assistance.

Robert E. Hunter is vice president for regional programs and director of European studies at the Center for Strategic and International Studies in Washington.

NEW YORK TIMES, December 9, 1990

IN THE NATION | Tom Wicker

Bush Ventures South

Those few *norteamericanos* who think about Latin America at all know that its nations have not been made safe for democracy by the collapse of the Soviet empire, by the two recent U.S. interventions in Nicaragua and Panama, or by the regional trend to free elections and free-market economies.

On his trip to five of those nations, President Bush made more headlines by his remarks on the Middle East than for anything concrete he offered or achieved. Still, if he had his eyes and ears open, he's bound to have come back to Washington with a heightened appreciation of Latin problems.

The most recent report of the Inter-American Dialogue, a high-level hemispheric forum, makes clear that the most pressing of these problems are economic. Since 1982, a debt-driven regional depression has cut per capita income in Latin America by more than 10 percent — 25 percent in Peru and Argentina.

Aggregate foreign debt is $410 billion, nearly $100 billion more than in 1982, and requires a net annual outflow in interest and principal payments of about $25 billion — or more than 20 percent of Latin American exports. Inflation and hyperinflation cripple the region. Infrastructure and industrial plant have deteriorated from lack of investment. Unemployment is up and wages are down, both drastically; housing, medical care and education have suffered in every country; crime is rampant in some.

He can help relieve Latin poverty.

In these circumstances, it's not surprising that 180 million Latins, 50 million more than in 1982, are living in poverty; that's two of every five people in the region. Only in Chile and Colombia have living standards risen — though not by much — in the last decade.

What can Mr. Bush do about any of this, with the U.S. also in an economic bind that's getting worse? The investment capital that Latin America needs is not readily available here; but Treasury Secretary Brady's debt-relief plan could be more flexible and the U.S. could write off some of its loans to Latin nations. Mr. Bush also might persuade U.S. banks to forgive some Latin debt, and he could influence multilateral lending agencies to be more lenient in debt rescheduling.

Most important, the President could work for — not just talk about — freer trade conditions in the U.S. and elsewhere, to open markets for Latin exports. That's doubly needed now, with recession in the U.S. likely to shrink imports.

One reason for Mr. Bush to take such steps is economic — a more prosperous Latin America would provide badly needed markets for U.S. exports, thus helping to cut the trade deficit. Other reasons, as detailed in the Inter-American Dialogue report, are political and important to the hemisphere.

Sharp income disparities and endemic poverty, for one thing, are not conducive to political stability; the Shining Path in Peru and other insurgencies feed on economic inequity and depression. But free markets are not as immediately effective in reducing poverty as are, say, food subsidies, transfer payments, or public-sector jobs. If restive populations force governments too heavily into such programs, inflation and restricted economic growth would result — making things worse economically, and probably causing the downfall of democratic governments not yet deeply rooted in Latin society.

Governments that stick to market economies and longer-term investments in health, education, and infrastructure are no doubt on the better road to higher living standards; but they will not quickly relieve Latin poverty. Even at a 5 percent growth rate — unrealistic in most cases — the Dialogue report estimates that "30 years or more would be needed to lift the poorest 20 percent of Latin Americans out of poverty." The slow pace of such reform also could bring popular reaction against democratic government and market economies.

The end of the cold war, however, casts a new light on Latin American affairs. Washington's exaggerated fear of Soviet penetration in the region, which brought so much grief to Chile, Guatemala, El Salvador and Nicaragua, is a dead letter; and Fidel Castro's problem in Cuba is no longer to spread revolution but to survive. Without cold war worries, moreover, the U.S. can more freely join with Latin America in coping with problems — drugs, crime, immigration, trade and environment — important to both.

Thus, the U.S. has a needed new chance to help build hemispheric stability, cooperation and economic growth, in its own as well as the Latin interest; and Mr. Bush's trip may be a better omen than his misguided intervention in Panama.

WASHINGTON POST, December 22, 1990

R. M. Koster

Panama: A Year Wasted

Both the United States and the government it installed in Panama have bungled the chance for a new beginning for that country, which was paid for in blood last December.

To begin with, instead of disbanding Manuel Noriega's army, the United States and Panama agreed to reconstitute it as the country's police. This was meant to save the time that would have been needed to train a new force, to lighten the political cost of the invasion by getting U.S. troops home quickly and above all to avoid facing the difficult problem of what otherwise to do with 16,000 goons that a Florida grand jury was ready to indict en masse as "a continuing criminal enterprise" and that are no more fit to defend democracy than Count Dracula is fit to guard a blood bank.

Like most decisions made in moral cowardice, this one was wrong. The recent rising by police elements and the need to deploy U.S. troops to put it down (since no trustworthy Panamanian units existed) are clear proof of this. Civilian rule in Panama still depends on U.S. troops to defend it from the army we beat last December. Far from having our forces freed, we must keep them on in Panama indefinitely at risk to themselves, to U.S. popularity and to the national interest should they be needed elsewhere, say, in the Mideast.

Meanwhile, the government of President Guillermo Endara has shown no eagerness to provide a fresh start for a country that is exhausted and bankrupted by tyranny, economic sanctions and invasion. For most of the dictatorship, the political classes did well. Few in office share the ordinary Panamanian's desperation at what happened to the country and his rage at those responsible.

The dictatorship's constitution is still in effect. It establishes the armed forces as a branch of government, co-equal to the executive, and gives legal sanction to military ambitions. The government evidently is happy with it, just as it has been happy to pamper people such as Capt. Fritz Gibson, who in December of 1979, directed and starred in the savage public beating given law professor Miguel Bernal for the "crime" of protesting Panama's grant of asylum to the shah of Iran. Thousands of Panamanians are still homeless because of the invasion, but Gibson lives in what was once the Canal Zone in one of the duplexes ceded by the United States as a result of the 1978 canal treaty. He enjoys a rich pension, as if the nation were grateful for his services.

The dictatorship's laws are still on the books, including a libel law under whose provisions a person can be jailed for five years on a simple accusation. Its mere existence violates the right to freedom of speech. President Endara has invoked it to dissuade criticism.

Some of Endara's closest advisers enjoyed influence during the dictatorship. The chief prosecutor was private secretary to puppet President Ricardo de la Espriella, who as head of the National Finance Council in the '70s and '80s made possible some of the worst thefts. The ministry of justice is stocked with holdovers from the dictatorship, including Gilberto G. Cazorla, who in 1984 had a printer jailed for producing opposition election materials, a perfectly legal activity, then jailed the printer's sons for good measure and who still defends these actions on the grounds that they were ordered by a colonel.

As may be imagined, these people have set no records in dispensing justice. A few of the old regime's worst criminals are in jail, but none has been tried, and plunderers go about in ostentation, a constant affront to decent citizens.

Some unsavory old-regime practices continue also. The United States, which turned a blind eye for years to Noriega's drug dealing, is pressing Panama, and conditioning $84 million in aid on it, for a treaty that would allow U.S. officials access to local banking records in order to end the laundering of drug money. Panama argues, with much reason, that ending banking confidentiality would destroy the country's finance center. On the other hand, while money laundering could be controlled internally, and while the banking community would welcome an end to it (since only a few of Panama's banks engage in it), the state banking commission has been lethargic in exercising its policing responsibilities.

Such lethargy is intolerable while ordinary Panamanians are suffering. Sanctions and invasion left the economy dead in the water. Some improvement has occurred, but unemployment is still near 20 percent. The government has made some useful efforts toward attracting investment but has failed to provide either leadership in the present emergency or hope for the future. The chief reason for this is that it is unwilling to break with the past.

Help and understanding from the United States are needed, but only Panamanians can solve the country's current problems. The dictatorship's constitution and laws must be scrapped. The dictatorship's criminals must be prosecuted and an effort made to recover stolen funds. The dictatorship's sympathizers must be purged from government. The dictatorship's soldiers must be replaced by a loyal and honest force of police.

Disappointing as the government has been, it is still a great improvement over what went before it. The trauma of two decades of tyranny could not, in any case, have been healed quickly. The pity is that a year has been largely wasted.

The writer is co-author of "In the Time of Tyrants," an account of military rule in Panama.

U.S. DEPARTMENT OF STATE

Office of the Assistant Secretary/Spokesman

For Immediate Release December 21, 1990

STATEMENT BY RICHARD BOUCHER/DEPUTY SPOKESMAN

GUATEMALA: STOPPING DELIVERIES OF MILITARY ASSISTANCE

THE UNITED STATES WISHES TO EXPRESS ITS DEEP DISAPPOINTMENT WITH THE LACK OF COMMITMENT OF THE GOVERNMENT OF GUATEMALA TO PROTECT HUMAN RIGHTS. THE RECENT SHOOTING OF CIVILIANS IN ATITLAN IS A VIVID ILLUSTRATION OF THE VIOLENCE WHICH CONTINUES TO PLAGUE THE COUNTRY. WHILE RECOGNIZING THAT THE GOVERNMENT DOES NOT PURSUE A POLICY OF ABUSING HUMAN RIGHTS, WE NOTE THAT IT RARELY TAKES ACTION TO THOROUGHLY INVESTIGATE AND PROSECUTE THOSE WHO DO.

FOR THE PAST SIX MONTHS, WE HAVE MET REGULARLY WITH PRESIDENT CEREZO AND MINISTER OF DEFENSE BOLANOS TO REQUEST THE IMMEDIATE DETENTION AND PROSECUTION OF THOSE WHO KILLED U.S. CITIZEN MICHAEL DEVINE ON JUNE 8, 1990.

WHILE SOME ACTION WAS TAKEN INITIALLY TO DETAIN SIX SUSPECTS, INCLUDING FIVE MILITARY MEN, UNFORTUNATELY THE CASE HAS NEITHER BEEN RESOLVED NOR MOVED AHEAD.

GIVEN THESE DEVELOPMENTS, REGRETTABLY, WE HAVE CONCLUDED THAT IT WOULD NOT BE APPROPRIATE TO CONTINUE A NORMAL MILITARY ASSISTANCE RELATIONSHIP WITH THE GOVERNMENT OF GUATEMALA AT THIS TIME. WE WILL THEREFORE IMMEDIATELY STOP DELIVERIES OF MILITARY ASSISTANCE.

IT IS OUR FIRM HOPE THAT THE NEW GUATEMALAN ADMINISTRATION WILL, AS SOON AS POSSIBLE, TAKE THE NECESSARY STEPS TO RESOLVE THE DEVINE CASE AND DEMONSTRATE ITS COMMITMENT TO THE RULE OF LAW AND HUMAN RIGHTS SO THAT WE MAY RESUME NORMAL MILITARY RELATIONS.

Boston Sunday Globe

Confronting Guatemala's state terror

BONNIE TENNERIELLO

Guatemala will hold its first post-Cold War elections today, but the scene is different from Prague or Berlin. While Czechs and Germans celebrate newfound freedoms, Guatemalans are still ruled by authoritarian practices. If the US wants to encourage progress toward real democracy under the next government, we must do what we failed to do under this one: confront the military over human rights abuse.

Hungry and illiterate villagers in the Indian highlands will mark the party symbol they favor on the ballot. Then, the men in these villages will pick up ancient M-1 rifles and return to unpaid work of scouting and spying for the army. In the city, a more literate crowd will choose from a slate of center-right candidates, none with a plan for reforming one of the most unequal land tenure systems in the hemisphere, or raising taxes from one of the least taxed private sectors in Latin America, or challenging the power of the army with the bloodiest record of all its neighbors.

Chances are that between today and the inauguration on January 13, another politician will be gunned down, as was Social Democrat Humberto Gonzalez Gamara last month. He was the fifth politician killed since July. Chances are that another campesino refusing to patrol for the army will be "disappeared," as was Sebastian Velasquez Mejia on October 6. He represented the Council of Ethnic Communities Runujel Junam, a group that tells peasants of their constitutional right not to patrol. He was the 11th group member killed or disappeared since the group's formation in 1988.

Political violence seems to be escalating among diverse sectors. Last month anthropologist Myrna Mack was stabbed to death as she left the Research Institute where she worked. On Oct. 26 Byron Barrera was shot in his car. His wife died in the attack. None of these crimes has been punished or even seriously investigated.

Guatemalan authorities argue that these crimes are committed by anti-system forces. If this is true, the state security forces would have an interest in solving them. But not one of the dozens of political killings has been resolved or punished. Even such prominent assassinations as Danilo Barrillas, a leader of President Cerezo's Christian Democratic Party, and Salvadoran Social Democrat Hector Oquelf remain mysteries.

It is clear why government forces have not found solutions – they are part of the problem. Cerezo has been either unwilling or unable to challenge the machinery of state terror by pursuing even a single case attributed to the military or police. Thus, today's elections take place with scant guarantees for political participation.

In the Indian highlands, villagers are too fearful to name the calamities that befell them under the military. The time when the army destroyed more than 400 towns and killed 70,000 people is known simply at "the violence." Similarly, presidential candidates speak of violence as a terrible problem which must be stopped, like inflation or unemployment, without mentioning the responsibility of the security forces.

In a welcome departure from the past, the US government has begun to acknowledge that a human rights problem exists. Ambassador Thomas Stroock has confronted the civilian Cerezo on human rights cases more aggressively than his predecessors in the Reagan administration confronted military dictators. Yet, like the highlands villagers, US officials speak only of an amorphous wave of terror. Surely the US can afford to name the problem more directly.

US policy toward the Guatemalan military has contradicted our human rights protests. Although military aid is now limited to a symbolic $2.28 million a year, we continue to send National Guard units to conduct civic action exercises alongside uniformed Guatemalan troops. Our drug enforcement programs work with Guatemalan military intelligence units, the same units notorious for orchestrating disappearances and torture.

PERRY A. REALO © INX

The US had never openly pushed for human rights prosecutions in the military until the recent killing of a prominent US citizen, Michael Devine, in which military involvement was evident. It is encouraging to see our embassy take a stand.

At the beginning of the Cerezo years, liberal members of the US Congress accepted arguments that pressure on the army would be counterproductive, that Cerezo needed to give the military something to prove his worth, that a new democratic leadership in the armed forces was working toward real reform. Military aid increased to $9 million a year. Two coup attempts and many killings later, the thesis of "constructive engagement" with the Guatemalan army has been shown a failure.

The next government is likely to request military aid and unlikely to voice criticism of the army's behavior. But the US must take a firm stand.

Direct aid to the military is now only symbolic, and it is true that our leverage is limited. The army is not as embattled or as dependent as its counterpart in El Salvador. When the US cut off military aid in 1977, the Guatemalans went it alone, and their policies gave rise to the expression "Guatemalan solution," which refers to openly repressive military tactics.

However, Guatemala faces tougher economic conditions. While it was able to purchase weapons from Israel and other countries in the mid-'70s, it may not be able to support its military budget if the US and other nations withdraw aid. Ultimately the foreign-currency support the US provides as the bulk of its aid may be the greatest leverage we possess. We may applaud one civilian handing over office to another for the first time in Guatemala's history. But we cannot celebrate democracy. If Vaclav Havel were Guatemalan, he would still be afraid for his life.

Bonnie Tenneriello is a staff member of the Washington Office on Latin America.

US to Close Out 1990 Refugee Resettlement on High Note

More refugees were resettled in the United States during fiscal year 1990 than in any previous year since 1981, according to statistics from the Department of State. More than 118,000 refugees, more than half of them from Indochina and the Soviet Union, came to the US during the past year. The vast majority of these refugees were resettled by private US voluntary agencies operating under cooperative agreements with the State Department's Bureau for Refugee Programs.

The increase over the previous year's refugee arrivals -- 107,000 arrived during fiscal year 1989 -- was due in part to successful political negotiations which allowed for large numbers of refugees to come directly from Vietnam and the Soviet Union. InterAction's Committee on Migration and Refugee Affairs played an instrumental role in lobbying the US government on behalf of these two groups.

"Once again, the voluntary agencies have clearly demonstrated the capacity and ability to resettle large numbers of refugees," said Robert DeVecchi, chairman of the Committee on Migration and Refugee Affairs and Executive Director of International Rescue Committee, one of the resettlement agencies. "The past year", he said, "proves yet again that the so-called 'compassion fatigue' does not exist within the American voluntary sector".

The single largest group of refugees that arrived during the year were Soviet Jews who continue to face persecution and harassment inside the Soviet Union, despite *glasnost* and *perestroika*. More than 40,000 Soviet Jews were resettled, many of them through the auspices of the Hebrew Immigrant Aid Society (HIAS). The willingness of Soviet authorities to allow emigration on such a large scale "is a signal of an exodus of Soviet Jews that may well reach more than 2 million, including those who depart for Israel", said Karl Zukerman, executive vice president of HIAS. Despite the pressures and costs involved in helping so many refugees adjust to a new life in the US, he said "it is the happiest kind of challenge we could ever hope to face".

Another special group of refugees are the Amerasians -- children fathered by American troops -- and their family members, who have been helped to leave Vietnam. More than 13,000 Amerasians arrived in the past year, many of them as a result of political negotiations that allowed them to leave directly from Vietnam via the Orderly Departure Program (ODP). According to Michael Kocher, Director of InterAction's Amerasian Resettlement Program," a lot of credit must go to the US Department of State, Bureau for Refugee Programs, and to officials from the ODP." Kocher expects another 15,000 would arrive in fiscal year 1991.

These individuals, once they arrive in the US, are assisted by voluntary agencies in designated "cluster sites" throughout the country. "These agencies do an excellent job, and are able to translate limited funding into comprehensive service delivery. There are a lot of dedicated people out there making the difference", said Kocher.

Federal funding and administration for the US refugee resettlement program is provided by the Department of State, Bureau for Refugee Programs, which provides overseas foreign assistance and regulates admissions levels, and the Department of Health and Human Services, Office of Refugee Resettlement, which provides support for refugees once they arrive.

Terry Rusch, Director of Refugee Admissions for the State Department, stated that "the regional admissions for this year came very close to reaching the levels we had hoped for. The program was able to meet the emerging needs of each region by shifting available numbers so that no previously approved numbers went unused". Rusch also said that for fiscal year 1991, "we hope to duplicate this effort, and facilitate the arrival of refugees over the course of the year in an even-keeled fashion so as to avoid last quarter surges and unused numbers".

Over the course of this past year, refugee arrivals by regions of the world broke down as follows:

Africa	3,445
Eastern Europe & Soviet Union	56,449
East Asia	51,596
Latin America/Caribbean	2,308
Near East/South Asia	4,933
Total	118,731

For fiscal year 1991, President Bush and the State Department have proposed to resettle 131,000 refugees, 10,000 of whom are privately funded cases. These numbers include:

Africa	4,900
Eastern Europe & Soviet Union	55,000
East Asia	52,000
Latin America/Caribbean	3,100
Near East/South Asia	6,000
Total	121,000

For further information on the US refugee program, contact Timothy McCully, InterAction's Program Officer for Refugee Affairs, at 212/777-8210.

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IMF ACTIVITIES

Managing Director's Address . . .

Experience of Other Countries Suggests That Reform Must Be Comprehensive and Bold

Following are excerpts from an address by IMF Managing Director Michel Camdessus to a Joint Session of Parliamentary Committees in Sofia, Bulgaria, on October 10:

We are very proud that Bulgaria has joined the IMF, making us an even more universal institution. Your country is at an important turning point in its history. The decisions that you are taking, and will take in the coming months, will shape the lives and future of the Bulgarian people. The economic system that you are now in the process of devising will not, by itself, create wealth and prosperity. But it will have the potential to establish a framework within which the Bulgarian people will be able to work, to innovate, to take risks, and in so doing create the possibility of a better life for themselves.

> *"The economic system that you are now in the process of devising will not, by itself, create wealth and prosperity."*

This is a stimulating prospect, as well as a daunting responsibility. It *must* surely be daunting, because of the complexity and magnitude of the task, and because your country also faces very severe immediate economic problems, including the disruption of its trading system, a severe oil shock, an upsurge of inflation, and a heavy external debt. This is really an exceptionally hard conjunction of adversities. The adjustments needed to correct the present internal and external imbalances will undoubtedly be major and difficult, and will require sacrifices in order to establish a sound basis for development of the economy. And, as always in such critical circumstances, the corrective measures will need to be implemented quickly, and with determination. Their successful implementation will require the unity of your people. No one should fail to take a full share in these efforts, and the international community should extend commensurate assistance.

Are these severe—but hopefully temporary—difficulties a reason to delay introducing the systemic reforms, or to be less determined in implementing them, in order to deal first with the short-term difficulties? Certainly not! Rather, it will be important to press forward simultaneously on both fronts. This is because the sooner you have a viable and functioning economic system in place, the sooner you will see the gradual emergence of a stronger Bulgarian economy.

I should remind you immediately that you are not alone! Not only in the sense that other countries in similar circumstances have started already on the road to a market economy; the lessons from their experience may be useful to you. But also in the sense that the eyes of the world are on you: you can expect the encouragement and assistance of other countries and international institutions, as the reform process unfolds.

Mr. Chairman, Bulgaria is joining an impressive set of countries, in Europe, Asia, and elsewhere, that are moving to a market-oriented system. Most of these countries, like you, have a difficult legacy of the past—economies that are relatively inefficient and unproductive and that allow only low living standards for their populations. In embarking on the path of systemic reform they are testing the various ways that economists and political leaders and thinkers have been debating. This has been—and still is—a period of intellectual ferment, and dramatic change. None of us should claim to have found all the answers. I would not pretend at this stage to have a blueprint of successful reforms to offer to Bulgaria, which faces starting conditions for the transition to a market economy that are exceptionally difficult. No: you will have to work out for yourselves—exercising your national sovereignty—how best to establish your own reformed economic system, in a way that will equip your economy to be integrated most productively with the world economy and benefit from increased exposure to world trade and competition. We can give you advice on all aspects of that—indeed it is our responsibility to do so, and to remind you of the rules of the game that govern the family of nations that make up the membership of the IMF. But the basic choice of system is yours.

The experience of other reforming countries may help you to make the best choices for Bulgaria. Let me touch briefly on five of the key features of their reforms.

Firstly, reforms should be as comprehensive as possible from the outset. This is important, because all the main elements of a market-oriented system have to be in place for it to work efficiently and equitably. Moving to market determination of prices is an essential step, of course: but the linkages between prices, wages, employment, production, foreign trade, and other parts of such a system are so close that it is desirable to introduce a considerable degree of freedom, and of decentralized decision-making power, with respect to each element. In addition, the need for comprehensiveness is shown, and I think conclusively, by the history books; they are littered with the sad tales of numerous failures of partial reforms.

Secondly, should reforms be implemented speedily, or slowly and carefully? There has been much debate about the merits of shock therapy versus gradualism. I do not think that debate has been very conclusive, beyond reinforcing our understanding that either approach, taken to excess, can be very harmful. An excessive shock therapy, based on a simplistic application of economic theories, would be dangerous. By contrast, an excessive degree of gradualism can be very costly to the country, and can

even threaten the success of the reform effort. This can be most vividly illustrated by the need to tackle the problem of inflation, whether open or repressed, at the outset, and decisively.

The optimal approach to reforms is both *bold* and *careful*. Bold, in the sense of moving with vigor and dispatch toward a market-oriented economy. Careful, in the sense that reforms are complemented by an appropriate provision of social safety nets, such as unemployment compensation, and measures to retrain workers and improve mobility.

Thirdly, one of the most frequently asked questions about reforms, even by those who are most convinced of the need for them, is how quickly will they produce results. It is a question that is difficult to answer in advance. As a general proposition, we may expect a reform package to take a long time to produce its full results. Some sectors will be particularly slow to respond. But in other sectors, agriculture, for example, a quick supply response may be forthcoming. The supply response may also be quicker, of course, with small-scale enterprises in the private sector, in agriculture, light industry, and services. This suggests that an effective optimal strategy is to introduce greater freedom for these sectors rapidly, and [to] let the farmers or other entrepreneurs exercise their talents and initiative. The resulting boost to production can be most beneficial: it can help dampen inflation; it can provide some early boost to the balance of payments; and it can help maintain public support for reforms, by showing concretely that they produce good results that help the living standards of the population.

IMF Managing Director Michel Camdeussus: Bulgaria "is at an important turning point in its history."

The importance of sustained public support for the reform process leads me to my fourth topic, which is the desirability of a high degree of transparency in policymaking. The IMF's experience in many member countries supports the general thesis that governments are more likely to succeed with their economic strategies if they marshal a popular consensus, in the following ways: by encouraging public participation in the analysis of the causes of the existing problems, in debating alternative solutions, and then in the implementation of appropriate strategies. Public support is more likely to be strong if there is widespread confidence that policies are applied uniformly and equitably: that there is an avoidance of hidden subsidies, for example, or special favored treatment for vested interests. The need for popular support and approval is especially necessary, I think, when the initial sacrifices are heavy and painful, and the full benefits of reforms in terms of improved living standards will only be reaped over an extended number of years.

The fifth and final feature that I wish to stress today is that the reforms will only succeed if they are introduced in an economic environment that is supportive. There is a domestic and an international aspect to this, and I shall touch on these separately.

Domestically, a reform package will produce its best results if it is introduced at a time when the authorities are maintaining strict financial discipline, both at the macroeconomic levels (through firm budgetary and monetary policies) and at the level of the enterprise. This is particularly true at the outset, when reforms are introduced, and there is the danger of an upsurge of inflation. Indeed, an initial corrective increase of some prices is probably inevitable—such as you have seen recently in Bulgaria. In these circumstances it is important to maintain financial discipline to prevent the initial price increases from triggering off a wage-price spiral that could escalate into hyperinflation. The recent example of Poland is an excellent illustration: after an initial sharp increase in prices in late 1989 and early 1990, the pace of inflation has been brought down substantially, through a consistent and steady application of careful budget, monetary, and wage policies. Inflation is now running at less than 2 percent a month, compared with 40 percent a year ago.

After the initial phase of reforms, steady application of sound macroeconomic policies continues to be important. The objective should be to establish and maintain a noninflationary environment in which the economic actors of the country will make the correct kinds of decisions—to save, to invest, to work, to consume—in ways that contribute to sustainable growth. In our experience, a strong central bank is an essential element in the creation of such an environment—especially through its decisions relating to interest rates, the exchange rate policy, debt management, and the prudential supervision of banking activities. [The] parliament and [the] Government have the responsibility to ensure that the central bank has sufficient independence to carry out these tasks and maintain price stability.

A supportive international environment is also essential if economic reforms are to produce their full results. This is true for several reasons. Most obviously, of course, a reforming country can expect to become more productive, and earn a higher quality of life for its population, if it is able to participate more actively in the international exchange of goods and services. But in addition to the gains from trade, it is possible that the discipline of a world price structure can be very useful as a means of curbing domestic inflationary pressures; but taking proper advantage of these international opportunities requires an open trade and payments system and smoothly functioning relations with commercial bank and official creditors. An early and fair agreement with creditors on your external debt will be essential.

One final word, with my deepest conviction. Maintaining a national consensus will be essential to your success: the orderly transition to a market economy is not just another program, it is a crucial moment in the history of your people. This is history. These changes cannot be imposed by anyone, they can only be achieved with the support of a very broad national consensus. I am certain that your parliament will be inspired by a longer-run vision of the country, and will bring about a major contribution to the consensus and these achievements.

I wish you, and the Bulgarians that you represent, all success.

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Robin Broad, John Cavanagh & Walden Bello

DEVELOPMENT: THE MARKET IS NOT ENOUGH

by Robin Broad, John Cavanagh & Walden Bello

As the 1990s begin, the development debate has all but disappeared in the West. Monumental changes in Eastern Europe and Latin America are widely interpreted as proof of the superiority of development models that are led by the private sector and oriented toward exports. Free-market capitalism is said to have prevailed because only it promises growth and democracy for the battered economies of Africa, Asia, and Latin America. World Bank President Barber Conable summed up this prevailing view in remarks made in February 1990: "If I were to characterize the past decade, the most remarkable thing was the generation of a global consensus that market forces and economic efficiency were the best way to achieve the kind of growth which is the best antidote to poverty."

Ample evidence exists, however, to suggest caution in the face of triumphalism. Warning signs are surfacing in South Korea and Taiwan, the miracle models of capitalist development. After decades of systematic exploitation, the South Korean labor force erupted in thousands of strikes during the late 1980s, undermining the very basis of that country's export success. Meanwhile, decades of uncontrolled industrial development have left large parts of Taiwan's landscape with poisoned soil and toxic water.

Additional evidence reveals extensive suffering throughout Africa, parts of Asia, and Latin America, where privatized adjustment has been practiced for more than a decade in a

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world economy of slower growth. As the United Nations Children's Fund noted in its 1990 annual report, "Over the course of the 1980s, average incomes have fallen by 10 per cent in most of Latin America and by over 20 per cent in sub-Saharan Africa. . . . In many urban areas, real minimum wages have declined by as much as 50 per cent." The World Bank estimates that as many as 950 million of the world's 5.2 billion people are "chronically malnourished"—more than twice as many hungry people as a decade ago.

In Latin America, people are talking about a lost decade, even a lost generation. In Rio de Janeiro, the lack of meaningful futures has given birth to a new sport: train surfing. Brazilian street children stand atop trains beside a 3,300 volt cable that sends trains hurtling at speeds of 120 kilometers per hour. During an 18-month period in 1987–88, train surfing in Rio produced some 200 deaths and 500 gruesome injuries. "It's a form of suicide," said the father of a *surfista* who was killed. "Brazilian youth is suffering so much, they see no reason to live."

This generalized failure of development in the 1980s is producing a very different kind of consensus among people the development establishment rarely contacts and whose voices are seldom heard. A new wave of democratic movements across Africa, Asia, and Latin America is demanding another kind of development. Through citizens' organizations millions of environmentalists, farmers, women, and workers are saying they want to define and control their own futures. They are beginning to lay the groundwork for a new type of development in the 1990s—one that emphasizes ecological sustainability, equity, and participation, in addition to raising material living standards.

The false impression that the free-market model has triumphed in development is rooted in three misconceptions about the past decade:

- that the newly industrializing countries (NICs) of East Asia were exceptions to the "lost decade" and continue to represent models of successful development;
- that socialist command economies in Eastern Europe or the developing world failed principally because they did not use market mechanisms;

- that the export-oriented structural adjustment reforms that were put in place in much of the developing world have laid the groundwork for sustained growth in the 1990s.

The NICs did achieve the fastest growth rates among developing countries over the last three decades. But as the Berlin Wall was dismantled, the costs of high-speed, export-oriented industrialization were beginning to catch up with South Korea and Taiwan. The foundations of these supposed miracles of capitalist development were cracking.

In South Korea centralized authoritarian development has created a virtual time bomb. From afar, South Korea's spectacular growth may seem to have justified so-called transitional costs like severe labor repression. But many South Korean workers feel differently. Taking advantage of a small democratic opening between 1987 and 1989, more than 7,200 labor disputes broke out, compared with only 1,026 from 1981 through 1986. No major industry was spared; over the 1987–88 period the number of unions increased two and a half times. In perhaps the best known confrontation, 14,000 policemen stormed the Hyundai shipyard in March 1989 to put down a 109-day strike.

The priority of many South Korean workers is not the maintenance of Korea's export competitiveness but rather acquiring what they regard as their overdue share of the fruits from three decades of growth. Indeed, the 45 per cent rise in average Korean wages over the last three years constitutes a central factor behind the erosion of Korea's export competitiveness. As export growth falls, the country is likely to experience its first trade deficit in years in 1990.

A new type of development will emphasize ecological sustainability, equity, and participation, in addition to raising material living standards.

While a resentful labor movement threatens South Korea's traditional growth model by demanding greater equity and participation, a powerful environmental movement in Taiwan is

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challenging the island's fragile social consensus on export-oriented growth. This decentralized multi-class movement comprises consumers, farmers, influential intellectuals, residents of polluted areas, and workers. Although less-publicized than Eastern Europe's environmental devastation, Taiwan's is also severe and results from the same technocratic assumption that "some" environmental damage is the necessary price of economic growth. As it turned out, "some" damage included at least 20 per cent of the country's farmland, now polluted by industrial waste. Dumping of industrial and human waste (only 1 per cent of the latter receives even primary treatment) has been unregulated. Uncontrolled air pollution has also contributed to a quadrupling of asthma cases among Taiwanese children in the last decade.

A growing awareness of these environmental realities has led some Taiwanese to fight back. Citizen actions have halted work on a Dupont chemical plant, shut down an Imperial Chemical Industries petrochemical factory, stopped expansion of the naphtha cracker industry, and prevented construction of a fourth nuclear power plant on the island, thus thwarting the government's plan to build 20 nuclear plants by the end of the century. Large segments of the populations of Korea and Taiwan now reject the path to growth long touted as a model for the Third World. According to one 1985 survey, 59 per cent of Taiwanese favor environmental protection over economic growth.

These points do not mean that South Korea and Taiwan are about to become basket cases. Nor does the argument deny that they experienced periods of economic growth greater than that of most other developing countries. Instead, the evidence demonstrates that both countries can no longer practice a growth strategy based on repression of workers and abuse of the environment. It is now clear that each would have been better off trading some economic growth for more democracy and more ecological sensitivity from the start. Korea and Taiwan hardly serve as exemplary models for development.

While the cracks in the NIC model of development have been largely ignored in the West, the failure of socialism as an agent of development has been overplayed. There is no disputing this

model's collapse; one cannot argue with the millions who have taken to the streets across Eastern Europe. Yet an overlay of the NICs experience with that of Eastern Europe suggests a less facile explanation for the failure of socialism than blaming it solely on the suppression of market mechanisms.

During the 1960s in Eastern Europe, the government-led "command" economies achieved growth rates higher than those of the capitalist world, according to a 1984 United Nations Conference on Trade and Development report, while building the infrastructure for further industrial advance. Only the Japanese, who seem less blinded by free-market ideology and more appreciative of the role of a centralized state, have reconciled the two models in a more insightful lesson. As an editorial in the *Japan Times* argued in December 1989:

> Communism has never been a complete failure, nor has capitalism been a complete success. If there are any lessons to be gleaned from the events of 1989, they do not point to a total victory or defeat for either system. . . . Command economies have the power to jump-start large scale industrialization, but they are unable to maximize efficiency. Such countries expand economically by making huge investments in productive capacity, but they cannot produce efficiently enough to compete with those of the Western industrialized world.

The authoritarian regime in South Korea also achieved spectacular growth rates by practicing command economics. This fact flies in the face of conventional development dogma. Government incentives, subsidies, and coercion fueled the drive for heavy industry in such areas as iron and steel that market forces would have rendered uncompetitive in the early stages. These sectors then built up the infrastructure South Korea needed to become a world-class exporter of such higher value-added goods as cars and VCRs.

South Korea's technocrats enlarged the application of market principles in the early 1980s, whereas the East European economies failed to do so. The South Korean economy's resumption of growth after a brief period of stagnation at the onset of the 1980s and Eastern Europe's slowdown after rapid growth in the 1960s confirm a more complex truth than that purveyed by free-market ideologues: Command economies may

propel societies through the first stages of development, but further growth into a more sophisticated economy necessitates a greater role for market mechanisms.

At the same time, there should be no illusions about the adverse consequences of market mechanisms on equity. Both China and Vietnam, for example, have increased agricultural output by freeing market forces. Yet both countries have experienced growing inequalities. While some farmers are getting richer, some consumers are going hungry in the face of rising food prices. Post-1978 economic reforms in China have increased income inequalities in both urban and rural areas.

Other lessons emerge from Eastern Europe and the socialist developing world. While some of these countries did perform redistributive reforms, providing significant health and education services, they, like the NICs, have failed in the realms of ecological sustainability and political participation. Indeed, proponents of the free market fail to address a common demand coming from the citizens of China, Eastern Europe, South Korea, and Taiwan: Free markets are not a panacea; the average citizen must participate in decision making that affects his or her life.

Most developing countries, however, fall neither into the category of the NICs nor into the socialist world. For the development establishment, the lesson drawn from the experience of the NICs and the socialist countries is that developing countries' only hope rests with exporting their way to NIC status through the purgatory of structural adjustment. Dozens of countries across Africa, Asia, and Latin America have been force-fed this harsh prescription.

Supervised by the World Bank and the International Monetary Fund (IMF), these adjustment packages mandate severely cutting government spending to balance budgets, eliminating trade barriers and social subsidies, encouraging exports, tightening money policies, devaluing currencies, and dismantling nationalist barriers to foreign investment.

Part of the West's sense of triumph flows from a feeling that a worldwide consensus has developed about the necessity of these reforms. But many Western development authorities ignore that this "consensus" has been pushed on

developing-country governments with a heavy hand. After borrowing sprees in the 1970s most developing countries ran into debt-servicing difficulties in the 1980s. Creditor banks, using the World Bank and IMF as enforcers, conditioned debt rescheduling on acceptance of export-oriented structural adjustment packages. In fact, many least-developed countries (LDCs) faced serious external constraints on export opportunities—from growing protectionism in developed-country markets to increased substitution for raw-material exports.[1]

The Failures of Structural Adjustment

The strategy urged on the LDCs suffers from other shortcomings as well. Structural adjustment in practice has damaged environments, worsened structural inequities, failed even in the very narrow goal of pulling economies forward, and bypassed popular participation. Now many of the democratic movements expanding across the globe are rejecting the profoundly undemocratic approach of structural adjustment.

Ecological sustainability has been undermined in country after country. In their frenzy to export, countries often resort to the easiest short-term approach: unsustainable exploitation of natural resources. The stories of ecological disasters lurking behind export successes have become common: Timber exporting has denuded mountains, causing soil erosion and drying critical watersheds. Cash crop exports have depended on polluting pesticides and fertilizers. Large fishing boats have destroyed the coral reefs in which fish breed and live. Tailings from mines have polluted rivers and bays.

One example is the production of prawns in the Philippines. Prawns were one of the fastest growing Philippine exports during the 1980s and are heavily promoted throughout Asia by some U.N. and other development agencies. By 1988, Philippine prawn exports had reached $250 million, ranking them fifth among the country's exports. The government's Department of Trade and Industry is seeking to boost that figure to $1 billion by 1993.

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[1] *See Robin Broad and John Cavanagh, "No More NICs,"* FOREIGN POLICY, *72 (Fall 1988), 81–104.*

Prawn farming requires a careful mixture of fresh and salt water in coastal ponds. Vast quantities of fresh water are pumped into the ponds and mixed with salt water drawn from the sea. But some rice farmers in the Philippines' biggest prawn area fear that as salt water seeps into their nearby lands, their crop yields will fall as they have in Taiwan. Other farmers complain that not enough fresh water remains for their crops. In one town in the heart of prawn country, the water supply has already dropped 30 per cent: Potable water is being rationed. Like many cash crops, prawns do little to increase equity. Invariably, they make the rich richer and the poor poorer, weakening the prospect for mass participation in development. In one typical Philippine province, the substantial initial investment of approximately $50,000 per hectare limited potential prawn-pond owners to the wealthiest 30 or 40 families, including the province's vice governor, the ex-governor, and several mayors. Moreover, as the wealthy renovated old milkfish ponds into high-tech prawn ponds, the supply of milkfish, a staple of the poor, fell and its price rose.

Structural adjustment hurts the poor in other ways, too. As government spending is reduced, social programs are decimated. One May 1989 World Bank working paper concluded that a byproduct of the "sharply deteriorating social indicators" that accompany contractionary adjustment packages is that "people below the poverty line will probably suffer irreparable damage in health, nutrition, and education." Another World Bank working paper, published in September 1989, on Costa Rica, El Salvador, and Haiti suggested that the concentration of land in the hands of a few, along with population growth, was a major cause of environmental degradation. Skewed land distribution, it argued, pushed marginalized peasants onto fragile ecosystems. However, as the report noted, the adjustment programs in these countries failed to address distributional issues, focusing instead on correcting "distorted prices." In this regard, Taiwan and South Korea offer historical precedents: Their economic success rested on an initial redistribution of the land. Although some recent agricultural policies have been biased against the peasantry, extensive land reforms in the 1950s

helped create the internal market that sustained the early stages of industrialization.

The failures of structural adjustment in the areas of environment and equity might appear less serious if the adjustment packages were scoring economic successes. They are not. The first World Bank structural adjustment loans were given to Kenya, the Philippines, and Turkey a decade ago; none can be rated a success story today. A new U.N. Economic Commission for Africa study has highlighted the World Bank's own findings that after structural adjustment programs, 15 African countries were worse off in a number of economic categories.[2]

None of these examples is meant to deny that developing countries need substantial reforms, that some governments consistently overspend, or that markets have an important role to play. Rather, the lesson of the 1980s teaches that there are no shortcuts to development. Development strategies will not succeed and endure unless they incorporate ecological sustainability, equity, and participation, as well as effectiveness in raising material living standards.

Countries focusing on any of these principles to the exclusion of others will probably fall short in the long run, if they have not already. The World Bank and the IMF, either by ignoring these first three principles in their structural adjustment reforms or, at best, by treating them as afterthoughts, have adjusted economies to the short-term benefit of narrow elite interests. Their fixation on high gross national product growth rates ensures that the costs in terms of people and resources will mount and overwhelm an economy at a later date, much as they have in South Korea and Taiwan.

People Power

While governmental approaches to development are failing across Africa, Asia, and Latin America, development initiatives are flourishing among citizens' organizations. Indeed, a natural relationship exists between the two levels. The failure of governments in development has given birth to many citizens' initiatives.

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[2]*For another view regarding Africa, see Stephen Brent, "Aiding Africa,"* FOREIGN POLICY *80 (Fall 1990), 121–140.*

Popular organizations are taking on ecological destruction, inequitable control over resources and land, and governments' inability to advance the quality of life. And often the people are struggling in the face of government and military repression. Many citizens' groups are pushing for a central role in development—a concept they do not measure solely in terms of economic growth. At the core of almost all these movements lies an emphasis on participation of members in initiating and implementing plans, and in exercising control over their own lives. Hence, democracy becomes the central theme.

In the Philippines some 5 million people participate in citizens' groups. Alan Durning of the Worldwatch Institute estimated in the Fall 1989 issue of *Foreign Policy* that across the developing world more than 100 million people belong to hundreds of thousands of these organizations. Official development organizations have difficulty taking these groups seriously and to date act as though they have little bearing on national development strategies. Our research suggests the opposite: The programs and experience of these grassroots groups will form the basis for new development strategies of the 1990s.

During the past decade, many of the most vibrant organizations have been born in battles over the destruction of natural resources. The Philippines clearly illustrates this phenomenon as various citizens' groups raise ecological issues as a key measure of sustainable development. By some estimates, the destruction of forests and other natural resources in the Philippines has been among the most rapid in the world. The Philippines loses more than 140,000 hectares of forest a year, leaving only 22 per cent of the country covered with trees—versus the 54 per cent estimated as necessary for a stable ecosystem in that country.

But out of the Philippines' devastation dozens of environmental groups have sprung up, with farming and fishing communities at their core. The largest and most influential is *Haribon* (from the Filipino words "king of birds," a reference to the endangered Philippine eagle). *Haribon* matured in a battle to save Palawan, an island that contains the country's most extensive tropical rain forests. A local citizens' group evolved into a *Haribon* chapter and took on the wealthy logger

whose forest concessions control 61 per cent of Palawan's productive forests. Among other strategies, *Haribon* launched a nationwide campaign to gather a million signatures to save Palawan's forest. In 1989 *Haribon* also joined with other Philippine organizations (more than 500 by April 1990) to launch a "Green Forum" that is defining what equitable and sustainable development would involve at both the project and national levels.

By the end of the 1980s, thousands of organizations across the developing world were campaigning against timber companies, unsustainable agriculture, industrial pollution, nuclear power plants, and the giant projects that many governments equate with development. In 1989, 60,000 tribal people, landless laborers, and peasants gathered in a small town in India to protest a series of dams in the Narmada Valley to which the World Bank has committed $450 million. On the other side of the world, Brazilian Indians from 40 tribal nations gathered that year to oppose construction of several hydroelectric dams planned for the Xingu River. Soon thereafter, Indians, rubber tappers, nut gatherers, and river people formed the Alliance of the Peoples of the Forest to save the Amazon.

In struggles over the control of resources, many also have ended up challenging powerful entrenched interests and inequitable structures. It is in this context that the president of *Haribon*, Maximo Kalaw, summed up the struggle over Philippine forest resources: "In the past fifteen years we have had only 470 logging concessionaires who own all the resources of the forests. The process created poverty for 17 million people around the forest areas."

In addition to ecology and equity, people's organizations have acted on the inability of governments to meet the most basic human needs and rights outlined in the U.N.'s International Covenant on Economic, Social and Cultural Rights: the rights to "adequate food, clothing and housing." All over the world, informal economic institutions have sprung up to fill the economic void left by cuts in government spending. Development analysts Sheldon Annis and Peter Hakim have filled a book, *Direct to the Poor* (1988), with examples of successful worker-owned businesses, transportation collectives,

peasant leagues, micro-enterprise credit associations, and other citizen initiatives across Latin America. Africa specialist Fantu Cheru, in his 1989 book *The Silent Revolution in Africa*, refers to such groups in Africa as participants in a "silent revolution."

Will this decade see coalitions of citizens' organizations drawing on mass participation create governments with sustainable development agendas in Brazil, the Philippines, South Africa, and elsewhere—much as they ushered new governments into Eastern Europe in 1989? Even where citizens' coalitions do not take over the reins of state power, will these new, innovative groups be able to build links to segments of bureaucracies and even militaries that express openness to the sustainable development agenda?

Our research has uncovered positive signs in many countries. But a caveat is important: In order to gauge the success of these initiatives one must shift away from exclusive interest in aggregate growth figures toward the more meaningful indicators of ecological sustainability, participation, equity, and quality of life for the poorer majority.

Beyond the sheer number of citizen initiatives that advance these indicators, a further measure of success revolves around the ability of local groups to form countrywide associations that address national issues. Over the past half decade in the Philippines, for example, a coalition of dozens of peasant organizations representing 1.5 million members has gathered tens of thousands of signatures for a comprehensive and technically feasible national "People's Agrarian Reform Code." The code could become the centerpiece of a national development strategy in this predominantly agrarian country that suffers from an awful land-tenure situation. The Philippine land distribution problem is also seen in the loophole- and scandal-ridden 1988 land-reform bill passed by President Corazon Aquino's Congress. According to land-reform expert Roy Prosterman, it is "likely to redistribute barely 1 per cent of the Philippines' cultivated land." By contrast, the peasant groups' code would cover all lands, abolish rampant absentee landownership, and offer support services to peasants acquiring land.

As the peasant supporters of the People's Agrarian Reform Code lobby Congress for passage of their code, they are simultaneously taking steps to implement portions of the desperately needed reform on their own. A 1989 report documented 14 representative cases around the country: actions by thousands of poor families to occupy 800 hectares of idle or abandoned lands, the seizure of idle fishponds, boycott of rent payments on land, spread of organic farming techniques, revival of traditional rice varieties, and the reforestation of mangroves in coastal areas. In other African, Asian, and Latin American countries, coalitions of peasants, workers, women, and small entrepreneurs are banding together to craft policy alternatives.

Ultimately, the greatest successes in sustainable development will come when citizen groups seat their representatives in government. Governments that are more representative can help transform sustainable development initiatives into reality. Such governments can help build up an economic infrastructure and an internal market, create a network of social services, and set rules for a country's integration into the world economy. These three tenets do not represent another universal model to replace those of free marketeers, Marxist-Leninists, or the World Bank; the past four decades are littered with the failures of universal models. However, the outlines of a more positive government role in development can be sketched using the principles of ecological sustainability, equity, participation, and effectiveness.

Even popular governments cannot provide the answer to the wide array of development problems.

South Korea and Taiwan offer positive lessons for the ideal governmental role in the economy. The main lesson is not that the government should be taken out of the economy. Instead, the NICs' experiences suggest that success depends on governments standing above vested interests to help create the social and political infrastructure for economic growth. Indeed, though it may sound paradoxical, one needs an effective government to create the market.

The problem in many developing countries is not too much government, but a government that is too tangled in the web of narrow interest groups. The Philippine government, for example, serves as the private preserve of special economic interests. In South Korea, on the other hand, the weakness of the landed and business elite allowed the government to set the direction for development in the 1960s and 1970s. Without an assertive government that often acted against the wishes of international agencies and big business, South Korea would never have gained the foundation of heavy and high-technology industries that enabled it to become a world-class exporter of high value-added commodities.

Placing governments above the control of economic interest groups presents no easy task in countries where a small number of powerful families control much of the land and resources. To increase the chances of success, strong citizens' groups must put their representatives in government, continue to closely monitor government actions, and press for redistributive reforms that weaken the power of special interests.

While independent governments can help push economies through the early stages of development, progress to more mature economies seems to require more market mechanisms to achieve effective production and distribution. For market mechanisms to work, however, there must first be a market. And for the majority of the developing world, creating a market with consumers possessing effective demand requires eliminating the severe inequalities that depress the purchasing power of workers and peasants. The "how to" list necessitates such steps as land reform, progressive taxation, and advancement of workers' rights.

Pragmatism is also essential for the integration of developing countries into the world economy. The choice facing these countries should not be viewed as an ideological one between import substitution and export-oriented growth, neither of which alone has generated sustainable development. Basing development on exports that prove to be ecologically damaging not only ignores sustainability, it fails to ask the more fundamental question of whom development should benefit. But building an export base on top of a strong internal market does make sense.

In this scheme, foreign exchange receipts would shift from primary commodities to processed commodities, manufactures, and environmentally sensitive tourism. China, India, South Korea, and Taiwan all based their early industrial development on slowly raising the real incomes of their domestic populations. Each opened up to varying degrees to the world market and to foreign capital only after substantial domestic markets had been developed and nurtured.

Concerted citizen action can bring about more participatory, equitable, and ecologically sustainable development. At least one historical precedent can be cited, albeit on a subnational level: the postwar experience of Kerala, traditionally one of India's poorest states. With a population of 27 million, Kerala has more people than most developing countries. A long history of large movements by people of the lower castes culminated in the election of progressive state governments beginning in 1957. Constant pressure by India's most active agricultural labor unions and other peasant organizations forced these governments to abolish tenancy in what was one of the most sweeping agrarian reforms in South and Southeast Asia and place a high priority on health and literacy. In periods when conservative governments were voted into power in Kerala, the nongovernmental citizens' organizations remained strong enough to win reforms and ensure enforcement of existing laws. Today, despite income levels below the Indian average, Kerala boasts the highest life expectancy and literacy rates among Indian states, as well as the lowest infant mortality and birth rates.

Kerala also highlights an important caveat: New, more accountable governments should not be seen as a panacea. Even popular governments cannot provide the answer to the wide array of development problems. No matter who wields state power, strong independent citizens' groups will continue to be central to sustainable development. Perhaps South Korea and Taiwan would be more successful societies if they had combined their early land reforms and thoughtful state intervention with a prolonged commitment to ecology, equity, and participation.

Democratic participation in the formulation and implementation of development plans forms the central factor in determining their medium-

and long-term viability. This, however, is a controversial premise. Indeed, such a pronounced emphasis on democracy flies in the face of political scientist Samuel Huntington's claim in the 1960s that order must precede democracy in the early stages of development. Many still believe authoritarian governments in Eastern Europe, South Korea, and Taiwan served as the catalysts for industrialization that in turn created the conditions for advancing democracy.

Experiences of the last two decades suggest otherwise. Africa, home to dozens of one-party authoritarian states, remains a development disaster. Argentina, Brazil, the Philippines, and other Asian and Latin American countries ruled by authoritarian governments have suffered similar fates. As political scientist Atul Kohli has documented, the economies of the relatively democratic regimes in Costa Rica, India, Malaysia, Sri Lanka, and Venezuela have "grown at moderate but steady rates" since the 1960s and income inequalities have "either remained stable or even narrowed."

Moreover, in South Korea and Taiwan, authoritarian characteristics of the government were not responsible for industrialization and growth. Far-reaching land reforms and each state's ability to rise above factions in civil society deserve credit for sparking growth. The only "positive" growth impact of repression by these governments was to hold down wage levels, thereby making exports more competitive. Yet heavy dependence on exports no longer serves as an option in today's increasingly protectionist global markets. The percentage of imports into the major developed countries that were affected by nontariff barriers to trade rose more than 20 per cent during the 1980s, a trend that is likely to continue. In this hostile global economic climate, respect for workers' rights can lead to the creation of local markets by increasing domestic buying power. Democratic development therefore implies shifting emphasis from foreign to domestic (or, for small countries, to regional) markets. This shift meets more needs of local people and takes into account the difficult world market of the 1980s and 1990s.

The portrait painted at the outset—of a global development crisis masked by triumphant Western development orthodoxy—was a decidedly

gloomy one. Why then should citizens' movements pushing for more equitable, sustainable, and participatory development stand a chance in the 1990s? Much of the answer lies in the extraordinary possibilities of the current historical moment.

Development After the Cold War

For four decades, the Cold War has steered almost all development discussions toward ideological arguments over capitalism versus communism, market versus planning. It has also diverted public attention away from nonideological global concerns (such as environment, health, and economic decay) and toward the Soviet Union as the source of problems. Hence, the dramatic winding down of the Cold War opens great opportunities for development.

At the very minimum, real debate should now become possible, getting beyond sharply drawn ideological categories in order to discuss development in more pragmatic terms. What are the proper roles of government and market? If one values both effectiveness and equity, what kind of checks should be placed on the market? What do the experiences of Japan, South Korea, and Taiwan offer to this discussion?

The 1990s provide other opportunities to cut across Cold War polarities. Paranoid Cold War governments often saw communists lurking behind popular organizations fighting for a better society. But citizens' movements played a central role in the recent transformation of Eastern Europe. A greater openness should emerge from this phenomenon. Not only should governments and development experts treat such nongovernmental organizations with the respect they deserve, but they should realize that these groups have vital roles to play beyond the reach of governments and individuals.

Beyond the Cold War, global economic shifts also offer new possibilities for the sustainable development agenda. While much attention has been focused on the relative decline of the United States, this shift offers potentially positive openings. A decade of unprecedented U.S. military spending, for example, has bequeathed fiscal deficits that preclude significant increases in foreign aid. This situation adds impetus to proposals that the United States give less but better aid.

That can be accomplished by slashing military aid that in areas like Latin America has often been used to suppress citizens' movements, and by redirecting development assistance away from unaccountable governments and toward citizens' organizations.

Likewise, persistent trade deficits are pushing the U.S. government to restrict imports that enter the domestic market with the assistance of unfair trade practices. The United States could assist developing-country movements for equity and workers' rights by implementing existing legislation that classifies systematic repression of worker rights as an unfair trading practice. Finally, the failure of the Baker and Brady plans to halt the pile up of debt should reopen the door for substantial debt plans that shift payments toward sustainable development initiatives.

Japan's displacement of the United States as the world's most dynamic large economy and biggest aid-giver provides perhaps more intriguing questions about development efforts in the next decade. Japan stands at a juncture fraught with both danger and opportunity. It can take the easy road and mimic what the United States did: ally with local elites and subordinate development policy to security policy. Or Japan can practice enlightened leadership by divorcing the two policies and opening up the possibility for a qualitative change in North-South ties. Will Japan seize the opportunities? During the Marshall Plan years, the United States bestowed substantial decision-making power on the recipient governments. Can Japan, using that experience as a starting point, broaden the decision-making group to include nongovernmental organizations? In fact, voices within Japan are calling for the Japanese government to redirect its aid flows to include citizens' organizations. As a January 1990 editorial in the *Asahi Evening News* commented:

> It is a task for Japan in the 1990's to provide aid for welfare and growth purposes according to the needs of the receiving countries as well as increase the total amount. It is also necessary to invite the participation of the people in the receiving countries so that its benefits will not be taken up exclusively by a particular group of leaders and bureaucrats.

The question also remains whether Japan will follow the U.S. example of using the World Bank and IMF as extensions of its aid, commercial, and trade policies, further eroding the credibility of these institutions in the Third World. Perhaps Japan's ascension will encourage these institutions to delve more objectively into the development lessons of Japan, South Korea, and Taiwan, thus adding realism to their prescriptions.

Finally, both Japan and the United States will have to face the need to respect the emerging citizens' movements as the groups reach out internationally to work with one another. The realization that governments suffer from severe limits in the development field should not be seen as negative. Rather, this understanding opens a variety of possibilities for new forms of government-citizen initiatives. In February 1990, for instance, African nongovernmental organizations, governments, and the U.N. Economic Commission for Africa jointly planned and participated in a conference that adopted a strong declaration affirming popular participation in development. NGOs may also enjoy an enhanced role at the 1992 U.N. Conference on Environment and Development in Brazil as the realization spreads that governments alone can do little to stop forest destruction and other activities that contribute to the emission of greenhouse gases.

In the face of such opportunities, the seeming death of the development debate in the industrial world represents an enormous travesty. Rekindling that debate, however, requires listening to new approaches from the rest of the world. Excessive confidence in free-market approaches melts when one examines the mounting crises in the supposed success stories of South Korea and Taiwan. Exciting alternatives to the dominant development paradigms are emerging in the hundreds of thousands of citizens' groups that flourish amid adversity and repression in Africa, Asia, and Latin America. These voices must be heard in the development establishments of Washington, Tokyo, and Bonn.

SECOND GLOBAL PROSPECTS CONFERENCE

Problems for the Nineties

The decade of the nineties is expected to result in significant improvement over what has now come to be known as the "lost decade of the eighties." The Second Global Prospects Conference sought to address the problems facing developing countries for the coming decade by inviting a number of experts to present views on selected topics of general interest together with a representative sample of country studies. The broad objective was to identify and discuss the problems of development to be faced by policy makers in the nineties with a bias towards the practical perspective.

There were five papers on general topics: economic issues for the nineties, role of government, foreign resource flows and developing country growth, Eastern Europe and finally a paper updating work on the global accounting framework. There were nine country studies. The countries were chosen to reflect a number of criteria--offer a reasonable geographic distribution, successful and not so successful experiences, small and large countries, together with some of the less fashionable countries. From Latin America, Mexico and Chile were chosen; from the Caribbean, Jamaica; from South Asia, Bangladesh; from South East Asia, Malaysia and the Philippines; from the Mediterranean region, Turkey, while East and West Africa were represented by Malawi and Guinea respectively. Each paper had an official discussant and the conference concluded with a Round Table discussion on issues for the nineties.

General Topics

The opening paper provided a review of global economic developments in the eighties together with a broad tour d'horizon of economic issues for the nineties. The industrial countries enjoyed a strong performance largely resulting from policy changes introduced at the beginning of the decade. Typically these involved restrictive monetary policy to contain inflationary pressures and a wide range of structural reforms to enhance supply conditions and improve the functioning of markets. The performance among developing countries varied greatly. Those that did well, largely in Asia, had investment to GDP ratios above 22 percent and were able to achieve a policy mix that enabled them to take advantage of opportunities in the global market. In the nineties this broad pattern is expected to continue. The industrial countries are projected to maintain robust growth but at a slightly lower level than in the late eighties. Increased globalization of the world economy is expected as trade, financial and production linkages are intensified. Among developing countries the more dynamic economies especially in Asia are expected to achieve growth rates of around 6 percent while the prospects for many of the countries in Latin America and especially in Africa are about half that level. When one factors in population growth rates the new decade does not hold too much promise for many of the poorer countries in Africa. The financing of development has undergone major changes during the past decade. The most notable change has been the precipitous decline of flows from commercial banks compared with the

levels earlier in the decade. This in turn has led to an increasing role for the official lending agencies. In short this means that for the great majority of developing countries resources for development will have to be increasingly generated domestically. This in turn implies the need for a credible government policy that can ensure the flow of adequate fiscal resources and at the same time provide the right milieu for private investors. Among events on the international scale are Europe '92 and structural changes in Eastern Europe. The former is expected to lead to a larger and freer market in Europe in a more competitive environment. There is also increasing discussion of reciprocity which may be a vehicle for some protectionist forces. This may lead to some difficulties especially for the dynamic export-oriented economies of Asia. Developments in Eastern Europe are likely to lead to some resources being channeled in that direction. Over time it is expected that this region will attract significant direct investment flows and maybe some redirection of flows to other LMICs. As these economies restructure it is expected that they will generate increased competition in the global economy but over time it is also expected that increased effective demand will result. Perhaps an even more interesting fallout will be the lessons or new paradigms that may result for development from the rapid changes occurring in Eastern Europe.

A major theme that pervaded a number of the papers was what should be the appropriate role of the state. The paper by Shapiro offered an illuminating case study of the automobile industry in Brazil in the period 1956-1968. The analysis indicated that in this instance the state was able to extract rents from the private sector and use them to shape investment behavior. Thus she argues that, with stable policy and concomitant credibility, the state was able to reduce the role of uncertainty and essentially eliminate the role of directly unproductive rent seeking activities. This offers one possible approach to ensure that state intervention does not necessarily lead to an inefficient outcome in either a static or dynamic sense.

The paper by Taylor focussed on the role of foreign resource flows in the growth of developing countries. Based on a set of studies of 17 developing countries he estimated that an additional inflow of about US$40 billion would be needed to support an extra one percentage point in faster capacity growth in the medium term. In order to restore historical growth rates to Sub-Saharan Africa and Latin America much larger transfers would be needed.

Gronicki discussed the recent changes in Eastern Europe and the likely economic evolution in the next few years. The demise of the central planning paradigm in those countries marks a watershed in economic policy making. The debate will continue on the appropriate role for the state and how to ease the transition towards more market-based economies. Many problems remain to be addressed, from determining the ownership of property to putting some form of security net in place, to moderate the social costs and concomitant pressures from the consequences of restructuring the economy. The problems faced by policy makers vary across these countries from the relatively well managed Czechoslovakia to the impoverished Romania.

In a somewhat more technical vein Riordan reviewed progress on the Global Accounting Framework. This is part of an ongoing effort at the World

Bank to develop a unified data system for all major global economic accounts. The author indicated that country-specific data bases are now being added and he provided examples of both cross-section and time-series views of selected country databases. It is expected that this data base will be made available to the public at large in a format that can be readily adopted to suit individual country groupings.

Country Studies

There were three Latin American studies which covered a wide range of experiences: Chile, Jamaica and Mexico. Chile has managed to generate a stable economic milieu while Mexico, after rescheduling its external debt, is beginning to resume growth. Jamaica had a number of stabilization plans in the early eighties which failed to induce the needed reforms. Presently it seems that it will need some restructuring of its official debt.

The two African case studies were symptomatic of many of the problems of that continent. Guinea has seemingly a whole plethora of problems of underdevelopment ranging from poor institutions through illiteracy to malnutrition. In addition Malawi is faced by a major challenge from the AIDS epidemic.

The one country from the Mediterranean region, Turkey, presented an interesting analysis of winners and losers under a structural reform program. It was argued that the traditional rentiers, the industrialists, were gradually replaced by financiers.

The three countries from Asia were Bangladesh, Malaysia and the Philippines. Bangladesh continues to face major problems of poverty exacerbated by a high population growth rate. The Philippines is torn by domestic political strife. Perhaps one of the few good stories is Malaysia, where a pragmatic policy mix seems to be achieving remarkable results.

In short, many of the problems of the eighties are still with us as we enter the nineties. In many countries these have become exacerbated. However, the debate has become less polemical and more practical. Perhaps the nineties will see a much more pragmatic approach to policy so that the major problems of development will begin to be redressed.

Economists studying the development process have always been ready to admit that economics is only part of the problem. Social, legal and institutional factors, together with the historical perspectives, were recognized by many to be of major importance. However, it now seems that economists may not be able to solve even the economic problems; in many instances a new paradigm is needed. Countries such as Malawi seem to have followed the "right" prescription but with little success while Malaysia seems to have achieved a great deal of success with policies that traditionalists might eschew.

BEYOND CATCH PHRASES: WHAT DOES SUSTAINABLE DEVELOPMENT REALLY MEAN?

David Brooks

"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs" — Our Common Future (the Brundtland Report).

This is the concise definition of sustainable development offered in what is arguably the most important document of the second half of the century. In many ways, the Brundtland Report is important not so much for what it says, but for the reaction it has stimulated.

It has had a galvanizing effect on international development at a crucial time. It made sustainable development a political issue by the very fact that it was a consensus document — not just from the East and West but also from the North and South.

Clearly, the Brundtland Report achieved its purpose: it got people talking about sustainable development. As a result, we have had a burst of analyses and articles about what we are doing and where we are going in both developed and developing countries. Indeed, sustainable development has become official policy in dozens of organizations around the world, most notably the World Bank.

All of this, and yet few people can offer a good explanation of what sustainable development really means. As always, confusion and misunderstanding are frequent side-effects of lofty proposals on environment and economic development.

The Brundtland Report must take at least some responsibility for the confusion, for its own definition is ambiguous.

Its definition is not new, clear, nor is it really complete. The authors have turned out to be their own worst enemies — they failed to draw out the implications of their own statements. Simply put, the authors want to have their cake and eat it too.

Sustainable development is a fundamentally radical notion that we must learn to use in all of our work. But, at the same time, it is conservative in that it can work within the traditional framework of economic theory. It is an alternative economics not an alternative to economics.

Sustainable development does not mean economics should be ignored, simply looked at from a significantly different perspective. It contradicts many common ideas about economic growth — but it does not say, in a knee-jerk fashion, that all economic growth is bad.

The inability to understand what sustainable development means has led to its mistaken acceptance by many organizations. Those using it as a standard often do not comprehend its implications.

Some Misconceptions — and a Better Definition

Because misconceptions surround the term sustainable development, a few clarifiers should be kept in mind. The adjective is "sustainable" not "sustained." The noun is "development" not "growth" and the word "economic" does not appear.

Although these distinctions may appear simplistic, they are important. Growth, for instance, means to increase in size by adding material. Development, on the other hand, is the realization of potential.

Many people use the term "sustainable growth" but it is a contradiction in terms. Sustainable refers to limits whereas growth means physical increase — the two concepts do not mix. Sustainable development, however, means limits placed on potential — quality can always be expanded, and in many more ways than mere physical size.

A better understanding of the idea of sustainable development can be found in a report by the World Conservation Strategy, which actually predated the Brundtland Report:

"The emerging paradigm of sustainable development... seeks to develop strategies and tools to respond to five broad requirements:

- Integration of conservation and development.
- Satisfaction of basic human needs.
- Achievement of equity and social justice.
- Provision for social self-determination and cultural diversity.
- Maintenance of ecological integrity.

These challenges are so strongly interrelated that it is difficult, and indeed unhelpful, to arrange them in hierarchical or priority order. Each is both a goal itself and a prerequisite to the achievement of the others."

This definition of sustainable development is better than that of the Brundtland Report because it does not rely on one specific axis for explanation. It points to the many implications and interconnected aspects inherent within the term sustainable development. It also confronts the incorrect notion that environmentalists are not interested in people.

Where Are We Now? Sustainable Development as a Microconcept

Environmentalism has made significant gains at the individual project level. New tools such as "environmental and social impact assessments" can indicate to what degree economic activity affects the environment. These tools allow for the fact that the environment serves as a repository for waste as well as a source of materials for production. They also show an increased recognition of the aesthetic value of nature and its resources.

"It is an alternative economics not an alternative to economics."

There is a growing recognition that, in many cases, bad economics is bad environment. Getting price signals right and getting rid of subsidies for vested interests may be the best thing for the environment.

But all of these gradual observations share the same philosophy: the present economic system is fine; we just have to fine tune it. We can continue to do what we are now doing, just do it better. But this is ignoring the key issue of sustainable development — the macroperspective.

Going Deeper: Sustainable Development as a Macroconcept

Sustainable development is not fundamentally about microeconomics or individual project analysis. It instead must focus on the big picture, macroeconomics and policy analysis. The key issues do not involve questions of how — how to allocate resources — but how much — the size of the economy. We have to look at how many people can live on this earth and, more important, how rich they can be in terms of their use of natural resources.

Traditionally, macroeconomics has within it no concept of the maximum size of an economy. There are no restrictions on the scale of an economy; bigger is always better.

But the environment imposes very real constraints on the size of an economic system. Human activity has pushed against the physical limits of the world. We are beginning to go beyond a scale at which we can comfortably survive. The problems of global warming and rising sea levels are only the most visible example of going beyond our limits.

Economic textbooks have emphasized the circular flow of income through a capitalist economy — the greater the flow the larger, and thus more prosperous, economy. But the inability, or unwillingness, to realize that economies must be limited in scale has pushed us back against a wall.

Sustainable development suggests an alternative perspective. Instead of focusing on a circular flow of income, we should be looking at a linear flow of natural resources — the depletion or degradation of resources caused by human use. By moderating this linear flow, we can go far toward ensuring that resources, whether renewable or nonrenewable, will be available for the future.

Some think the limitations of our environment can be offset by technology or by recycling. They can, but only partially. Technology and recycling can graft on new solutions without addressing the root of the problem: the mentality that an economy can grow indefinitely.

To address the problem, most environmental economists have concluded that, just as we need ethical criteria to help determine the distribution of income in an economy, so too do we need ecological criteria to help us determine appropriate limits to the scale of an economy.

One of the foremost alternative economists, Herman Daly of the World Bank, prefers this approach. He argues that there is a fundamental difference between quality development and growth. An economy, he believes, should be efficient enough to ensure quality development. But growth in the scale of that economy must become increasingly constrained by the capacity of the ecosystem to regenerate natural resources and absorb waste outputs. Growth, in other words, must be limited by the environment.

Sustainable Development and the Third World

We are still learning how to introduce these notions of sustainable development into larger economic considerations. Thus, it is too early to state categorically how it might apply to developing countries. However, we can suggest that the introduction of the concept will have four important benefits.

First, sustainable development will force both economists and ecologists to look much more carefully at their models and their definitions. Many things previously on the fringe of economic theory, such as the concept of entropy, will now rightfully move toward the centre.

Second, we will get some specific tools to measure the effects of human activity on the environment. Economic indicators, such as gross national product, will come to include the depletion of natural resources and their degradation through pollution.

The third benefit, and most relevant to international development agencies, is the introduction of sustainable development as a set of criteria into both project analyses and reviews of wider policy choices. We are a long way from having a full set of criteria — economic, social, cultural, and ecological — but the ground is being laid.

Fourth, and maybe most important in the long run, sustainable development is on its way to becoming a philosophical concept that will infuse all work on development, whether in richer or poorer countries. If it is accepted seriously, apparent rates of return on a nonsustainable proposal are simply irrelevant when compared to a proposal that has a lower yield but is sustainable. Whether or not a project is "sustainable" will become the standard of success in international development.

By David Brooks, Associate Director, Environmental Policy, IDRC, Ottawa.

Nicaragua: Challenges of the New Strategy

On January 25, 1990 a fourteen-party coalition led by Violetta Chamorro recorded a stunning electoral triumph in Nicaragua, capturing 55 percent of the popular vote. Mrs. Chamorro's victory laid the groundwork for fundamental transformation of the Nicaraguan economy, away from the statist approach of her Sandinista predecessors and the oligopoly of the earlier Somoza regime, toward a market economy driven mainly by exports of agricultural products such as cotton and coffee.

For this transformation to happen, the formidable legacy of the previous government must be overcome, stripping away structural rigidities introduced over the past ten years and recreating competition as the basis for supply of goods and services.

Sandinistan heritage

The Sandanistas came to power in 1979 with an agenda for the complete political and economic transformation of Nicaragua. This was achieved in their eleven years of power. The state's role in production, finance, and commerce expanded dramatically. The Sandinista Front (Frente Sandinista de Liberación Nacional) became an important social agent. However, as a result of various internal and external factors, such as the continuing civil strife with the Contras, the U.S.-imposed economic sanctions, the sheer mismanagement of the economy, and a miscalculation of public sentiment, the Sandinistas were forced to give up power after being defeated in free elections. They left behind an economy in total disarray and a country deeply divided along ideological lines.

Total output has fallen each year since 1984, and by the end of 1989 was 10 percent lower than at the beginning of the decade. Inflation in mid-June 1990 stood at 880 percent on an annual basis, after having reached 1,690 percent in 1989, and over 33,000 percent in 1988. Additionally, the volume of exports has been falling since 1983 and now is about half the level of 1980. By mid-1990 the country's total external debt had reached $10 billion, almost nine times as much as the present GDP; of this amount $3.5 billion was in arrears, 44 percent of it unpaid interest. By mid-1990, the per capita burden of the arrears alone was almost four times larger than GDP per capita.

At the sectoral level the picture is equally bleak. In agriculture, for example, the area planted to cotton in 1989 was about half what it had been at the start of the decade. The number of cattle in the country was estimated to have fallen from 3 million head to 1 million during the same period. Concerning education, whereas significant gains in enrollment were recorded in the first part of the decade, these flattened out in recent years. Both pre-school and primary school attendance was low, and the illiteracy rate was on the rise by the end of the decade.

How the economy came to deteriorate so completely and rapidly is a complex issue. Certainly, the Sandinistas inherited a strife-torn economy and a highly skewed distribution of resources. Over time, the continuing civil strife required significant military expenditures, and the U.S. economic sanctions led the government to rely on a highly inefficient system of bilateral economic assistance. But these factors — not denying their importance — were an overlay to the centrally managed economy, established by the Sandinistas, where it was difficult to enforce fiscal or monetary discipline, provide incentives, or set relative prices. The result was macroeconomic disequilibria: highly negative real interest rates, hyper-inflation, price distortions, multiple exchange rates, and a thriving black market.

The critical element in this development proved to be the state's role in the economy as envisioned by the Sandinistas. The Constitution of 1987 reserves to the state both domestic and foreign trade activity. As a result, the state became the primary commercial agent, the sole marketer of agricultural export crops, the importer and distributor of agricultural inputs, and the owner of major retail outlets. It also fixed domestic prices, including wages, as well as the exchange rate, where it instituted a system of multiple exchange rates that penalized exporters.

The state also owned a large share of the country's capital stock, acquiring it by the expropriation of the properties owned by General Somoza (his agricultural holdings left the Sandinistas with over half the country's cultivated area) and his cronies, and later — through decree — the property of other private owners as well. By the end of 1989 the market share of about 300 state-owned enterprises and Frente-associated cooperatives had increased to about 40 percent in the manufacturing sector and above 50 percent in agriculture. The combination of wage and price (including exchange rates) fixing and lack of control over fiscal accounts eroded production incentives. This led to the downward spiral of output, decline of capital investments, and deteriorating financial conditions for individual firms.

The financial sector was also reserved to the state by provisions in the Constitution. Inevitably, standard credit norms were disregarded and loan losses mounted. Negative real interest rates encouraged producers to act as financial intermediaries. As a consequence, the sum total of domestic credits increased and the quality of the loan portfolio deteriorated. By 1990 all four commercial banks in the country were insolvent, and the Central Bank, being responsible for back-stopping the banks, recorded large losses as a result.

When the Chamorro government took office in April, 1990, it faced a grossly overvalued exchange rate, depleted international reserves, a large swell in domestic credit, and a swollen fiscal account that was largely absorbed by public sector wages. Its first 150 days were further marked by confrontations with the opposition, which drew on its network of labor unions and public sector employees to dispute and disrupt the government's economic plans. In the period between the election and Chamorro's assumption of power, the Sandinistas raised wages, increased spending and increased credit to thwart the new government's announced intention of reducing inflation to zero in three months.

Basic objectives

The government itself was ill-prepared to mount a stabilization and reform program. Largely because no one expected them to win, the Chamorro government came to power with only broad objectives and few specific measures to achieve them. The paradox that emerged in the initial days of the Chamorro government has characterized the stabilization and reform process ever since. On the one hand is a deep and bitter ideological division in the country, with neither side having a dominant position but each well organized to rally around their respective cause. On the other hand is the realization that attacking the fundamental economic disequilibria in the economy will require consensus building, public awareness, and compromise.

Nonetheless, the government introduced some corrective measures, and there are some initial signs that the transformation is taking hold. A new currency, the *cordobas oro*, linked to the dollar, is being phased in slowly; multiple exchange rates were discontinued, public utility rates increased, and some state-owned enterprises privatized. The government has been able to eliminate the exchange losses of the Central Bank. Broader fiscal and monetary discipline, however, has proved elusive and has prompted the government to examine more closely the causes of the current economic chaos and be more specific about the required reforms.

The government has outlined five basic objectives for the next three years:

- eliminating the underlying causes of inflation by reducing the fiscal deficit to a level that can be financed without monetary creation, linking the growth of bank credit to the ability of the financial sector to attract new resources, and exercising greater control over state-owned enterprises.
- full introduction of the new currency (and anchoring it to the dollar), thus addressing the decline in demand for the old hyper-inflated currency and completing the process begun several months earlier.
- improving efficiency and competitiveness through deregulation, liberalization of the financial sector and foreign trade, tax reductions, foreign investment, and privatization.
- alleviating the social costs of adjustment and eradicating extreme poverty through the social emergency and social investment funds.
- creating a climate of confidence to permit a speedy reactivation of production, investment, and employment through the return of expropriated assets where justified, a clear definition of property rights, and a process of national consultation.

Barriers of ideology

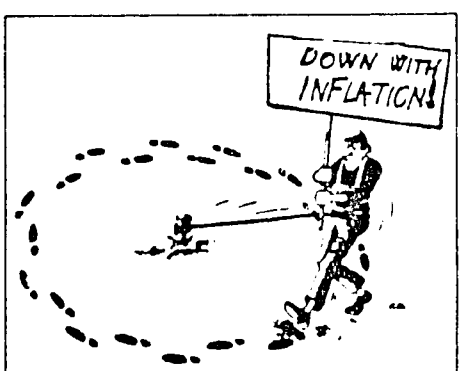
Three factors make the Nicaraguan transformation distinctive:

- It is being done in the context of an external debt overhang that poses an insurmountable financing gap and puts in doubt the sustainability of the reforms. Without considerable debt forgiveness on current debt and concessional terms on new monies to finance the government's stabilization program, reform will not be possible.
- Large-scale demobilization of the Nicaraguan army and the Contra forces is necessary to provide relief to the budget and free resources for the proposed social emergency programs.
- Above all, a significant segment of the population, although a minority, has not rejected the ideology and political impetus of the former statist approach. Thus, while the government has a mandate for transformation, the appropriate mechanism for bringing it about is not clear.

The recently announced reform measures, as outlined above, go a long way toward correcting the current situation and achieving a true transformation of the economy. Additionally the government is working closely with the international community through a broadly constituted consultative group to address the issues of debt overhang, technical assistance, and new financing. Fundamentally they seek to harness the fiscal and monetary forces generating hyperinflation and instability. This implies not only tighter control on the central government but also — in an initial stage — the imposition of strict supervision of state-owned enterprises, including the banks, and later a large-scale privatization effort.

To do this, however, the government must tackle the ideological issue in three ways. First, it needs to take charge of the state machinery where it has not yet done so, to be able to implement its announced goals and objectives. Second, given Nicaragua's adverse social indicators compared to its neighbors, the government must pay careful attention to the social costs of adjustment and design well targeted programs of assistance. And third, it must continue to work at maintaining a national consensus on the need for reform. As the new government has said on several occasions: the costs of doing nothing are far greater, and the benefits of idleness much smaller, than the cost of undertaking these far-reaching reforms.

Richard Clifford
LA2CO



from the Yugoslav magazine Jeza

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Introduction

1.1 Education has been recognized as a cornerstone of economic and social development. More recently, however, it has become even more important to the development process as accelerated technological change and new organizations of production transform the world economy. Information, biological enhancement, and new materials -- more than machines or labor alone -- are the bases of new sources of wealth. Development in all its forms -- economic, social, and cultural -- will depend increasingly on knowledge-intensive industries, agriculture, and services. Education is a key to developing that knowledge and the sense of personal efficacy needed to adjust to rapid change.

1.2 Although these new conditions place new demands on the educational system worldwide, the continuing economic crisis has jeopardized the ability of many countries even to maintain the present levels and quality of their educational services. The "knowledge gap" -- the disparity in the capability of countries or groups within countries to participate in the gains of technological innovations and new production processes -- is growing Many countries are falling farther behind in providing the education and training needed by their youth to create and adapt available knowledge to their environment. A widening gap has serious implications for the future economic development of those countries falling behind. It guarantees that they will be increasingly hindered in efforts to enhance and shape their own economic and social development process. Their already low standard of living could also fall.

1.3 These new conditions suggest a new message. There is a need for more and better education in all countries -- industrialized and less-industrialized, high-income and low-income. Providing universal primary schooling in India or reducing high school dropouts in the United States is each a crucial development issue in that particular society. Developing the cadre of scientific and technical personnel to lead the country into an age of transformation in information, biological, and materials sciences is important in France and Zimbabwe. But the rapid changes in the world economy and the growing gap between rich nations and poor also suggest that not all countries face the same educational problems. All countries should be striving to increase student learning and to equalize access to knowledge, and all can learn from each other in using educational techniques that work. But lower-income countries with high rates of illiteracy and children out of school may also require qualitatively different approaches to improving and expanding schools than those possible in higher-income countries with much higher average schooling levels and more resources.

1.4 Detailed data on the major areas of educational policy and practices are available to produce a new analysis of these challenges and to recommend coherent, practical policies for the future. The World Bank has been active in this field for 25 years, other international agencies such as UNESCO have collected massive amounts of data, many countries have been investigating their own education at a national and comparative level, and individual scholars worldwide have also produced a wealth of educational research. Three decades of educational

analysis and investment -- much of it by the Bank -- provide a solid base for understanding the relationship between education and economic development, for analyzing the contribution of various levels and types of education, for evaluating measures to improve the quality of education, for assessing the successes and failures of past educational policies, and for suggesting concrete alternatives for countries facing different economic and educational conditions, to cope with the changed circumstances of the 1990s.

1.5 The World Bank plays a singularly important role in international lending for education. In many countries the Bank is the major source of educational advice, and other agencies increasingly follow the Bank's lead in such policy and lending. Therefore, its experiences carry particularly significant weight in how educational development and lending proceeds worldwide. An analysis of these experiences, past educational policies, and new directions for policy would make an important impact on educational change -- hence economic development -- in the coming decade.

1.6 This is therefore a particularly opportune moment for taking a fresh look at educational development and donor educational policy.

1.7 In order to address these themes on education, an extensive bibliographical review was carried out and available statistics, research results, and policy studies were scanned. Not only has there been an enormous body of statistics compiled by UNESCO and other agencies over the past 25 years on enrollment growth and educational spending and costs, but the World Bank and other international and bilateral lenders have amply documented and analyzed their vast experience in financing educational projects. In addition, these same lenders and academics have carried out hundreds of research studies on various aspects of educational policy. For presentation purposes, these available statistics and studies are divided into four sections: (1) The Contribution of Education to Economic and Social Development; (2) Trends in Educational Development; (3) Lessons from World Bank and Other Donor Experience in Assisting Education; and (4) Policy Issues and Directions. Data availability in each of these categories is assessed below. An extensive bibliography is also attached (pages 73-99).

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INTERNATIONAL FOOD POLICY RESEARCH INSTITUTE

RESEARCH REPORT 83 OCTOBER 1990

DEVELOPMENTAL IMPACT OF RURAL INFRASTRUCTURE IN BANGLADESH

RAISUDDIN AHMED AND MAHABUB HOSSAIN

The role of infrastructure in development of rural areas of developing countries has been controversial, and in recent years donors have shied away from funding such projects. The difficulty of measuring the direct and indirect effects of infrastructure has also contributed to the lack of solid data concerning its impact on the rural poor. In this study, *Developmental Impact of Rural Infrastructure in Bangladesh*, Research Report 83, Raisuddin Ahmed and Mahabub Hossain establish an empirical basis for evaluating infrastructure development's effects on rural areas. It shows unequivocally that infrastructure is the central element of a rural growth strategy. Its effects are positive and profound. For example, where infrastructure is developed, crop output is 32 percent higher and household income 33 percent higher. Wage income for the landless almost doubles. Moreover, although the research is based on Bangladesh, its findings are likely to hold true for many developing countries in Asia and Africa.

This comprehensive approach for measuring the effects of infrastructure in 16 villages in Bangladesh, grouped according to their degree of infrastructure development, is derived from data collected in an extensive 1982 survey by the Bangladesh Institute of Development Studies in collaboration with the International Food Policy Research Institute. It links rural infrastructure to economic growth and alleviation of poverty through a range of potential effects on agricultural production, employment, household income, consumption, savings-investment behavior of rural households, and market and social development. Implications for public policies on infrastructure development are drawn, and factors that often hinder public resource allocation for development of rural infrastructure are examined.

AGRICULTURAL PRODUCTION

Infrastructure affects agricultural production through prices, diffusion of technology, efficient use of inputs, and efficient combination of outputs. The study finds that fertilizer prices are 14 percent lower and the wage rate is 12 percent higher in the developed villages (those with more infrastructure) compared with those that are underdeveloped (those with less infrastructure). Irrigation tubewells are more numerous and more likely to be in working order in villages that have better infrastructural facilities. Due to the strong relationships between irrigation and high-yielding varieties (HYVs) and between infrastructure and irrigation, the rate of adoption of HYVs is 71 percent higher in developed villages (Figure 1). The combination of lower fertilizer prices, increased access to supplies, and greater diffusion of HYVs (which require more fertilizer) results in a 92 percent higher fertilizer use in developed villages. Although the increased adoption of HYVs leads to an increase in the demand for hired labor, the total increase in labor use in developed villages was small—only 4 percent—because demand is partially offset by increased real wages.

Crop output is 32 percent higher in developed villages because the technical and overall economic efficiency of producers is greater. Farmers in the developed areas tend to be more efficient in allocating labor according to its costs and the value of its output, which accounts for 8 percent of the production increase. And, the output of farmers in developed areas is 24 percent higher for the same amount of labor and fertilizer.

EMPLOYMENT AND LABOR MARKET

The development of infrastructure generates more productive nonfarm employment for households whose members have the necessary capital and skills. This opens up opportunities for wage employment in agriculture for the remaining households. Landless households in developed areas spend nearly 33 percent more time on agricultural labor than those in underdeveloped areas, where they are self-employed in less-productive nonagricultural activities. These changes in the employment

structure occur in all household groups. The number of days spent in construction, transport, services, and cottage industries are significantly higher in the developed villages. Employment opportunities are also greater for poor women in developed villages, where, among the landless, women make up almost 22 percent of the work force, compared with 10 percent in the underdeveloped villages.

There is evidence that infrastructure expands the size of the wage-labor market in general, given that the number of days of labor hired out by household members in developed villages was 77 percent higher than in underdeveloped villages. More important, infrastructure indirectly affects wage rates, which are about 12 percent higher in developed villages. The shifting of labor from one sector to another increases productivity, representing a more efficient allocation of labor resources. Both of these effects contribute to the alleviation of rural poverty.

HOUSEHOLD INCOME AND POVERTY

In a comparison of the sources of household income in the three most and the three least developed villages in the sample, it can be seen that crop income increases about 24 percent due to increased output, whereas income from livestock and fisheries increases by 78 percent. Wage income almost doubles, while income from business and cottage industries increases by only 17 percent (Figure 2). The overall increase in income attributed to infrastructure is about 33 percent.

Incomes of landless and small farmers from wage labor and livestock and fisheries increase proportionately more than those of large landowners. Although the increase in income from business and industry is captured mainly by the large landowners, who may have the capital to take advantage of opportunities, the landless and small landowners could increase their income from these sources if they had improved access to credit through institutions such as the Grameen Bank. Increased crop income in developed areas is also based on better access to markets, to credit, and to new technology. Therefore, incomes of the landless and small landowners could be enhanced by improving their access to these elements. The increased income-earning opportunities for the rural poor in areas where infrastructure is developed have a substantial positive effect in alleviating rural poverty.

INFRASTRUCTURE AND CONSUMPTION LINKAGES

Detailed estimates of the relation between income and consumption by commodity are compared for the developed and underdeveloped villages. With savings accounting for only about 14 percent of household income, spending on consumption goods has important potential linkage effects with the rest of the economy.

The consumption basket changes with infrastructure development, which leads to a reduction in the share of food expenditures and an increase in the share of nonfood expenditures (Figure 3). The share of the food basket devoted to cereals is sharply reduced, even though the average share of noncereal food increases only modestly. Although changing tastes, prices, and availability of food change the composition of the food basket in developed areas, they do not lead to any loss in nutritional status.

Infrastructure development does, however, result in a change in expenditure elasticities, reducing the elasticity of cereals while enhancing that of all other products except milk and milk products. In developed villages, because higher-income households spend a larger share of their income on foods other than cereals and on nonfood items, the linkage effects on other sectors are greater. In underdeveloped villages, the budget shares follow the same pattern for households in all income groups.

SAVINGS-INVESTMENT BEHAVIOR

The study also measures the influence of rural infrastructure on household savings and investment within a comprehensive framework that considers infrastructure along with other determinants. The average savings rate for all villages is 14 percent, but it is slightly higher in the developed areas. While 36 percent of all households have a zero or negative savings rate, gross savings are concentrated, with about 75 percent generated by households in the top two income deciles. However, the main effects of infrastructure are indirect; current income is the most important factor influencing savings, and infrastructure has a substantial positive effect on income.

Agricultural investment per acre of cultivated land did not increase in the developed areas even though more land is sown in HYVs. Analysis shows that, although modern technology requires large amounts of inputs, the fixed capital requirements are not so high because irrigation infrastructure is largely provided by the government. The cost of irrigation (treated as a current input) is equivalent to about 18 percent of gross capital formation in developed villages, while the cost of fertilizer is 23 percent. If these costs are treated as investments, the impact of infrastructure on agricultural investment is quite high. It should also be noted that in the developed areas, investment in livestock and fisheries is higher—sectors that provide important sources of income for the rural poor. Investment in housing is also common; whenever rural households have surplus income above what they need for food, they allocate the largest share of it to housing.

MARKET AND SOCIAL DEVELOPMENT

Rice markets play a critical role in rural life in Bangladesh. The consumption of milled rice instead of home-pounded rice increases substantially with infrastructure development, rising from 40 percent of total rice consumption in underdeveloped villages to almost 74 percent in developed villages. The prices paid to farmers for their paddy vary considerably from season to season, with greater variation in the underdeveloped areas. Poorer farmers tend to market more of their paddy production just after harvest when the prices are lowest and to purchase rice when the prices are highest. Infrastructure improves market access so that price variations are reduced. In the developed areas, there is increased marketing of paddy and other agricultural output by farmers across all landowning groups.

Access to institutional credit is mostly limited to landowning households; borrowers from the small landowning and landless groups depend on friends, relatives, and private moneylenders. Infrastructure development does improve access to institutional credit, but mainly for the landowning classes. However, infrastructure development also transforms the noninstitutional supply system from one dominated by friends, relatives, and a few moneylenders, to a system composed largely of moneylenders. Analysis of the utilization of credit finds that infrastructure development helps shift credit from nonproductive to productive activities.

Illiteracy is widespread and related to a household's ownership of land and the sex of the individual. No direct link between infrastructure and literacy could be shown, although the study finds that members of the landless and small landowning households in underdeveloped villages drop out of school earlier than those in developed villages. The development of infrastructure, however, does have a significant direct effect on health through improved access to health care and dissemination of information. For example, family planning is twice as likely to be practiced in developed areas.

POLICY IMPLICATIONS

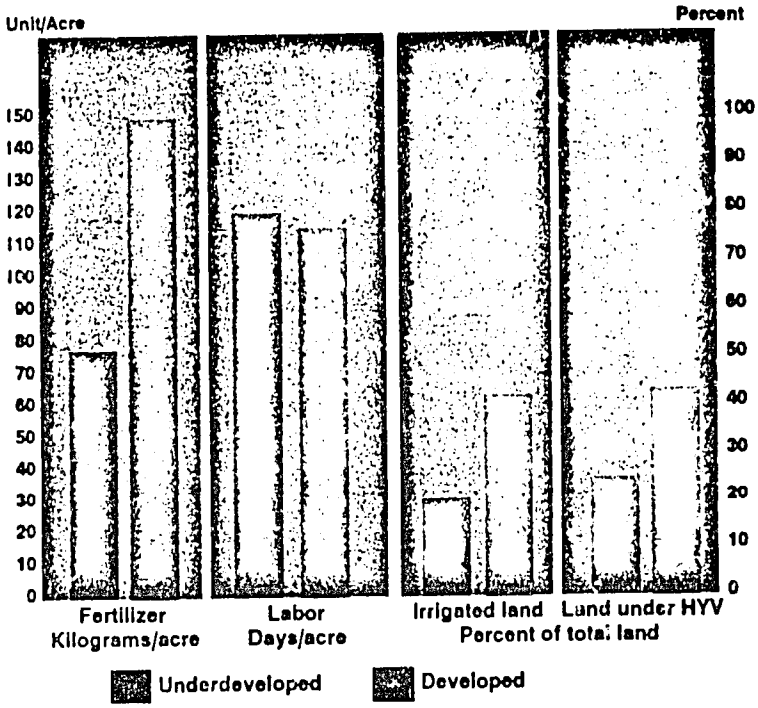
In view of the crucial role of infrastructure in the economic development of agriculture-based, low-income developing countries such as Bangladesh, a fresh look at public policies for rural infrastructure is called for.

Assuming that infrastructure development constitutes a central element of a country's development strategy, all potential infrastructure development projects should be identified and their prospective benefits and costs estimated; then they should be ranked in the order of benefits relative to costs. Public resources should be systematically allocated to develop the highest ranking infrastructure first. This ideal approach is, however, extremely difficult to practice. The task of estimating benefits is a challenging one, involving sequencing the elements of infrastructure and imaginatively exploring the potential for long-term development.

These resource allocation measures should be complemented by simultaneous development of local government institutions, which should have the authority to generate resources at the local level and to hire skilled manpower. The flow of central government funds should be linked to local initiative. A systematic mechanism for sharing revenues (from land taxes and foreign aid, for example) between the local and central governments should be devised.

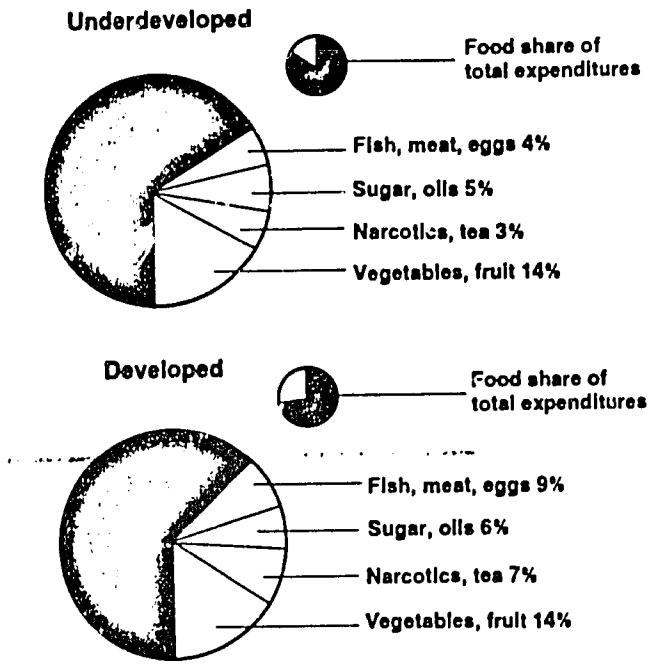
In recent years, development of infrastructure has lost its priority status in the donor community, partly as the result of "aid fatigue" and partly because structural adjustment policies discourage public expenditure. But privatization and infrastructure development have to be treated separately. Based on the results of this study, the donor community should make an effort to restore infrastructure development to its priority level in the 1960s.

Figure 1
Increased use of agricultural inputs in developed areas, compared with underdeveloped, 1982



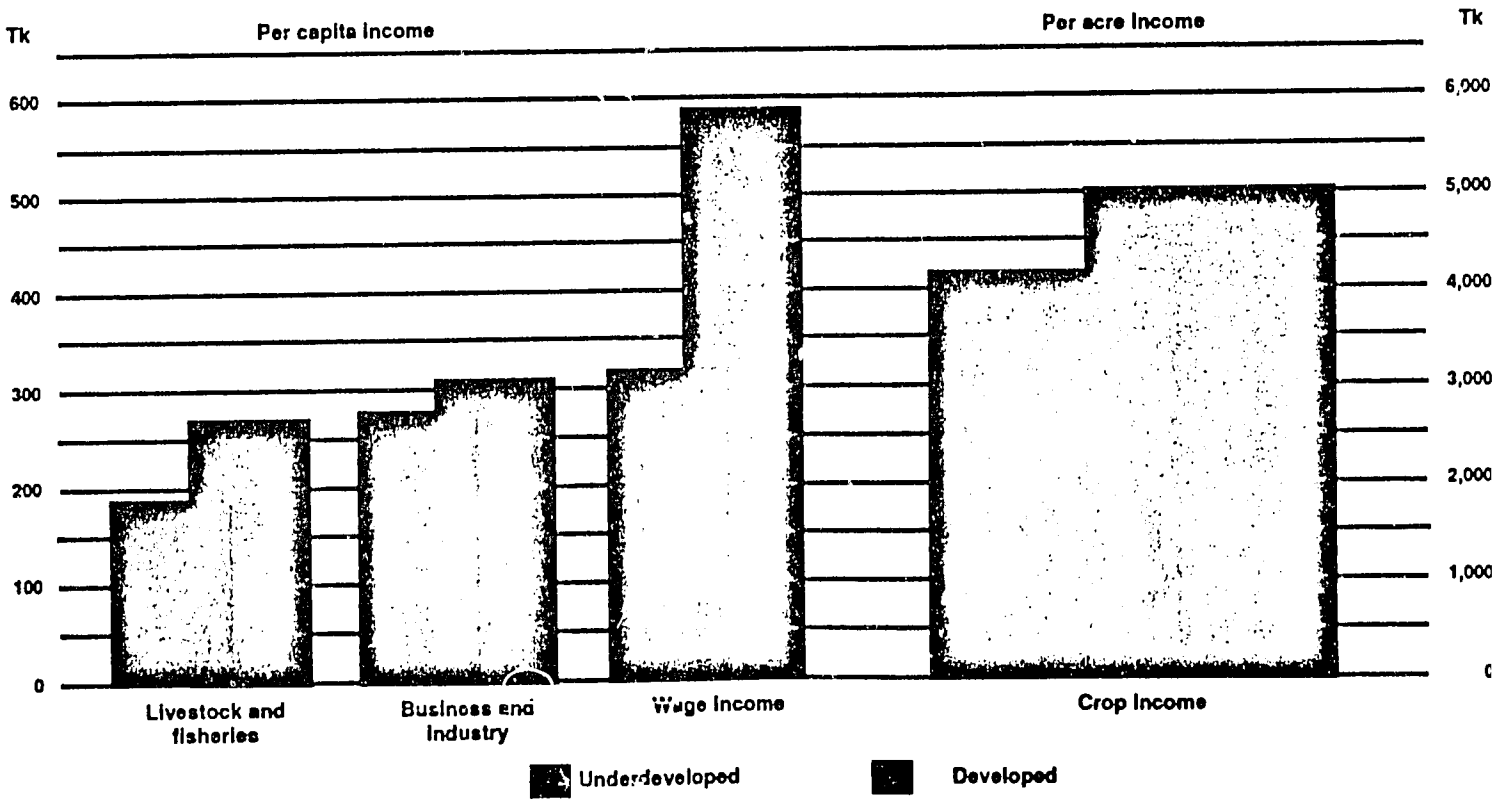
A combination of all of these factors results in a 32 percent increase in agricultural production from increased use of new technology in developed areas.

Figure 3
Average budget shares of household food expendi tures in underdeveloped and developed villages



The diminishing share of cereals in household food expenditures r flects changing taste patterns and a wider range of choices in dev oped villages, indicating increased potential for linkages with the re of the economy.

Figure 2
Crop income per acre and other income per capita in underdeveloped and developed areas, average of all households



The shift of labor into more productive wage labor and the increased marketing opportunities for livestock products and fish in developed areas both lead to higher incomes for the poor and landless.

Book Published by IMF Explores Fiscal Issues Facing Developing Countries

Public finance and macroeconomic policy in open developing economies is the focus of a new IMF publication. Edited by Vito Tanzi, Director of the IMF's Fiscal Affairs Department, the book is entitled *Fiscal Policy in Open Developing Economies.*

The volume, which has an introductory overview by Tanzi, comprises two sections. The first deals with general issues that affect the relationship between developing countries' public finances and their external sectors. The second presents case studies of four countries (Chile, Korea, Mexico, and Turkey) and two areas: the Arab world and commodity exporting developing countries.

In the first chapter, Johannes Linn of the World Bank and Deborah Wetzel of Oxford University examine the links between fiscal policies and trade policies. They note that a failure to examine these links "will likely lead to inconsistent and unsustainable policies, thus hindering a country's trade and development prospects." Linn and Wetzel stress three conclusions:

- A competitive real exchange rate, improved trade performance, and trade liberalization are based on sound fiscal management, as the experiences of, for example, East Asian newly industrializing economies show. Trade policies and trade liberalization may, however, have a negative effect on fiscal balances, which must be considered and compensated for.
- Improving competitiveness and reducing protection are likely to involve reforms of both trade tariffs and domestic taxation because tax policy is often used as an instrument of protection. More efficiently designed user charges for publicly provided goods and services can strengthen a country's international competitiveness.
- Correct priorities should be set for public expenditures to ensure that they support trade and tradable goods production. Notably, public spending on physical infrastructure and human resource development can play an important role in this regard.

The interaction between trade and fiscal policy is also the subject of a paper by Mario Blejer and Adrienne Cheasty of the IMF, who discuss the fiscal impact of trade liberalization. They note that, although many empirical studies have confirmed the advantages of freer trade, "the benefits of a liberalization take longer to become evident than the costs, not only for the economy in general but particularly for the budget. Moreover, any attempt by the government to speed up the process of adaptation tends to require an increase in the budgetary burden imposed by the liberalization policies."

Blejer and Cheasty point out that trade tax revenue will bear the most direct impact of a liberalization policy involving tariff reduction. However, such revenue will not fall by the value of the tariff cut; much will depend on the price and income elasticities of the demand for imports, the elasticity of substitution between imports, the market structure of import trade, and the degree of exchange rate flexibility, among other influences. Apart from affecting trade taxes, liberalization may have a budgetary impact that arises from an initial contraction in activity and from a redistribution of income and consumption patterns brought about by changes in relative prices. In sum, "despite the promise of a better long-run future, the economy may face a temporary drop in income and a deterioration in the budget balance (as well as in the trade balance) in the short term." This does not mean liberalization should be postponed until the macroeconomy is balanced, the authors caution. Indeed, such balance might be difficult to find in the presence of trade distortions. An important purpose of the paper, they suggest, is "to highlight the short-run costs of liberalization, so that they might be explicitly budgeted for. If the likely size and duration of adjustment costs could be estimated . . . the task of liberalization would be that much easier."

Theo Hitiris of the University of York, United Kingdom, investigates empirically the relationship between tax structure and economic development using data from 105 industrial and developing countries. He finds that both tax rates and tax structures in developing countries tend to differ from those in industrial countries. In particular, the effective trade tax rate and the share of trade taxes in total revenue fall with economic development, while the total tax burden and the share of income taxes in total tax revenue rise. Moreover, the degree of developing countries' fiscal dependence on trade taxes is positively associated with the relative size of the trade sector in the economy and negatively associated with the level of per capita income and the share of income taxes in total tax revenue.

Juan Carlos Gómez-Sabaini of the Inter-American Center for Tax Studies in Buenos Aires, Argentina, discusses why developing countries use export taxes, the ways in which they do so, and the economic effects of such taxes. He points out that developing countries with poor tax administrations find, in primary exports, "a significant taxable base that can be easily exploited." Some have taxed their primary exports when a substantial devaluation of the exchange rate has taken place. Under these circumstances, substantial tax revenues can be obtained from temporary export taxes, while private expenditure is contained. Export taxes have also been used to

Vito Tanzi: Many economists don't fully appreciate the interaction between developing countries' public finances and their external sectors.

- provide an indirect subsidy to local industries that manufacture or process primary goods, to encourage exports with higher value added;
- hold down urban wages, because such taxes often amount to a subsidy to local consumers of essential primary goods; and
- reduce inflation that results from the rise in the prices of taxed commodities on world markets. By reducing the income derived from the exports of these commodities in the short run, the tax can ab-

sorb some of the increase in their prices.

In short, export taxes have been imposed not only to increase revenue, but also to achieve stabilization and to improve the allocation of resources and the distribution of income.

Gómez-Sabaini suggests that the probable negative effects of export taxes on the level of production and the volume of exports are one of their main disadvantages. He adds, however, that some of the other objectives of these taxes—for example, that of achieving stabilization—"could, at least in principle, justify their use." He concludes with a brief description of how export taxes have been used in Argentina.

The relationship between fiscal policy and the exchange rate is the focus of two papers. In the first, Jesús Seade, Mexico's Ambassador to the General Agreement on Tariffs and Trade in Geneva, discusses whether an adjustment in the exchange rate affects tax revenue. Does a devaluation, for example, necessarily raise tax revenue? Using a general equilibrium framework, Seade concludes that the answer depends very much on the structure of taxes. Specifically, devaluation will:

- increase tax revenues if tariffs are present and imports are relatively price inelastic. This result will most likely occur in countries whose imports consist largely of necessities;
- tend to lower revenues in countries that rely heavily on wage taxes;
- lower revenues in countries where the devaluation is used to finance repayment of foreign debt, thus causing leakage from the economy; and
- lower revenues—or erode potential gains in revenues—in the short run (a year or two), while imports suffer from the effects of the devaluation but fresh investment on exports has yet to be made.

Seade suggests that, in real life, devaluation would probably raise revenues, because tariffs are almost always present in many developing countries, and they have the effect of shifting taxable value added toward the foreign trade sector, which is easier to tax.

In the second paper on the relationship between fiscal policy and the exchange rate, Helmut Reisen of the Organization for Economic Cooperation and Development deals with the impact of real changes in the exchange rate not on tax revenue but on the public budget, especially in the presence of large external debt. He points out that the presumption that devaluation improves the government budget has "not been confirmed for problem debtor countries." In these largely inward-oriented economies, the rise in local currency tax receipts and new inflows of foreign finance have been too limited to make up for the rise in local currency costs for foreign currency debt service following the devaluation. He then examines the conditions under which devaluation will improve the fiscal accounts.

Mario Blejer and Adrienne Cheasty: The benefits of trade liberalization take longer to become evident than the costs, not only for the economy in general, but particularly for the budget.

With regard to policy, Reisen concludes that the negative fiscal implications of devaluation do not necessarily imply that devaluation should be avoided. Alternative policies, such as deflation, are likely to have the same, or even a worse, fiscal impact. Moreover, experience suggests that the currencies of problem debtor countries were largely overpriced as long as foreign capital was readily available. The best policy is to reduce fiscal imbalances, because "fiscal reform is often a . . . prerequisite to correct overvalued and multiple exchange rates."

The problem of revenue instability that affects many developing country exporters is the subject of a paper by Fuat Andic and Suphan Andic, formerly of the University of Puerto Rico, and Irma Tirado de Alonso of Florida International University.

On the basis of evidence from 27 non-oil, export-dependent countries, the authors find that many governments face the problem of revenue instability in the face of a secular growth in expenditure, which complicates fiscal management. They investigate the feasibility of policies to stabilize tax revenue. One such scheme is an "export tax revenue stabilization fund," into which both exporters and governments make deposits when export prices rise relative to a "norm" and from which they make withdrawals when export prices fall below the norm. The authors show that such schemes have, at best, a limited scope because they are feasible only if export prices fluctuate around a rising trend, which is often not the case. Moreover, they require effective demand management policies, which are often politically difficult.

Ke-young Chu of the IMF focuses on the impact of unstable commodity prices on developing countries' public finances and the policy implications. Comparing the structure of public finances of 17 commodity exporting developing countries with those of 11 industrial countries during 1972–83, Chu finds that fiscal deficits in the first group substantially exceeded those in the second. Notably, revenues were "conspicuously more unstable" in the commodity exporting countries. This instability reflected both the narrowness of tax bases in these countries and unstable world commodity prices. Foreign financing, which is determined largely by conditions in donor countries, also tended to be unstable.

Chu points out that, given the limited availability of revenue-side policy instruments, revenue instability in commodity exporting countries leads to serious fiscal difficulties. Maintaining a stable deficit path would result in volatile expenditure, which would involve social and economic costs. On the other hand, maintaining a stable expenditure path would imply a volatile deficit, domestic financing, and domestic prices. This, in turn, often implies a volatile real exchange rate, which ad-

versely affects external balance.

Revenue instability is also the subject of a paper by Abdullah El-Kuwaiz, Secretary General for Economic Affairs at the Gulf Cooperation Council in Riyadh, Saudi Arabia, who reviews the experiences of oil exporting Arab countries. El-Kuwaiz points out that the impact of the dramatic decline in oil revenues since 1985 has by no means been all negative. While the decline has jeopardized earlier, more ambitious industrialization plans and caused much economic dislocation, it has also provided governments with incentives for economic reform. Illustrating from the experiences of Algeria and Kuwait, El-Kuwaiz points out that falling oil revenues have led to a general review of fiscal and monetary objectives that, "almost without exception, has resulted in more rational economic planning, greater reliance on private sector initiatives, and a re-evaluation of taxation policies." Both capital and current budgets have been trimmed back, and development projects are now evaluated more carefully. He adds that "this process, while more or less painful, has been healthy and has left the Arab oil exporting countries well placed for the next phase of their development."

The book's last four articles deal with the relationship between public finance and economic performance in individual countries. Vittorio Corbo of the World Bank focuses on the role of public finance and trade policies in the adjustment experience of Chile during 1973–88. At the start of the period, Chile faced major macroeconomic disequilibria, including a large and unsustainable current account deficit, a public sector deficit of almost one third of GDP, and an inflation rate approaching 500 percent. Microeconomic distortions were also rife.

According to Corbo, Chile's experience suggests that

- reducing fiscal deficits requires strong actions on both the revenue side and the expenditure side. In Chile, the tax system was dramatically restructured to reduce distortions, and the system of public expenditure was revamped to enhance the productivity of spending.
- controlling the public sector deficit is necessary but not sufficient to reduce inflation. Incomes policies are also needed, especially when inertial inflation is present.
- once macroeconomic imbalances are corrected, growth with low inflation can be achieved even in the face of reduced net transfers from the rest of the world and unfavorable terms of trade.

Guillermo Ortiz, Mexico's Undersecretary for Finance and Public Credit, explores the links between internal and external adjustment in Mexico's response to the debt crisis. He notes that Mexico has undergone substantial fiscal adjustment since the outbreak of the debt crisis in 1982. External adjustment has also taken place; Mexico has continuously achieved current account surpluses since 1983 (except for a small deficit in 1986, because of the oil shock). However, the internal adjustment has been insufficient to stabilize the economy. Notably, inflation has remained high. Ortiz attributes the inflation not to the fiscal deficit—he argues that in Mexico, inflation has caused the fiscal deficit to rise rather than the other way round—but to actions taken to protect the balance of payments from external shocks and to resource transfers needed for external debt servicing. Notably, external debt-service obligations, combined with the curtailment of external finance, required a transfer of savings from the private to the public sector. The reluctance of society to effect this transfer forced the Government to resort to the inflation tax, which was brought about through exchange rate depreciations. Ortiz adds that the servicing of external debt might also have reduced Mexico's ability to grow by reducing the availability of resources for investment.

Guillermo Ortiz: The servicing of external debt created substantial inflationary pressures in Mexico.

The experience of Turkey in the 1980s is the focus of a paper by George Kopits and David Robinson of the IMF. They note that at the start of the 1980s, Turkey emerged from a severe balance of payments crisis and five decades of virtual economic isolation through a comprehensive stabilization and liberalization program. The program, in which fiscal policy played an important role, led to both a substantial reduction in the external imbalance and satisfactory economic growth.

After providing an overview of Turkey's macroeconomic development from 1980 to 1987, the authors build a model to simulate alternative combinations of fiscal and exchange rate policies in Turkey during 1984–87. One conclusion they reach is that a significant rise in the public sector deficit, accompanied by real exchange rate depreciation and increasing real wage stickiness, can result in a surge in inflation. "In essence," they suggest, "protection of the balance of payments through real depreciation without tackling the root cause of the problem, namely, the fiscal imbalance, is not a viable option over the medium term."

In the last chapter, Taewon Kwack of Seoul City University in Korea examines how fiscal incentives helped Korea succeed with an export-oriented growth strategy. Kwack first reviews the main financial and fiscal incentives that were provided to exporters in Korea during the twenty-five years to 1988. Financial incentives included commercial bank loans at below-market interest rates and "export loans," which are loans proportional to the value of exports provided to exporters who present evidence of an export contract. Fiscal incentives included generous corporate tax exemptions on incomes from exports and various "tax-free reserve systems," under one of which, for example, 1 percent of the total value of a firm's exports is deducted from its taxable income and kept in reserve. After a two-year grace period, the amount is prorated over the following three years and added to taxable income. Other incentives for exporters included accelerated depreciation allowances on machinery and equipment, tariff exemptions on imported intermediate goods, and preferential rates on the use of electricity and rail transport.

Kwack develops a model to quantify the effects of the various export incentives, from which, he shows, exporters have benefited considerably. He finds, however, that tax incentives have played, at best, a minor role in export promotion, while financial incentives have played a major role.

Copies of *Fiscal Policy in Open Developing Economies* are available for US$15.00 each from Publication Services, Box S-306, International Monetary Fund, 700 19th St., N.W., Washington, D.C. 20431, U.S.A.

ECONOMIC AND TECHNOLOGICAL DEVELOPMENT IN EASTERN EUROPE
Academy Industry Program
National Research Council at National Academy of Sciences

Rapporteur's Report
By Elizabeth Laking

Donald Pressley, Director, Office of European Affairs, U.S. Agency for International Development
Phillipe Nouvel, Division Chief, Europe, Middle East and North Africa Region, The World Bank
Frank Vukmanic, Advisor to the Executive Vice President, Inter-American Development Bank; formerly Director, Office of Multilateral Development Banks, U.S. Department of the Treasury

on

Development Assistance Programs
October 24, 1990

I. Donald Pressley- A.I.D.

A. Congress

1. Legislation for Eastern European support (SEED 1) began in the summer of 1989, following President Bush's trip to Poland and Hungary. The President stated that the United States would continue support as Eastern Europe moves towards democracy.

2. SEED 1 passed in the Fall of 1989, while Eastern Europe was in the process of political and social renovation. The U.S. government was not prepared to involve Eastern European governments in the democratization process according to SEED 1. SEED 2 will address this issue as well as plans for various economic goals which will involve the new standing governments.

B. Agency for International Development's (A.I.D.)/ Assistance

1. The Polish Stabilization Fund was created to stabilize currency and reduce inflation. Its current status is encouraging, as reserves are higher than anticipated. Investments are taking place within the country on market terms, the profits of which are being turned over into new projects within the country.

2. The Private Sector Fund involves the Import-Export Bank and enables small programs to help private farmers.

3. The Technological Training Scholarship ensures educational exchanges and promotes democracy channeled through the Endowment for Democracy to make sure that elections are fair.

4. Environmental Assistance is investigating the effects of propane fuels in Krakov and establishing an Environmental Protection Agency in Budapest to evaluate problems regionally.

5. Medical assistance has been targeted towards children's hospitals and the Center for Disease Control.

C. Plans for 1991

1. The G-24 has asked the European Community Commission to be its Secretariat in a coordinating role to determine how other countries are providing aid, as well as provide an information exchange to improve aid allocation. It will help to sort through the various international offers for assistance to choose those which are useful for the present and the future.

2. Assistant Secretary Lawrence Eagleberger stated that there is presently a mechanism to coordinate assistance from 35 U.S. agencies offering aid.

3. Assistance will depend on how much and how quickly Eastern European countries are willing to move toward democracy, an open market and friendly relations with the West. If they show only limited efforts, then the U.S. limit their role to aid to purely humanitarian purposes.

4. Technical assistance will be given over the next 5 to 10 years until the region reached an acceptable level of technical expertise.

5. The privatization process will continue to be supported but the process will be neither easy nor quick due to diverse social and economic approaches. Eastern Europe needs to focus on developing international business and accounting skills that can be linked with management training.

6. Aid will be given to encourage governments to make their industries environmentally conscious and energy efficient.

7. Various institutions are bidding for grants to develop human resources by making current skills more business worthy. The proposed program must be cost efficient and when the chosen institution leaves there must be a stable infrastructure the Eastern Europeans can sustain.

II. Philippe Nouvel-World Bank

A. The World Bank in Eastern Europe

1. Eastern Europe is not a new regional focus for the World Bank. Poland has been a member since 1940. Current dealings in Eastern Europe include Yugoslavia, Czechoslovakia, Romania, Hungary, Poland and Bulgaria. The World Bank lent over one billion US dollars to Eastern Europe from July 1989 to June 1990.

2. Consideration for aid relies on the countries willingness to adopt and adhere to the Bank's proposed packages.

3. Poland is still not credit worthy, as it has not yet cleared its present debt. Yugoslavia is considered to be in a good credit situation. Hungary has a good market but its huge debt continues to drain the economy regularly.

B. Issues critical to reform

1. Following liberalization, Hungary and Poland have experienced hyperinflation. The World Bank has tried to provide incentives to continue with the liberalization by assisting them with stabilization programs.

2. During the initial consequences of the stabilization program, the countries will experience a contraction of their economy, unemployment, and losses in their markets.

3. It is difficult to estimate the affect of dismantling the old system of trade relations (COCOM); they project the loss will be 4% to 8% of their trade.

4. The World Bank will support the reform process by:

a. providing incentives to the financial sector

b. establishing a framework that provides a sense of stability now, and for the future to relieve social tensions

c. restructuring the enterprise sector through privatization of joint projects and ventures

d. harmonizing banking and financial sectors

e. restructuring industry on realistic terms

f. Improving roads and railways to help market products and entice joint ventures

g. Decreasing the high level of energy consumption

III. Frank Vukmanic- Inter-American Development Bank

A. Why did the Inter-American Development Bank create motive objectives?

1. In 1989 and early 1990, the European Community led by French President Francois Mitterand, proposed the creation of a development bank for Eastern Europe, the EBRD.

2. By creating a bank exclusively for development purposes rather than using existing infrastructures, Eastern Europe was assured that it would have no competition for funding.

B. The focus of European Bank for Reconstruction and Development (EBRD)

1. The bank wants to promote political and economic liberalization as stated in the preamble of the organization's charter: "At least 60% of banks lending in any one year or over five years must be to private sector firms or firms changing to private sector and the remaining goes to the development of infrastructure."

2. The purpose of the bank is to promote business autonomous from the state and to serve as a catalyst for other lenders to invest. If the countries move away from the progression towards a market economy the aid will be cut off.

C. Dimensions of membership

1. The European Economic Community, International Investment Bank and forty other donor countries comprise the membership. The larger industrialized countries are required to invest a set percentage of the total shares.

2. The capital is sizeable and denominated in European currency appropriate to the investment size. Those shares offered in cash are accepted in yen, U.S. dollars or European currency.

3. Loans will be offered for the best possible rates with a small commission required.

4. Bank will be termed functional when two-thirds of the members have subscribed (paid membership dues). The closing date is March 31, 1991 for subscribers but the more likely scenario is December 1991 or January 1992 in which the earliest transactions will be in February 1992.necp2200

Highlights

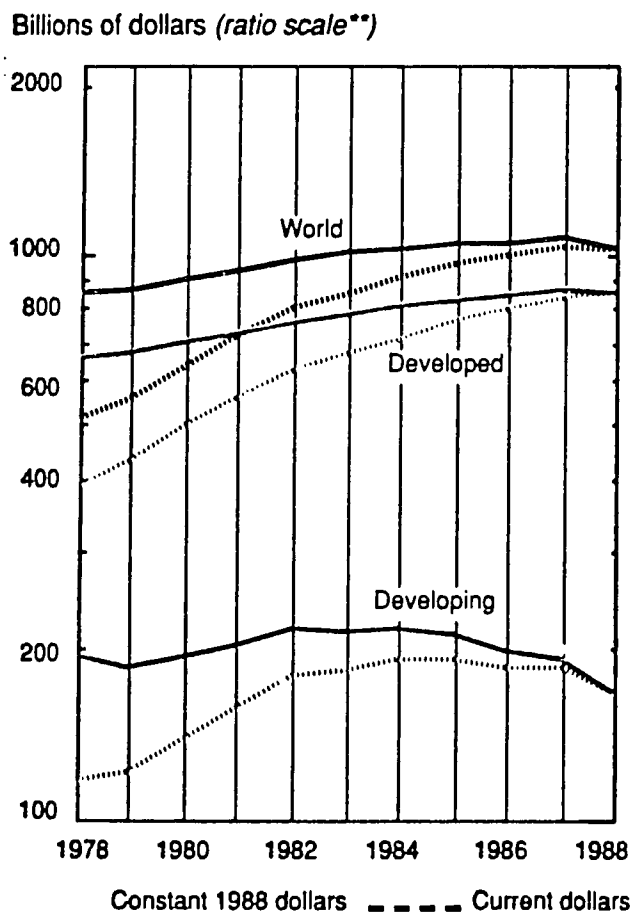
Military Expenditures

Global Trends

World military expenditures declined slightly in 1988 despite surpassing the one trillion dollar mark for the second year in a row (Main Table I). This decline of $1.7 billion in current dollars was entirely the result of decreased military spending by developing countries.

With the drop in the value of the dollar to more realistic levels since 1985 and with the change to the use of 1988 exchange rates in this edition, world aggregates in dollars rose to new heights.* Figure 1 shows world military spending trends in both current dollars, reflecting inflation, and constant dollars, based on 1988 exchange rates.

Figure 1
World Military Expenditures, 1978-1988



In constant dollar terms, the overall slowdown in world military expenditures that began in 1985 is evident. The average growth rate for the second half of the decade 1978-1988 was 0.8%, compared to 2.4% for the total period (Table 1). Sizable increases in military expenditures initially continued into the second half of the decade; however, they were not sustained, and in 1988, expenditures fell to pre-1985 levels.

Mirroring the global trend, military spending by the developed countries also declined in 1988 for the first time during the decade. Despite this decline, however, the developed countries experienced fairly strong annual growth since 1978 (3.1% for the decade and 2.1% during the last half). Military spending by developed countries declined 1.2% in 1988, bringing the level of expenditures to $865 billion, a total that not only represents more than four-fifths of world military expenditures, but also accounts for roughly one-third of the global decline.

The pronounced decline in military spending by developing countries, particularly since 1984, has been the principal cause of the global slowdown. Developing-country military expenditures rose during the first half of the decade at an average rate of 2.8%. After peaking in 1984, however, military spending declined rapidly through the end of the period for an average -4.7% rate in the second half of the decade. In 1988, military expenditures for developing countries decreased $25.1 billion from the previous year, to $167.3 billion. Besides being the largest single decrease of the decade, this represents the lowest level of military expenditures by developing countries for the entire decade. In addition, this decrease accounts for 70% of the global decline.

* See Statistical Notes, Conversion . . . to Dollars, for a discussion of the effects of exchange rate changes.

** The logarithmic or ratio scale used in this and other figures is designed to facilitate growth rate comparisons. A ratio scale is compressed as values increase so that equal vertical distances show equal ratios of value and equal slopes show equal growth rates anywhere on the chart.

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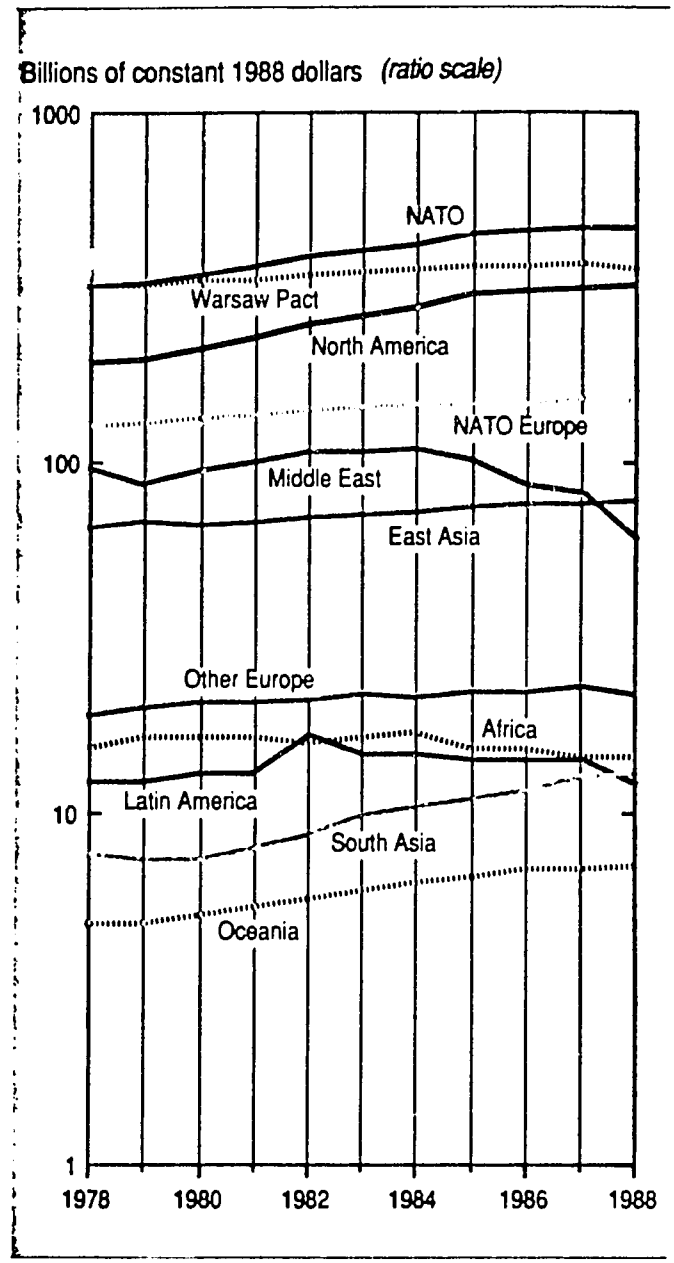
Table 1
Military Expenditures: Shares and Growth
(In percent)

	World Share		Real Growth Rate*	
	1978	1988	Decade 78-88	2nd Half 83-88
World	100.0	100.0	2.4	0.8
Developed	77.1	83.8	3.1	2.1
Developing	22.9	16.2	-0.5	-4.7
Region:				
Africa	1.8	1.4	-1.0	-3.4
East Asia	7.6	7.5	1.9	1.9
Europe, all	54.1	51.4	1.6	0.9
NATO Europe	14.8	14.5	1.0	0.8
Warsaw Pact	37.1	34.7	1.5	0.9
Other Europe	2.2	2.1	1.5	0.6
Latin America	1.4	1.2	0.8	-3.2
Middle East	11.4	5.9	-2.5	-10.4
North America	22.3	30.8	5.9	4.1
Oceania	0.6	0.7	4.5	3.5
South Asia	0.9	1.2	6.5	5.7
Organization				
NATO, all	37.1	45.3	4.4	3.0
Warsaw Pact	37.1	34.7	1.5	0.9
OPEC	10.3	5.0	-3.1	-10.8
OECD	41.7	50.6	4.3	3.0

* Average annual rate, calculated as a compound rate curve fitted to all points. (See Statistical Notes.)

Figure 2
Military Expenditures by Region, 1978-1988



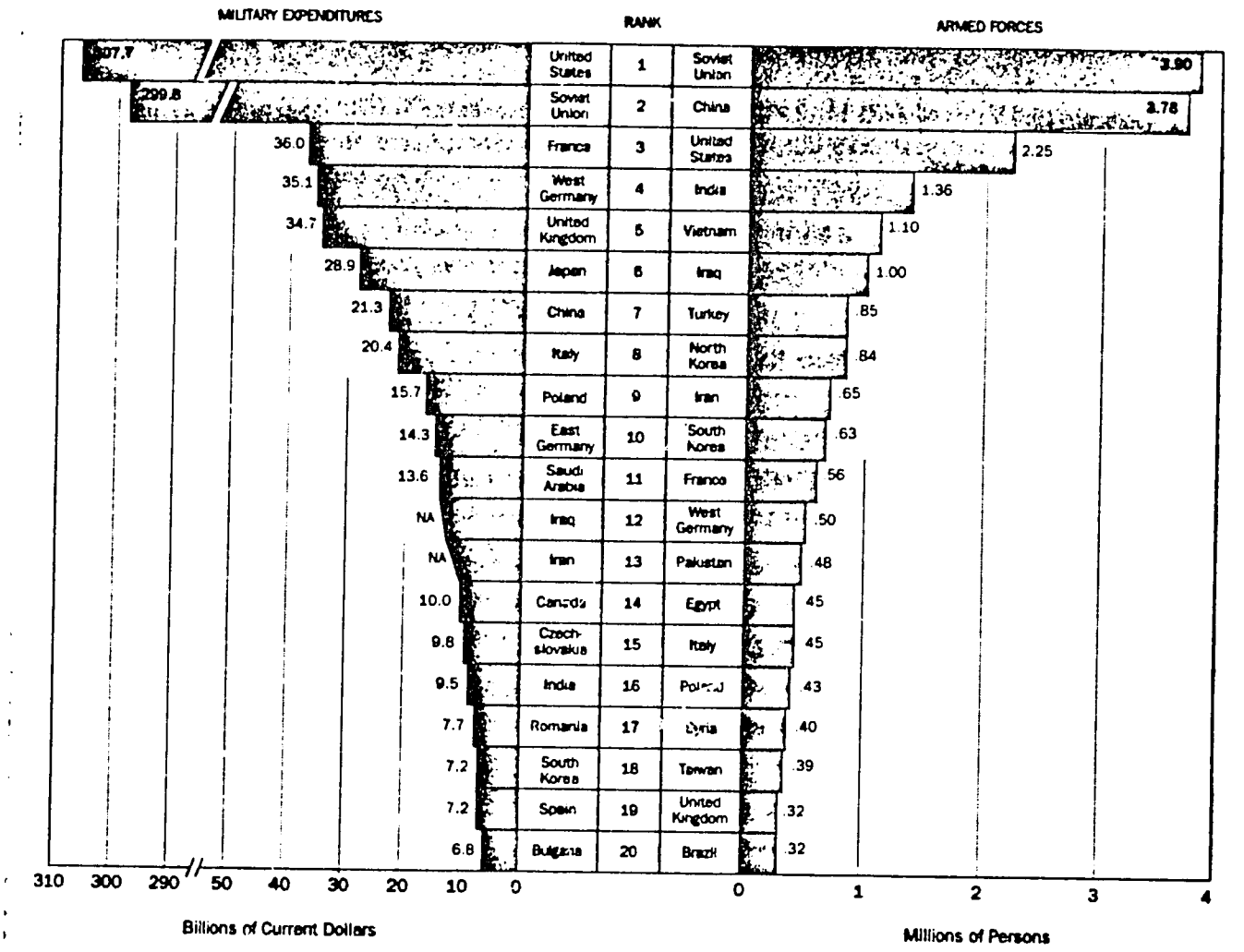
Regional and National Trends

Among the developed regions, **North American (mainly US) military expenditures increased rapidly through most of the decade but slowed at the end** (Figure 2). Although for the period as a whole the growth rate was a strong 6%, it dropped to 4.1% in the second half and to 0.6% in 1988.

Military spending by NATO countries continued to grow steadily throughout the decade at a rate of 4.4%, slowing to 3% during the last five years. This slowdown is due to the combined effect of slower growth in North America, as well as in NATO Europe, which grew modestly by 1% annually over the entire decade and by 0.8% during the last half. At the end of the decade, the largest changes in the level of military expenditures amongst NATO member countries occurred in Italy, the United Kingdom and the US. Military expenditures in the United Kingdom decreased roughly $1.3 billion in 1988, a decrease that was almost exactly offset by the nearly $1.3 billion increase in Italian expenditures. US military expenditures increased $1.7 billion in 1988, accounting for almost the total increase in NATO military expenditures of $1.8 billion. Spending by the rest of Europe, other than NATO and the Warsaw Pact, grew at a rate of 1.5% for the decade and 0.6% during the last half.

Warsaw Pact military spending showed modest but steady growth for all but the last year of the decade.

Figure 3
Leading Military Powers, 1988



Overall growth was 1.5% for the decade and 0.9% during the last five years. In 1988, Pact military expenditures declined for the first time during the period, falling 3.7%, or $13.6 billion. This decline is due, almost entirely, to the $13.2 billion decrease in military expenditures by the Soviet Union.

Among the developing regions, **growth in East Asian military spending remained steady at 1.9% throughout the decade, as well as during the last five years of that period. South Asia, on the other hand, continued to maintain its position as the region with the fastest growing level of military expenditures.** South Asian military expenditures for the decade 1978-1988 grew rapidly at a rate of 6.5%, compared to North America (5.9%) and Oceania (4.5%), the only two other regions with high growth rates. During the last five years of the decade, growth in South Asian military expenditures slowed slightly to 5.7%, which was still higher than growth in both North America (4.1%) and Oceania (3.5%).

Military expenditures in India and Pakistan, South Asia's first and second largest military spenders, respectively, **experienced rapid growth during the decade.** In India, spending increased at a rate of 5.8% throughout the decade, a rate that barely changed during the second half of the decade. Military expenditures in Pakistan increased at the much more rapid pace of 10% during the decade and 7.1% for the last half. An especially large increase occurred in 1983, when Pakistani military expenditures jumped nearly 26%. Sri Lanka, a country that has historically had very low levels of military spending (in 1988 Sri Lanka's military expenditures were a mere 3% of India's military expenditures), is nevertheless the third

THE NEW YORK TIMES, SATURDAY, SEPTEMBER 29, 1990

Help the Children, Here and Abroad

By Matilda R. Cuomo

Tomorrow, leaders from more than 70 nations will convene at the United Nations to participate in a World Summit for Children. The meeting will reflect a growing world wide commitment to the rights of children everywhere.

Every day 40,000 children under the age of 5 die in developing countries. Millions of other children are killed each year by curable and preventable illnesses such as measles, whooping cough, tetanus, pneumonia, polio and diphtheria. War and poverty have crippled tens of millions more.

Surely we can provide the dollar's worth of health care, the nutritious food, the clean water and sanitation that would save most of these lives. In fact, Unicef reports that an additional $2.5 billion a year more in spending would save the lives of 50 million children under the age of 5 by the year 2000. How can we afford to spendless?

How, too, can we tolerate the escalation of drugs, violence and family breakdown that is ravaging the lives of children in developing and industrialized nations alike? How can we turn our backs on the children being victimized by political upheaval?

In 1988, as part of a Unicef delegation, I traveled to Zimbabwe to participate in the "International Symposium for the Survival and Development of the Child." We witnessed firsthand apartheid's impact on the lives of the children in the frontline states.

In Mozambique, I saw 10,000 children crowded into a single refugee camp. They were homeless, orphaned, starved, mutilated and terrorized'... children who had watched as their parents were murdered ... children trained to kill, and forced to fire on friends and relatives. In one hospital we saw children missing limbs, bearing the weight of crude, wooden prostheses ... vacant-faced children in their mothers' arms, their bellies distended from hunger.

These were not my children. Nor are they yours. But they are *our* children. They are gifts from God and we are their stewards, charged with the obligation to give them the best possible care.

The World Summit for Children reminds us that the health and welfare of the world's children must be a top priority for leaders of all nations. The World Summit will enable all nations to express that commitment by ratifying the historic 1989 U.N. Convention on the Rights of the Child, which sets minimum standards for survival, health and education, as well as explicit protection against violence and exploitation.

We can save 50 million lives by 2000.

The United States should lead the world in supporting the convention. And its ratification here would be more than a symbolic gesture: it would be a recognition of the vulnerability of our own children. Today, three million more American children live in poverty than in 1980. The number of children living in foster care homes, detention centers and homeless shelters is rising, as are the numbers of crack-addicted mothers giving birth to babies with bent minds and bruised bodies.

As we wait for the Federal Government to launch a National Decade of the Child — to reduce our disgraceful infant mortality rate, to help provide universal pre-kindergarten education, to begin a national campaign to reduce accidental deaths and to insure that young Americans have medical insurance up to age 18 — we can, as a nation, take a giant step forward by helping the children of the world. The World Summit provides a golden opportunity to begin. □

Matilda R. Cuomo is the honorary chairwoman of the New York State Council on Children and Families.

THE JOURNAL OF COMMERCE, Thursday, October 11, 1990

UN Can Help Build Democracy

By LUCY KOMISAR

Soviet support of the United Nations role in the Middle East has given new importance and influence to that international body. But Iraq ought not be the only focus of the United Nation's attention. It needs to take on a role as a peacekeeper inside, as well as between, countries.

Indigenous movements in the developing world which have struggled for years against government repression have been accelerated in some places by the end of the Cold War, which has cut off dictators' options of playing Americans against Soviets.

But the horrible carnage that has attended efforts at change in Haiti, Liberia and Burma demonstrates the dangers these movements run. Washington, which played a role in the emergence and longevity of some dictatorships and now understands the inherent instability of authoritarian rule, ought to help devise a way to limit the casualties as citizens throughout the world try to attain democracy.

That help is dramatically needed in Zaire, which exemplifies the challenge to U.S. policy.

The shadowy 1961 murder of Congolese Prime Minister Patrice Lumumba, who was opposed by Washington, the CIA-aided defeat of rebel troops in 1963 and the 1965 coup by Col. Joseph Mobutu, said to be an agent of both Belgian and American intelligence agencies, led to 25 years of dictatorship by Mr. Mobutu. Now there is a nationwide demand for democracy and Mobutu Sese Seko — who changed his name for "authenticity" when he renamed the country Zaire — was nervous enough to promise a multiparty system April 24.

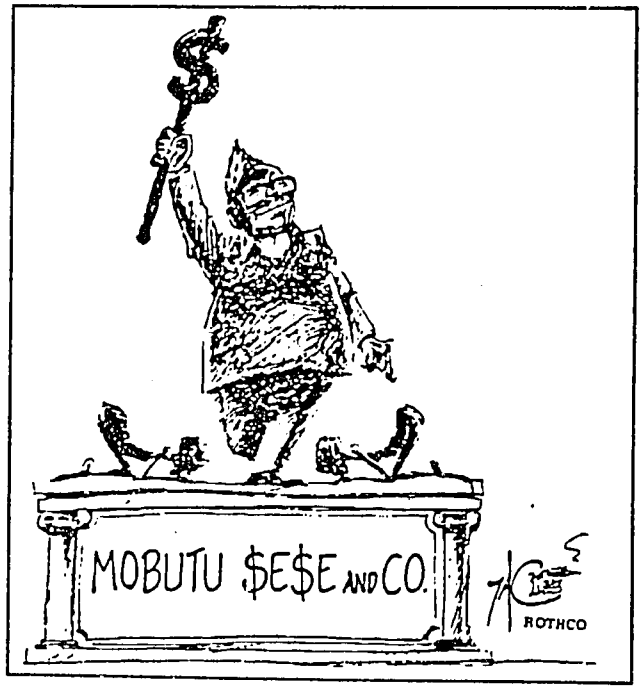
His announcement was prompted by a swing around the country for "consultations" with the population and by a conversation with U.S. Secretary of State James A. Baker, who apparently told President Mobutu to reform or risk withdrawal of U.S. support.

But the outpouring of joy — and the founding of new political parties and newspapers — chilled Mr. Mobutu's family and tribal establishment, which has looted the country for years. He quickly scaled back his promises. "Not this year," he said. Then, to reinforce the old terror, security forces attacked students at the university in Lubumbashi in a five-hour nighttime rampage that left from 30 to 300 dead, according to various sources.

Mr. Mobutu also declared that parties would not be legal yet. Security forces raided a meeting of the Union for Progress and Democracy, the underground opposition party whose members — some of them ex-parliamentarians — have been in and out of prison, internal exile and house arrest, for a decade. Activists were beaten, bayoneted, arrested, raped.

Mr. Mobutu says he is willing to "negotiate" with oppositionists, but he has refused their demand for a national conference of political groups to organize elections.

An aide to the president expressed the fear that the massacre at Lubumbashi might not be an isolated event. "The U.S. has to give us a strategy to neutralize the presidential guard," he told me. The guardsmen are members of Mr. Mobutu's Ngabande tribe who, he said, are "trained to kill indiscriminately" on behalf of their leader.



Zaireans are frightened by what they see around them and by Western inaction. "We look to America to defend democracy," said Kititwa Tumansi, a former Zairean ambassador to Moscow and Paris and now a member of the opposition Democratic Social Christian Party.

The United States bears some responsibility for supporting this dictatorship. Jimmy Carter sent planes to transport Belgian, French and Moroccan troops to repel exile invasions of Zaire in 1977 and 1978, convincing Zaireans that revolt would be futile as long as Washington backed the Mobutu regime. Ronald Reagan also embraced the Zairean leader, who transshiped U.S. arms to Angolan rebels.

Similarly, the United States supported the regimes of Haiti's Duvaliers and of Liberia's late president Samuel Doe, as well as Doe's authoritarian predecessors. U.S. aid helped build up the security forces that now threaten the attempts to achieve democracy in those countries.

Washington ought to promote an international consensus to make acceptance of U.N. forces to oversee free elections a condition for the international and bilateral assistance on which many Third World dictatorships depend. Haiti's planned Dec. 16 elections would be an appropriate beginning.

Otherwise we shall see the irony of U.S.-supported "authoritarian" regimes subjecting their citizens to bloodbaths as the communist dictatorships they were supposed to repel are transformed into democracies.

Lucy Komisar, a New York journalist who recently spent a month in Zaire, is writing a book on U.S. foreign policy on a grant from the John D. and Catherine T. MacArthur Foundation.

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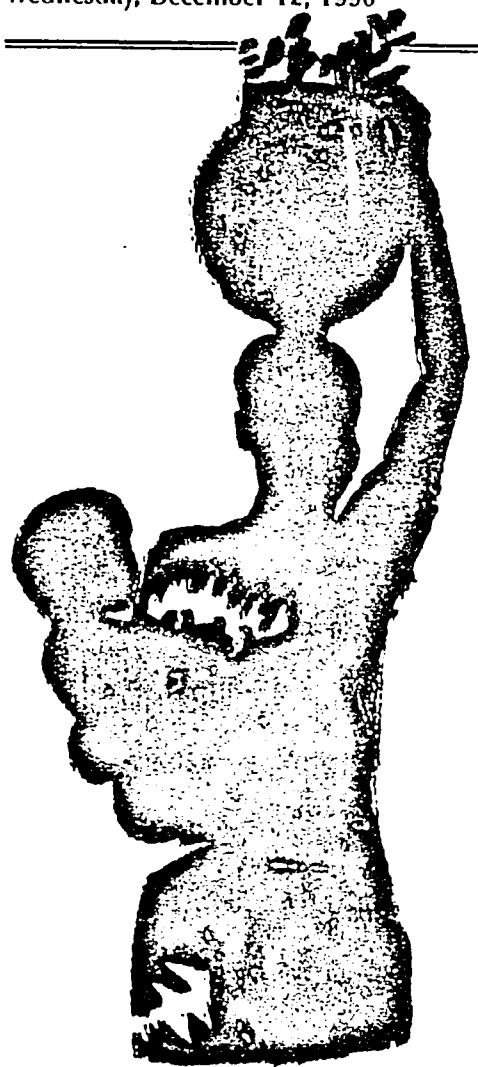

GUY STUART – STAFF

Fresh Hope For Africa

Successful development at the grass roots

By Pierre Pradervand

'MAASTRICHT Conference on Africa: averting a nightmare,' cries out the title of a recent population newsletter. Gloom and doom seem to have become almost the norm when people start speaking about sub-Saharan Africa. Yet such a pessimism is dangerously one-sided. New leadership is springing up, new political freedoms are being won, and above all a startling mobilization is taking place at the grass roots, mainly in rural areas.

For anyone familiar with the grass roots of Africa for the past 15-20 years, this evolution is stunning. Isolated peasant farmers who once felt like helpless victims of circumstances have set up well-organized, increasingly efficient organizations.

The Naam movement of Burkina-Faso is an example. This organization has over 200,000 members in more than 4,000 villages fighting successfully against desertification. They are setting up peasant social security and credit and banking systems, organizing sophisticated barter exchanges on an international scale, and undertaking family planning education in remote villages.

This grass-roots mobilization is not only happening in rural areas, or only in Africa. As Alan Durning of the Washington, D.C.-based Worldwatch Institute illustrated in his pioneering study "Action at the Grass-roots: Fighting Poverty and Environmental Decline," this empowerment is happening worldwide, from the shanty towns of Lima to the fishermen of Kerala, India. Though it is often still fragile, it is possibly the most hopeful sign on the world development scene.

Grass-roots empowerment points to the main failure of what has been called "development" over the past 30 years – the total lack of grass-roots participation. "Development" has been done to people, for people, despite and against people, and especially without them.

Authentic empowerment, or even meaningful partnership, is impossible where there is financial dependency on donors – be they so-called Northern NGOs (nongovernmental voluntary organizations), Western governments, or international institutions.

This dependency expresses the "charity" orientation of most aid coming from the voluntary sector in the North. It is imperative to replace traditional forms of assistance with innovative schemes for financing grass-roots development – schemes which empower our partners in the South to become financially independent. Such approaches already exist and are beginning to function well. Thanks to them, people's organizations are setting up businesses with the aim of making a profit – and they're making one!

For three decades, thousands of private voluntary organizations in the North have solicited funds from the public, with the promise that these donations would create "development." Yet never in the history of humanity have so many people suffered from hunger (35,000 die each day as the result of chronic undernourishment). Never have so many been unemployed, homeless, illiterate. Children eat newspaper instead of bread, prostitute themselves for 6 cents in Bangkok brothels, and I have met women who walk daily 24 miles for water. Between 700 million and 1 billion people live in conditions of poverty that defy any definition of human decency. Clearly, "charity" has not worked in terms of alleviating massive poverty, even if it has helped millions on an individual basis.

Why? Because in a world where the economic structures are fundamentally weighted against the poor and dispossessed, building a well here, a maternity ward there, handing out a few pills and even vaccinating millions of children will not fundamentally alter the picture. The structural injustice will continue. Fundamental changes in world economic policies are needed, and they will come only through the pressure of public opinion.

In November I attended the general assembly of Africa's largest peasant farmer NGO, the so-called "6-S Association." In a startling move the representatives of 400,000 third-world peasant farmers gave their organization a new goal: the education of the public in the North! A growing number of voices in the South are pressing their NGO partners in the North to devote more and more of their time, effort, and money to educating their own public. NGOs from the North, they say, should concentrate in the South on institution building and training. Their top priority should be to make themselves useless as soon as possible. After all, isn't this what we have been preaching for 30 years – self-help for the poor?

In the coming five to 10 years, private voluntary agencies in the North should be spending at least 50 percent of their income for massive educational campaigns at home. They need to set deadlines for handing over the totality of their projects to their partners in the South – the indigenous NGOs and especially the people's organizations. Thomas Jefferson once wrote, "I know of no safer depository of the ultimate powers of the society than the people themselves; and if we think them not enlightened enough to exercise their control with a wholesome discretion, the remedy is not to take it from them, but to inform their discretion."

Do we believe that?

■ *Pierre Pradervand is author of "Listening to Africa – Developing Africa from the Grass Roots" (Praeger, N.Y., 1990).*

U.S. AND GLOBAL MACROECONOMIC TRENDS

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Testimony by Alan Greenspan (Chairman, Board of Governors of the Federal Reserve System) before the Committee on Banking, Finance, and Urban Affairs, U.S. House of Representatives, November 28, 1990

Mr. Chairman and members of the Committee, I appreciate the opportunity to participate in your examination of the economic implications of developments in the Persian Gulf.

The world economy is being profoundly influenced by these developments, including their effects on oil markets during the past four months. However, before turning to an examination of the effects of higher oil prices on the U.S. and world economy, it is useful to step back for a moment and review the trends that our economy appeared to be following prior to the Iraqi invasion of Kuwait. On the positive side, the data released in recent weeks have confirmed that the economy was still expanding when the oil shock hit. Indeed, real GNP currently is estimated by the Commerce Department to have increased in the third quarter. In addition, the index of industrial production increased at a 3.7 percent annual rate last quarter, indicating that much of the strength in the economy during the summer was in the goods-producing sectors, where a weakening of overall activity typically would be expected to show through most clearly. On the negative side, however, growth of private payrolls was at a virtual standstill in July, and the unemployment rate, which had fluctuated narrowly for several quarters, began to rise around midyear, albeit from a level that was quite low by recent historical standards.

On the inflation front, data through July suggest that price increases had not yet begun to decelerate as of mid-summer. In fact, there were disturbing signs in the first half of the year that the core rate of inflation had crept up somewhat. However, the latest data on hourly compensation hint that labor cost increases were beginning to

slow in the third quarter, and, had oil prices not jumped after August 2, some easing of underlying price pressures might well have become evident by now.

To summarize, Mr. Chairman: The data that we have received during the past four months indicate that, prior to August 2, the economy was expanding at a moderate pace and underlying inflation pressures probably were beginning to ease. This suggests that things were developing in line with our policy objectives, which were to achieve a slowing of inflation in the context of continued expansion of real activity.

Regrettably, however, the events in the Persian Gulf have altered the immediate economic situation rather substantially. Consumer and producer price indexes have jumped in the past couple of months because of surges in the prices of energy products. Other, less direct, effects are becoming evident as the higher oil costs are being passed through into the prices of items that are heavily dependent on oil--notably airline fares and other transportation costs and materials that rely heavily on petroleum feedstocks. Over time, the higher prices may feed through to labor costs, as workers seek to delay the inevitable declines in their real incomes. These same influences are being felt, in one degree or another, in most other economies regardless of whether they are net oil importers or net oil exporters.

Not only have the higher oil prices added to overall price pressures here and abroad, they also have begun to restrain real activity. These effects work through several channels and are difficult to sort out with great precision. First, to the extent that the United

States is a net importer of oil, a hike in oil prices drains away purchasing power from American energy users to foreign oil producers. Specifically, the higher prices cut into the real disposable income of households, which in turn reduces their spending on all categories of goods and services. Second, the weaker path for consumption subsequently is likely to spill over to business investment as many firms--their profit margins already squeezed by higher energy costs--lower capital spending in response to the reduced demand for their output.

In addition to the effects of the higher oil prices *per se*, the enormous uncertainty about how, and when, the tensions in the Persian Gulf will be resolved also affects the economy in a negative way. Such uncertainty tends to engender withdrawal by producers and consumers from their normal activities as they respond cautiously to new developments. However, the surveys of people's concerns about the outlook have pointed to greater weakness than has been revealed by what people, at least to date, are actually doing.

Most of these same influences on prices and activity are affecting the economies of our major trading partners. Although countries that are not net oil importers, such as Canada and the United Kingdom, do not face the net drain on real national income from higher oil prices, they are adversely affected by economic developments in the oil-importing countries and by higher oil prices which tend to depress real personal income, at least in the short run. Consumers and producers in these countries are also affected by the uncertainties

surrounding the entire situation. All this has negative feedback effects on our own economy through lower exports.

In the current episode, the clearest manifestation of the actual effects on U.S. activity is in the labor market, where private employment and hours of work dropped markedly in October, and where initial claims for unemployment insurance have moved significantly higher over the past several weeks. In addition, industrial production--especially in the motor vehicle and construction supplies sectors--fell in October, and the weekly data through mid-November point to pronounced further weakness. The drop in employment and hours is causing personal income to decline at the very time that rising energy prices are squeezing many household budgets; this drop in real purchasing power, along with plunging consumer sentiment, does not bode well for the near-term trends in consumer demand especially in the context of an already-low saving rate. It is noteworthy that retail sales in October were about unchanged in nominal terms, and undoubtedly fell significantly in real terms.

Higher oil prices, however, are not the only force restraining activity. In particular, as I reported to the Congress in July, there was considerable evidence at that time that banks--along with other lenders--had tightened the terms and other conditions for supplying credit. Data since then, including Federal Reserve surveys of bank lending officers as well as the recent sluggishness of the monetary aggregates, suggest that the tightening of credit has proceeded somewhat further since July.

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As yet, there is only limited statistical evidence on the extent to which tighter credit conditions have directly affected businesses and consumers. However, the available anecdotal information clearly suggests that many types of businesses are encountering greater difficulty obtaining financing. This has been seen most clearly in the commercial real estate market, but it extends to borrowing for a variety of other purposes as well.

The interaction of rising oil prices, Persian Gulf uncertainties, and credit tightening is apparently creating a greater suppression of economic activity than the sum of the forces individually. Thus, although economic activity seems to have been better maintained through the summer than many forecasters had expected, all indications are that a meaningful downturn in aggregate output occurred as we moved through October and into November.

Amidst these adverse developments, the depreciation of the dollar we've seen this year, other influences aside, may be expected to provide some stimulus to our exports and restrain our imports. However, a weaker dollar also is a cause for concern: It adds upward pressure to U.S. import prices, compounds the inflation impulse emanating from the higher oil prices, and may put at risk our ready access to net inflows of foreign saving.

In the oil market itself, rates of overall production of crude petroleum currently appear to have been restored to pre-crisis levels, after a temporary disruption in the wake of the Iraqi invasion. At the end of July, OPEC had agreed to reduce its production rate from about 23-1/2 million barrels per day to 22-1/2 million barrels per day.

Before the new accord could take hold, of course, Iraq invaded Kuwait. The subsequent United Nations-sanctioned embargo removed 4.3 million barrels per day of Iraqi and Kuwaiti crude oil production from the market, an amount equal to almost 10 percent of production in market economies.

This loss has since been fully replaced through increased liftings by other members of OPEC, chiefly Saudi Arabia, as well as significantly increased production in the North Sea. As a result, in October, crude production in market economies was back up to about the same rate as during the first half of this year, almost 46 million barrels per day. Although the replacement crudes are slightly "heavier" than the lost oil, and therefore yield less output of light products such as gasoline and kerosene, such differences appear manageable.

While the response of world crude oil production to the Iraqi invasion can be gauged fairly readily, the reaction of world oil consumption is more difficult to discern. Available data on world shipments of petroleum products actually show a greater-than-normal increase in the third quarter. But a substantial portion of this increase is thought to have been reflected in secondary and tertiary stockbuilding, rather than in an increase in actual consumption. Secondary stocks, incidentally, are those held by product retailers and distributors, while tertiary stocks are held at the point of consumption, such as industrial plants.

Primary commercial stocks of petroleum and products held on land by refiners and marketers in the industrial countries appear to be a bit above normal for this time of year. In addition, rough indicators

of the level of stocks afloat suggest that after a small decline in the third quarter, these stocks may be increasing. Some of these stocks, which are held in ocean tankers, represent unsold heavier crude oil from Saudi Arabia and Iran. Overall, world stocks of petroleum and products currently are at levels that, under normal circumstances, probably would be viewed as being comfortable or perhaps even slightly excessive. This relatively comfortable situation is consistent with the current pattern of futures prices, which show a decline of about $6 to $8 a barrel by the second half of next year from the recent spot price levels of about $33 per barrel for West Texas intermediate crudes. Indeed, at the current apparent balance of supply and demand for crude oil, spot prices might have been expected to be substantially lower were it not for the uncertainties associated with the situation in the Gulf. What we have seen in varying degrees since August 2 is a general scramble for existing inventories by refiners here and abroad to guard against a possible further short-term disruption of supplies. This has contributed to the bidding up of prices on spot markets.

The situation in markets for a few specific oil derivatives may be somewhat tighter than in markets for crude. The shutdown and blockade of refineries in Kuwait and Iraq removed about 2 percent of the world's refinery capacity from the market. The lighter-end products, such as kerosene or jet fuel, produced by these refineries went primarily to Japan and other Asian countries. Attempts by Asian consumers to replace the lost products, coupled with increased Gulf-related military demand, resulted in a bidding-up of world kerosene and jet fuel prices during September and October relative to crude and other

petroleum products. But these spreads have since retraced most of their earlier increase. At the time of the invasion, refineries in Western Europe had been operating at relatively low utilization rates, and there appeared to be some excess capacity, globally, in operations that convert heavier products into lighter ones. Production rates have presumably risen in these areas since the invasion.

In the United States, gasoline markets were relatively tight over the period prior to the invasion, owing to strong demand and a series of disruptions at refineries. Stocks of gasoline fell further in August, rebounded through September and the first half of October, and have edged off over the past six weeks. The level of stocks last week was roughly in line with its level a year ago, and about 6 percent above what is considered the minimum operating inventory required to ensure against normal operating problems and shortages.

The rapid rise in crude oil prices following the Iraqi invasion helped boost the domestic average price of gasoline from $1.10 per gallon in the second quarter to an average of roughly $1.40 per gallon during the past two months. However, average margins between the cost of crude to refiners and retail prices at the pump fell significantly from July through October. Recently, margins have recovered somewhat, but they still appear to be about 5 to 10 cents per gallon below their average level in the second quarter this year.

Turning to the question of how the Gulf crisis has affected monetary policy, the first point is that the uncertainties surrounding the situation are considerable and that it is difficult to isolate the Federal Reserve's response to this particular event when so many other

things are affecting the policy equation. Moreover, we must not lose sight of the fact that there is no policy initiative that can in the end prevent the transfer of wealth, and cut in our standard of living, that stems from higher prices for imported oil.

The role of monetary policy is to provide the financial environment that is consistent with the nation's longer-run economic objectives. Since the spring of 1989 this has implied some easing of reserve conditions, and the federal funds rate has come down from near 10 percent to its current level of around 7-1/2 percent. Our latest policy adjustments have been in response to indications of a weaker economy, partly as a consequence of the prospects for a degree of fiscal restraint as a result of the budget agreement, and partly because of some further tightening in the availability of credit since mid-summer. In this context, we shall want to make certain that money and credit remain on appropriate growth tracks, with due attention to the credit situation. Whether further adjustments to policy will be needed cannot be spelled out in advance and will depend on the specifics of the circumstances as they develop.

In the final analysis, I can only offer the assurance that the Federal Reserve will seek, as we have in the past, to foster economic stability and sustainable growth. As in the past, this will require not only attention to the level of economic activity but also the pursuit over time of price stability--a task made all the more challenging by the effects of the Gulf crisis.

NBER Reporter

NATIONAL BUREAU OF ECONOMIC RESEARCH, INC. FALL 1990

Program Report

Economic Growth

Robert J. Barro and Paul M. Romer

In the 1950s and 1960s, there was widespread interest among economists in the long-run rate of economic growth. Initially, economists followed the pattern set by Robert M. Solow's seminal papers and developed the theory of dynamic models in tandem with empirical work on growth accounting.[1] But by the 1970s, theoretical and empirical work on growth and development diverged. Professional interest in growth waned, despite the paramount importance of these issues. Two years ago, we created a growth project to encourage the kind of interaction between theory and evidence that once had been so successful.

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This issue of the *Reporter* highlights the Bureau's Project on Economic Growth. Next, David S. Scharfstein describes his research into corporate finance in the United States and Japan. After a biographical sketch, news of NBER conferences, the Conference Calendar, and other NBER news and reports, the *Reporter* concludes with short summaries of recent NBER Working Papers.

Recent Trends in Empirical and Theoretical Work

Two recent sources of data have been influential in stimulating renewed empirical work on growth. In *Phases of Capitalist Development*, Angus Maddison summarized much of his work on constructing comparable sets of data that extend over a century or more for a small set of developed countries. Separately, Alan Heston and Robert Summers have compiled national income accounts data for a large cross section of countries since World War II. Because these data correct for differences in relative prices in different countries, they permit more meaningful comparisons of the level of income per capita than were previously possible.

From the early analyses of these data, several questions emerged.[2] First, why is it that poor countries, on average, do not catch up with the rest of the world? Traditional theory suggests that convergence should take place almost automatically. Further, productivity and income per capita within the developed countries have converged to a substantial degree.

Second, why do long-run data show a correlation between the rate of savings and the rate of growth? According to the neoclassical model of growth, the only explanation for the correlation is that variation in the rate of technical change induces variation in both

[1] R. M. Solow, "A Contribution to the Theory of Economic Growth," Quarterly Journal of Economics 70 (1956), pp. 65-94, and "Technical Change and the Aggregate Production Function," Review of Economics and Statistics 39 (1957), pp. 312-320.

[2] P. M. Romer, "Increasing Returns and Long-Run Growth," Journal of Political Economy 94 (1986), pp. 1002-1037, and "Crazy Explanations for the Productivity Slowdown," in S. Fischer, ed., NBER Macroeconomics Annual 1987, Cambridge, MA: MIT Press, 1987, and W. J. Baumol, "Productivity Growth, Convergence, and Welfare," American Economic Review 76 (1986), pp. 1072-1085.

the rate of savings and the rate of growth. But the magnitude and importance of the observed correlation suggest other possibilities: that variation in the savings rate might cause variation in the rate of growth; or that variation in government policy might cause variation in both the savings rate and the rate of growth.

More extensive investigation of the Heston and Summers data, supplemented by data collected by Robert J. Barro, identified other important correlations.[3] Everything else equal, a higher rate of investment by either the private or public sector, a lower share of government consumption spending, higher school enrollment rates, greater political stability, and lower fertility all are correlated with a faster rate of growth. This sample, with its large number of poor countries, also reveals evidence about convergence. Everything else held constant, a lower level of initial income per capita is associated with a faster rate of growth. This means that poor countries would grow faster if the other variables did not vary systematically with the level of income. But they do. Poor countries have lower rates of investment, lower school enrollment rates, higher fertility rates, and less political stability. Barro and Xavier Sala-i-Martin also find that income per capita in U.S. regions has converged over the past 150 years.[4]

All of these empirical findings point to the importance of alternative models in which the long-run growth rate can be influenced by policy variables and individual preferences. It is difficult to believe that exogenous differences in the rate of technological change alone can lead to this pattern of correlations. Two complementary approaches are developing now to provide more theories linking growth, technological change, savings, and policy variables. The first assumes that even though technology is intangible, it is analogous to education or on-the-job experience and therefore can be modeled using the same perfectly competitive framework that is applied to human capital in the labor market.

The second approach emphasizes the observation that ideas that constitute a technology differ fundamentally from other economic goods. According to this second view, ideas and technological change are not transmitted in the perfect markets used in the neoclassical growth model and in the analysis of human capital. Both types of models are described in greater detail below.

Growth with Perfect Markets

When economists first assumed that technological change was determined outside of the economic sys-

[3] *R. J. Barro, "Economic Growth in a Cross Section of Countries," NBER Working Paper No. 3120, September 1989, and P. M. Romer, "Human Capital and Growth: Theory and Evidence," NBER Working Paper No. 3173, November 1989.*

[4] *R. J. Barro and X. Sala-i-Martin, "Economic Growth and Convergence Across the United States," NBER Working Paper No. 3419, August 1990.*

tem, they intended this specification to be provisional. Recent work on growth with perfect markets extends neoclassical models so that all economic improvement can be traced to actions taken by people who respond to economic incentives. Sergio T. Rebelo, and Larry E. Jones and Rodolfo Manuelli, construct models in which persistent growth can arise from a convex, stationary technology if additional variables are added.[5] Rebelo's paper, which builds on work by Robert E. Lucas, Jr., shows that a capital good sector with constant returns to scale can lead to persistent growth.[6] Jones and Manuelli show that even such fixed factors as labor can be introduced into this sector, provided that output is asymptotically a constant returns function of the capital stocks, as assumed by Rebelo. In both of these analyses, human capital keeps growth going.

In a paper that also uses a linear technology based on human capital, Gary S. Becker, Kevin M. Murphy, and Robert F. Tamura examine the interaction between the decision by parents to invest in more children and the decision to invest in more human capital per child.[7] Adding a description of the preferences that affect fertility decisions, they show that, depending on the initial conditions, a country could end up either on a path with low growth in the population and rapid growth in per capita income or become trapped in an equilibrium with rapid growth in the population and stagnant income per capita. The model also reproduces one of Barro's strongest empirical findings: that high investment in education is associated with low fertility.

A well-known deficiency of the neoclassical model is that neither policy nor preferences can affect the steady-state rate of growth. The importance of this limitation sometimes is minimized by observing that even in the neoclassical model, policy and preferences do matter somewhat along the transition path to a steady-state growth path. Robert G. King and Rebelo have shown, however, that the transition dynamics in the neoclassical model explain only a small part of growth.[8]

Growth with External Effects

Human capital theory as developed in labor economics offers one way to model the accumulation of ideas, but there are aspects of innovation and invention that this approach does not address. When a carpenter learns a new skill, like how to hammer a nail, there is no threat that someone else will be able to free ride on the benefits of his investment in human capital. Nor does the new skill raise the productivity of his coworkers. In contrast, some discoveries can raise the productivity of many different firms or people at no cost to the discoverer, and these discoveries sometimes can be exploited by free riders who do not compensate the discoverer.

Many of the recent models of endogenous growth have captured these aspects of ideas by allowing for external increasing returns and knowledge spillovers. In the learning-by-doing formulation first outlined by Kenneth Arrow, a discovery is assumed to have no direct value to the person who makes it. Discoveries arise as an unintended side effect of some other activity and then are freely exploited by others. Mervyn A. King and Mark Robson show that the particular assumption used by Arrow, and subsequently by Romer, that the stock of economywide knowledge is proportional to the stock of capital, is quite restrictive.[9] A plausible, and more general form of knowledge spillovers can lead to complicated dynamics, important forms of persistence in rates of growth, and very different predictions about how such policy variables as taxes can influence growth.

Nancy L. Stokey uses a model based on knowledge spillovers from education and skill acquisition to show how the introduction of new goods can be linked to increases in human capital, and to address the effects of trade between developed and less developed countries.[10]

In contrast, Jess Benhabib and Boyan Jovanovic have shown that the cross-country correlation between the rate of investment and the rate of growth is consistent with a model with no external effects.[11] In their model, the underlying fundamentals are the same in each country, but persistent random shocks to the technology can induce the correlation that is observed.

One of the interesting developments of the last ten years is the increasingly close connection between growth theory and the theory of macroeconomic fluctuations. The real business cycle models that evolved from the neoclassical model of growth have analogs that are based on growth models with external effects. For example, Murphy, Andrei Shleifer, and Robert W. Vishny have shown how a specific type of external increasing returns could generate macroeconomic fluc-

[5] S. T. Rebelo, "Long-Run Policy Analysis and Long-Run Growth," NBER Working Paper No. 3325, April 1990, and L. E. Jones and R. Manuelli, "A Convex Model of Economic Growth," NBER Working Paper No. 3241, January 1990.

[6] R. E. Lucas, Jr., "On the Mechanics of Economic Development," NBER Reprint No. 1176, May 1988.

[7] G. S. Becker, K. M. Murphy, and R. F. Tamura, "Human Capital, Fertility, and Economic Growth," NBER Working Paper No. 3414, August 1990.

[8] R. G. King and S. T. Rebelo, "Transitional Dynamics and Economic Growth in the Neoclassical Model," NBER Working Paper No. 3185, November 1989, and "Public Policy and Economic Growth: Developing Neoclassical Implications," NBER Working Paper No. 3338, April 1990.

[9] M. A. King and M. Robson, "Endogenous Growth and the Role of History," NBER Working Paper No. 3151, October 1989.

[10] N. L. Stokey, "Human Capital, Product Quality, and Growth," NBER Working Paper No. 3413, August 1990.

[11] J. Benhabib and B. Jovanovic, "Externalities and Growth Accounting," NBER Working Paper No. 3190, November 1989.

tuations.[12] Ricardo J. Caballero and Richard K. Lyons use time-series data for manufacturing industries to show that business cycle fluctuations are consistent with the presence of strong external increasing returns to scale.[13]

Growth with Market Power

Models with learning-by-doing and knowledge spillovers can explain how accidental discoveries arise and are exploited but cannot explain intentional attempts to make discoveries. In the microeconomic analysis of innovation and invention, market power is an essential part of the incentives that induce people to search for new discoveries. Because of secrecy or explicit legal protection of patents and copyrights, the discoverer of a new idea expects to be able to charge a price for use of the idea that is higher than the opportunity cost (equal to zero) of letting it be used by others. Models with external effects depart from the perfect markets assumptions of welfare economics, but they retain the price-taking assumptions that greatly simplify the formal analysis. Models that recognize the importance of market power must abandon price taking as well, and for this reason are more difficult to analyze.

In an extension of earlier work that focused only on external effects, Romer argues for the fundamental importance of market power in the analysis of innovation and technological change, even at the aggregate level.[14] The key concepts in the analysis of ideas are the ones developed for the analysis of public goods: rivalry and excludability. In general, a good that is not rivalrous introduces a nonconvexity into the technology. Research in public finance has shown that if this nonconvexity is local, perfect price-taking competition can be supported between groups of people organized into coalitions called clubs. Jeremy Greenwood and Jovanovic analyze a growth model in which information about investment projects has this partially nonrival character.[15] In their analysis, the clubs are interpreted as perfectly competitive financial intermediaries. But if the nonconvexity is global, as it is for many ideas, then price taking cannot be supported and explicit attention to market power is required.

In a separate paper, Romer uses a model with market power and explicit R and D.[16] He finds that increased trade between similar regions, such as North America and Europe, will speed up growth because of the increase in market size. In a series of papers that use this model of the introduction of new goods, Gene M. Grossman and Elhanan Helpman show that trade can have complicated and offsetting effects on growth, especially when countries differ in some fundamental way, as in a product cycle model of trade between a developed and a less developed country.[17]

Innovation in these models is described as being associated with the introduction of new goods. Philippe Aghion and Peter Howitt develop an alternative model in which innovation consists of improvements in existing goods.[18] They are able to capture the dual character of innovation, which creates monopoly profits for some at the same time that it destroys monopoly profits for others. Grossman and Helpman refine this model of quality improvement, illustrate its close formal resemblance to the model in which new goods are introduced, and consider its trade implications.[19]

Policy

One of the conclusions common to all of the endogenous growth models, both the perfect markets and the imperfect markets models, is that policy choices and preferences influence long-run growth rates. In this sense, all of these models are quite distinct from the exogenous growth models. If consumers are more patient, growth will be faster. If government taxes or distortions discourage the activity that generates growth, growth will be slower. All of these models support general lessons from development outlined by Anne O. Krueger.[20] Bad government policies can affect both the level of income and the long-run rate of growth, and the welfare losses can be very large. In an explicit example, William Easterly shows how policies that affect the sectoral allocation of resources can have large effects on growth rates and welfare.[21]

Beyond these general lessons, the specific policy conclusions depend on the structure of the model. For example, in Barro and Sala-i-Martin, the optimal gov-

[12] *K. M. Murphy, A. Shleifer, and R. W. Vishny, "Increasing Returns, Durables, and Economic Fluctuations," NBER Working Paper No. 3014, June 1989.*

[13] *R. J. Caballero and R. K. Lyons, "The Role of External Economies in U.S. Manufacturing," NBER Working Paper No. 3033, July 1989.*

[14] *P. M. Romer, "Are Nonconvexities Important for Understanding Growth?" NBER Working Paper No. 3271, February 1990.*

[15] *J. Greenwood and B. Jovanovic, "Financial Development, Growth, and the Distribution of Income," NBER Working Paper No. 3189, December 1989.*

[16] *P. M. Romer, "Endogenous Technological Change," NBER Working Paper No. 3210, December 1989.*

[17] *G. M. Grossman and E. Helpman, "Comparative Advantage and Long-Run Growth," NBER Working Paper No. 2809, January 1989; "Endogenous Product Cycles," NBER Working Paper No. 2913, March 1989; and "Growth and Welfare in a Small Open Economy," NBER Working Paper No. 2970, May 1989.*

[18] *P. Aghion and P. Howitt, "A Model of Growth Through Creative Destruction," NBER Working Paper No. 3223, January 1990.*

[19] *G. M. Grossman and E. Helpman, "Quality Ladders and the Theory of Growth," NBER Working Paper No. 3099, September 1989, and "Quality Ladders and Product Cycles," NBER Working Paper No. 3201, December 1989.*

[20] *A. O. Krueger, "Government Failures in Development," NBER Working Paper No. 3340, April 1990.*

[21] *W. Easterly, "Policy Distortions, Size of Government, and Growth," NBER Working Paper No. 3214, December 1989.*

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ernment fiscal policy is different in models with perfect markets, external effects, and market power.[22]

Project Activities

To support research on growth and to facilitate communication among economists doing research on empirical and theoretical topics, the growth project holds small research meetings on a regular basis, typically in the fall or spring. Because their intent is to foster interaction among different areas of economics, the meetings offer an eclectic collection of papers and participants, with interests that include abstract equilibrium theory, history, macroeconomics, development, industrial organization, the microeconomics of research and development, and productivity analysis. The most recent meeting is described on pages 20–21 of the Summer 1990 issue of the *NBER Reporter*. Many of the papers from that meeting are scheduled for publication in a special May 1991 issue of the *Quarterly Journal of Economics* (*QJE*) devoted to growth theory.

To facilitate exchange of data and encourage replication of results, the project increasingly is taking responsibility for maintaining and distributing datasets. Heston and Summers have been invited to present descriptions and updates on their dataset in two different project meetings. A paper describing the most recent revision and extension (Penn World Table Mark 5) will be published in the *QJE* special issue.[23]

Conclusions

The theoretical work of the last few years has established that policy can have a significant effect on growth. The empirical work demonstrates that the range of variation in growth rates is large, so that if only a small part of that variation can be traced to variation in policy, then the welfare gains from adopting better policies can be very important. Together, the empirical work and the theoretical work have outlined the set of policies that are most likely to foster growth: support for education; incentives for investment in physical capital; protection of intellectual property rights; support for R and D; international trade policies that encourage the production and worldwide transmission of ideas; and the avoidance of large government-induced distortions in the market. Ongoing theoretical and empirical work is directed at going beyond this menu of policy choices. Ultimately, economists should be able to quantify the effects of these different policies and to lead us sooner to reliable answers to the oldest question in economics: What is it that determines the wealth of nations?

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[22] *R. J. Barro and X. Sala-i-Martin, "Public Finance in Models of Economic Growth," NBER Working Paper No. 3362, May 1990.*

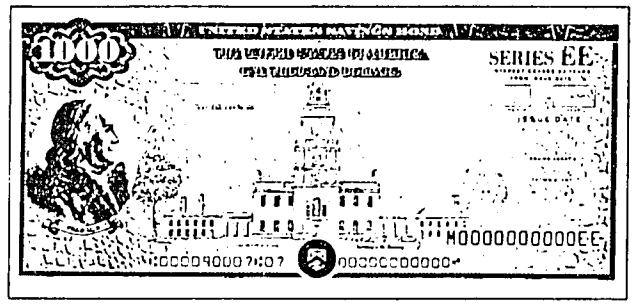
[23] *Anyone interested in obtaining documentation and floppy disks containing the cross-century data collected and analyzed by Barro can write to Holger Wolf at the NBER in Cambridge. Also, in 1991, floppy disks containing the Penn World table can be obtained by writing to the Publications Department of the NBER in Cambridge. In the future, we plan to make available a dataset containing personal income by state for the United States from 1880 to the present.*

INTERNATIONAL ECONOMIC INSIGHTS, September-October
Institute for International Economics

INTERNATIONAL REVIEWS

The Decline of World Savings

In the last few years, economists and others have become acutely aware of the inadequacy of the world's savings. In many developing countries, the ratio of investment to GDP has fallen by a third compared to the level prevailing in the 1970s, as national savings had to be sent abroad for service of the debt, domestic capital sought a refuge abroad and capital inflow ceased.



At the same time, the United States swallowed a large part of the savings in the rest of the industrial world, as reduced private US saving and a persistent government deficit created a huge current account deficit. On top of this, the developments of the past year have laid bare an enormous need for investment in Central Europe and the Soviet Union to modernize factories and the infrastructure, to provide decent housing and, perhaps worst of all, to undo decades of abuse to the environment. The socialist economies had been known for their high rates of saving and investment. But much of that investment now proves to have been misallocated by central decision-making operating in the dark in the absence of economic prices or interest rates.

Throughout the West, the shortage of savings found its expression, in the 1980s, in a rise in real interest rates. This rise has received an additional fillip in the last year as the investment needs in Eastern Europe became evident and as the Federal Republic of Germany showed its willingness to apply part of its savings to the capital shortage in the GDR.

These developments have increasingly focused attention on a major issue in the world economy: the decline in savings rates world-wide.

In the industrial countries, the ratio of aggregate saving to GNP in the 1980s was about 20 per cent, as against 25 percent in the early 1970s. Although savings rates differ widely among countries, their decline was universal, with some of the largest declines in Japan and Germany. Falling savings rates in these two countries did not lead to current account deficits, as happened in the United States. On the contrary, both countries ended up with large current account surpluses as their investment rates fell even more sharply.

In most industrial countries, reduced government savings (smaller surpluses or larger deficits) accounted for a substantial part of the decline in the overall savings rate, but private savings also declined in Japan, the United States, France and the Nordic countries. There is little evidence in this data to support the theory that private saving responds by offsetting changes in government saving. There may, indeed, be a perverse causation in the sense that the categories of public expenditures in the United States that have grown most rapidly in the last two decades (public retirement and disability programs, unemployment insurance, student aid and housing assistance) are those that tend to reduce personal saving.

One of the important factors in the declining trend in personal savings has been the increased value of household wealth as the prices of equities and houses rose during the 1980s, for example in the United States and even more in Japan. According to established economic theory, the rise in wealth would diminish the need for saving out of current income. Or — to put a different gloss on the same phenomenon — households may have spent for consumption a part of their capital gains (realized, or with easy access to credit, even unrealized capital gains). In Japan, the ratio of household net wealth to GNP quadrupled between 1982 and 1987, and this has been estimated to account for a decline in the savings rate of 3.2 percentage points, or about three quarters of the total decline. In the United States, IMF staff estimates that the rise in the ratio of wealth to income during the 1970s and 1980s could explain a 2 percentage point decline in the personal saving rate.

Other contributing factors to the decline in private savings rates include improvements of the relative income position of the elderly, financial liberalization which has facilitated the access to credit, and tax distortions.

At the world level, the relative impact on the supply of resources for investment brought about by the decline in savings in the industrial countries has been compounded by an even larger decline (8 percentage points) in saving in the developing countries. This decline almost completely reversed the rise in their savings rate since the early 1960s. Here the change was not universal. Savings were well-maintained in the developing countries in Asia and Europe, but fell sharply in the Middle East, with the decline in oil prices, and Africa. In Latin America, the private savings rate was roughly stable through the 1980s but public saving fell from 6 percent of GDP in 1980 to 0.5 percent in 1982; it has since recovered to about 4 percent.

Are these savings tendencies likely to reverse? Private savings rates seem to have recovered somewhat since the October 1987 stock market crash. And a National Bureau of Economic Research (NBER) study holds out hope for a rise in the US savings rate over the next 30 years (but not beyond 2020). This improvement would be due to the fact that more Americans are entering high-earning and high-saving age brackets. But demographic trends are not the sole determinants of the savings rate; if they were, savings in the 1980s would have been twice as high as they actually were.

Clearly, the most direct way that government policy can raise national saving is to increase government saving. This is of particular importance to countries with large fiscal deficits. Since increases in taxes will lead to a partial offset by a decline in private saving, reducing government consumption is likely to have a larger effect on national saving than an equivalent increase in taxes — although a choice between the two will, of course, also have to weigh the relative value of private consumption verses government services.

In this general fiscal area, moreover, it is important to realize that choices among taxes and among categories of government expenditure can have major impacts both on savings and on economic growth.

Tax policy can also be used to promote private saving by exempting some forms of saving from taxation. In general, tax incentives of this nature suffer from the fact that some (or even much) of the gain in private saving may be offset by reduced government saving. In that respect, the elimination of tax incentives to borrow may be more productive in that it increases both private and government saving.

— Jacques J. Polak

This review based on: IMF Occasional Paper 67, "The Role of National Saving in the World Economy: Recent Trends and Prospects"; IMF/IBRD, Finance and Development, June 1990, (articles by Aghevli & Boughton; Bovenberg; Lehmussaari); NBER Working Paper No. 3150, "Demographics, Fiscal Policy and US Saving in the 1980s and Beyond."

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Key Features of Deficit-Reduction Bill

The five-year, $236.3 billion deficit-reduction measure (HR 5835) fell almost $10 billion short of the target set by White House and congressional negotiators, but congressional leaders and President Bush agreed that the package was close enough — particularly in the last-minute scramble for enough House votes to pass the measure.

Leaders had to slash the agreed-upon savings in Medicare spending by about $10 billion to gain passage.

Nevertheless, the measure represents the largest deficit-reduction measure in history and includes sweeping changes in current law that call for a variety of new and/or higher taxes, significant savings in Medicare and farm subsidies and a host of other, minor changes in current law.

The bill's most notable feature is $137.2 billion in new revenues, including a higher income tax rate for the wealthy, a five-cent a gallon increase in the gasoline tax, higher taxes on cigarettes, beer, liquor and wine, and luxury taxes on expensive cars, jewels and furs.

In addition, projected spending for Medicare will be slashed by $42.5 billion over the next five years.

Other Savings: The so-called reconciliation measure is the principal component of a five-year $500 billion deficit-reduction agreement between Congress and President Bush. The remainder of the cuts will largely come from reduced spending contained in the 13 annual appropriations bills over the next five years and reduced interest payments on the national debt.

The lion's share of the appropriations cuts will come from the defense budget (about $170 million in the next five years).

Major Components

Taxes.

- The top tax rate for the wealthy will be increased from 28 percent to 31 percent and the top rate for upper-middle income taxpayers will be reduced from 33 percent to 31 percent.
- A phaseout of the personal exemption for taxpayers with incomes above $100,000 (single return) or $150,000 (joint return).
- A 3 percent reduction in itemized deductions for income above $100,000.
- Income subject to the Medicare tax will be increased to $125,000.
- Top rate on capital gains of 28 percent.
- 5-cent-per-gallon increase (to 14 cents) in the gasoline tax.
- A new 10 percent tax on some of the cost of luxury items.
- Tax on beer doubled, to 32 cents per six-pack.
- A 16-cent (8 percent) liquor tax increase.
- An 18-cent (600 percent) table wine tax increase.
- A four-cent increase in 1991 and an additional four-cent increase in 1993 on the cigarette tax — bringing the tax to 24 cents per pack after 1993.
- A 25 percent increase on a number of aviation taxes, including the 8 percent tax on airline tickets.
- State and local government employees who do not have other pension coverage will be required to participate in Social Security on July 1, 1991.
- Renewal of the 3 percent telephone excise tax.

Medicare, Medicaid:

- Monthly Part B premiums (the voluntary program that pays doctors' bills) will be increased from the current $29.90 to $46.20 in 1995 (a 55 percent increase). Current law calls for an increase to $35.40 a month by 1995 (18 percent).
- The Part B deductible will be raised from the current $75 to $100, effective in 1991.
- Cuts in payments to doctors, including for "overpriced" procedures.
- A variety of cuts in Medicare payments to hospitals.
- Drug manufacturers will be required to lower their prices for drugs to be offered by state Medicaid programs.

Other Key Deficit Reductions:

- Agriculture savings of $14.9 billion over five years, achieved largely through reducing the amount of acreage eligible for government subsidy programs. On 15 percent of the land now eligible for subsidies, farmers could plant crops for which they could not receive federal assistance.

Savings would also be achieved by reducing dairy price supports, charging loan origination fees for farm loans and changing the method for calculating deficiency payments.

- The Federal Deposit Insurance Corporation will be authorized to raise deposit premiums charged to member banks.
- The Federal Housing Administration's mortgage loan program will be restructured, including increased up-front costs for homebuyers and added mortgage insurance premiums.
- Tightened eligibility for schools that wish to participate in the Guaranteed Student Loan program. Students at institutions with high default rates would not be eligible for the government-backed loans.
- Increased civil fines for violations of Occupational Safety and Health Administration and Mine Safety and Health Administration regulations.
- Higher premiums paid by companies to the Pension Benefit Guarantee Corporation to insure their pension plans.
- The Nuclear Regulatory Commission will be authorized to collect higher fees for its services, making it self-sustaining.
- New Coast Guard fees of between $25 and $100 for recreational boats of more than 16 feet.
- Elimination of the lump-sum method of paying retiring federal workers their retirement benefits.
- The Postal Service will be responsible for a larger portion of civil service retirement benefits.
- Reductions in certain veterans benefits, including a limitation on the inheritance of benefits and elimination of benefits for surviving spouses who have remarried, and an increase in Veterans Affairs home loan fees.

Child Care. An omnibus child care bill was included in the reconciliation measure. Key features include:

- A child care block grant to states for their use in providing child care services, improving the quality and availability of child care and helping poor parents pay for child care. The funds would also be used to improve early childhood development and to provide before- and after-school child care.

Child care programs receiving funds would have to meet minimum safety and health standards.

The bill authorizes $750 million in fiscal 1991, $825 million in fiscal 1992 and $925 million in fiscal 1993.

- Tax credit provisions that will increase the earned income tax credit (EITC) for poor families. The size of the credit will be related to the number of children in the family.
- A new child health insurance tax credit.

Spending Caps.

To ensure that discretionary spending is reduced by the agreed-upon amount, the measure contains spending ceilings for the next five years. In fiscal 1991-93, spending caps are established for each of three subgroups: defense, international affairs and domestic programs.

The defense spending authority caps are $288.9 billion in fiscal 1991, $291.6 billion in fiscal 1992, and $291.8 billion in fiscal 1993 — about $67 billion less than needed to keep pace with inflation.

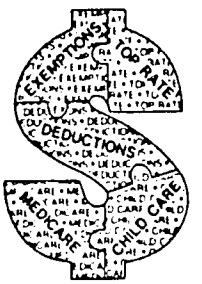
For domestic programs, the caps are $182.7 billion, $191.3 billion and $198.3 billion, keeping up with inflation.

One Outcome of Budget Package: Higher Deficits on the Way

New policy shift downplays size of deficit, excuses Congress from tackling problems it didn't create

Reconciliation Wrapup

New Budget Process 3712
Final Tax Package 3714
Who Pays? 3715
Medicare 3719
Medigap Insurance 3720
Help for Poor Kids 3721



BUDGET '91

After months of backroom bargaining and weeks of brawling floor debate, Congress finally approved a deficit-reduction bill that could radically reshape the way Congress produces the nation's annual budget. Ironically, one of the new law's most immediate impacts will be sharply higher deficits.

Under the bill's complex new math, the deficit is expected to climb to more than $300 billion for the next two years. The number is supposed to trend down to zero after fiscal 1995, but some analysts think a souring economy could keep deficits near the $300 billion level indefinitely.

"To paraphrase [former Reagan administration budget director] David Stockman," said one congressional budget aide, "it's $300 billion for as far as the eye can see."

The most obvious reason is revised bookkeeping that would inflate the apparent size of the deficit. The new law changes calculations under the Gramm-Rudman antideficit law by subtracting the Social Security surplus, which served to offset nearly $60 billion worth of deficit spending in fiscal 1990 and is expected to grow substantially in coming years. The bottom line will be a much bigger deficit.

But more importantly, Congress approved a major budget policy change as part of the new law, deciding that the sheer size of the deficit, which has driven the congressional budget process since Gramm-Rudman was enacted in 1985, should not matter anymore.

Instead, Congress will shift to keeping a lid on its own spending initiatives, while letting events beyond its control — a recession, for instance — increase the size of the deficit without penalty. Under the new scheme, at least for 1991-93, the deficit could grow to huge proportions without forcing spending cutbacks — as long as the growth was not caused by any overt act by Congress.

The new law could also alter the balance of budget power between Congress and the White House, giving the Office of Management and Budget (OMB) closer scrutiny of legislation as it is being crafted, and further limiting the role of the Budget committees.

Because it sketches out major spending and taxing parameters for the next three to five years, the law promises what some hope will be an era of relative budget peace stretching at least through the 1992 elections.

Others warn, however, that the law will merely replace one big budget showdown at the end of the year with a series of budget confrontations throughout the session, as various interests find they have to vie for resources within distinct categories, rather than reaching throughout the budget for money as they often have in the past.

Some predict that the new budget process could collapse under the weight of the new regulatory complexity and potentially enormous deficits even before the '92 elections.

Stanley Collender, director of federal budget policy for Price Waterhouse, says that with spending divided into four different categories — each capable of triggering its own automatic, across-the-board spending cuts — the law might simply prove too complex for Congress to live by. "I don't think the process stays in place more than a year and a half," he says.

Getting a Final Deal

Budget legislators who just lived through one of the worst Octobers in their political lives probably will not care for that prediction. Congress cleared the sprawling new tax and spending package (HR 5835) on Oct. 27, after weeks of extraordinarily painful debate.

In the end, frustrated and angry lawmakers were forced to stay in session closer to the fall elections than at any time since World War II before approving the bill, the cornerstone of the fiscal 1991 budget package. After an all-night session, the House voted 228-200 near dawn to approve the bill. Eleven hours later, near dusk, the Senate cleared it, 54-45. The 101st Congress adjourned for good only hours later. *(House vote 528, p. 3764; Senate vote 326, p. 3769)*

Over the next five years, the measure, known as a reconciliation bill, is supposed to raise nearly $140 billion in net new revenues and require nearly $100 billion in user fees and cuts in entitlement programs such as Medicare. When combined with separate cutbacks in defense spending and interest on the national debt, it is expected to reduce the deficit by more than $40 billion in fiscal 1991 and by nearly $500 billion in fiscal 1991-95.

The bill was a last-minute compromise stitched together to satisfy House Democrats without alienating Senate Republicans, the two groups that had

By George Hager

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both the political clout and the inclination to block it. Agreement was possible only after negotiators worked out differences over the size of Medicare cutbacks and tax increases for the richest taxpayers. *(Weekly Report, p. 3574)*

No one was thoroughly happy with the compromise, but leaders said it was the best deal that could be achieved, given the sharp divisions between the Republican White House and the Democratic-controlled Congress.

President Bush promised to sign the measure, and he briefly praised it. "I think the spending cuts, when you look at them, are good. The entitlement reform is good. The tough enforcement provisions are tougher than I ever thought we could ever get in any way out of this Congress," he said.

But freed from months of trying to hold his fire to get a deal with a Congress he did not control, Bush lashed out at the Democrats, blaming them for the package's tax increases."We're not going to take it any more," Bush said. "It is time that American people say: 'Enough is enough. No more Democratic control of the Congress.' "

Democratic leaders responded angrily. "Our country needs a leader who acts like a president instead of a president who acts like a party chairman," said House Majority Leader Richard A. Gephardt, D-Mo.

Senate Majority Leader George J. Mitchell, D-Maine, accused Bush of duplicity, saying he instructed his budget negotiators to avoid tax increases for the wealthy, while never admitting that policy in public. "He protected the millionaires very well," Mitchell said.

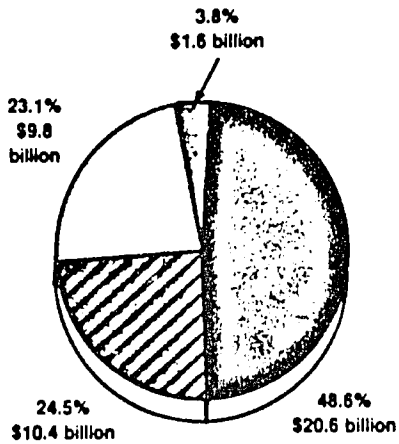
Changing the Budget Process

Often lost in the campaign rhetoric and the partisan infighting over the raw numbers were significant changes in the way Congress will produce the budget for the next five years. Congressional staff and budget analysts who stayed in Washington after Congress adjourned saw these major new shifts in the way congressional budgeting will proceed in 1991:

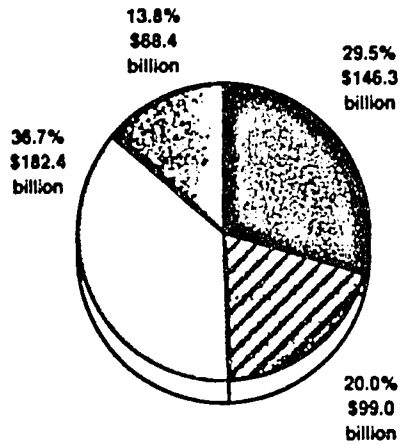
• **Discretionary spending.** The Appropriations committees, which control discretionary spending, were among the biggest winners when new budget procedures were drawn up. Under the new law, appropriations will be capped in three separate categories during fiscal 1991-93: domestic, international and defense. For fiscal 1994-95, the categories will be lumped together under a single cap. But only the defense

The Deficit-Reduction Pie

Fiscal 1991 Total Savings
$42.5 Billion



Fiscal 1991-95 Total Savings
$496.2 Billion



- Taxes and Other Revenues
- Entitlement Cuts, Other Mandatory Spending Cuts and User Fees
- Discretionary Spending Cuts
- Interest on the Federal Debt

By any measure, the deficit-reduction bill passed just hours before Congress adjourned was the most ambitious effort ever to turn the tide of federal spending.

Projected tax increases and spending cuts totaling $42.5 billion in fiscal 1991 and $496.2 billion over five years far exceed the two-year $75 billion deficit-reduction package that came out of the 1987 budget summit, or the $121 billion three-year package of tax increases and domestic and defense spending cuts enacted in 1984.

The five-year savings projection anticipated that the biggest cuts would come in discretionary spending: $182.4 billion.

The first-year discretionary cut of $9.8 billion would come entirely from defense, as would cuts in the second and third year. Although some in Congress — particularly House Democrats — assumed the entire five-year discretionary savings would come from defense, that seemed far from certain. Mechanisms to enforce the cuts left sizable leeway in 1994 and 1995 to cut domestic spending and foreign aid.

Overall, discretionary spending, which yields 23 percent of the cuts in 1991 and 37 percent over five years, makes up about two-fifths of all outlays. Virtually all defense and foreign aid spending is discretionary, but domestic discretionary spending is little more than 25 percent of all domestic outlays.

The next biggest chunk of the savings would come from tax increases totaling $20.6 billion the first year and $146.3 billion over five years. Those numbers include $3 billion for fiscal 1991 and 9.4 billion over five years due to enhanced Internal Revenue Service tax collection efforts.

Entitlement cuts — Medicare and farm price- and income-support payments, especially — and user fee increases would yield one-fifth of the total deficit reduction, $99 billion over five years. Entitlements remain the largest and fastest-growing part of the federal budget.

Finally, net interest on the federal debt, which is expected to top $1 trillion over the next five years, would be $68.4 billion more if the other savings evaporated and the government had to borrow more to offset the difference, or if interest rates do not fall in response to the budget-cutting effort.

SOURCE: House Budget Committee

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New Budget Process for Congress

When members of Congress get back to business in less than three months, they will find that the familiar budget process of the past five years has been drastically altered.

Not only has the budget calendar been changed again, but the roles of the Appropriations and Budget committees have been altered, and the scheme of automatic spending cuts under the Gramm-Rudman antideficit law has been replaced by three discrete "sequesters" that work in significantly different ways. Following are the key changes in the budget process included in the just-passed deficit-reduction bill (HR 5835):

• **Calendar changes.** The president's budget request to Congress, though rarely delivered on time, will now be due the first Monday in February, not the first Monday after Jan. 3. If a budget resolution is not adopted by April 15, the Budget committees will have to report spending limits for the Appropriations committees based on discretionary spending in the president's budget. And although the fiscal year will still begin Oct. 1, automatic spending cuts will not be triggered until 15 days after Congress adjourns.

• **Five-year budgeting.** Budget resolutions and necessary reconciliation bills will have to project spending, revenues and deficits for five years.

• **Automatic spending cuts.** The old Gramm-Rudman procedure — an initial automatic spending cut or sequester that is calculated in mid-August and takes effect Oct. 1, followed by a final sequester Oct. 15 — is gone.

Instead, there will be a set of three sequesters, each of which kicks in 15 days after Congress adjourns: The first will offset discretionary appropriations for the coming fiscal year that exceed statutory limits and will only affect discretionary spending. The second will be triggered if Congress enacts entitlement spending increases or revenue decreases during the year and will only affect "non-exempt" entitlements. The third will offset an increase in the deficit above the limit set in the law, if the first two sequesters have not eliminated the excess deficit; it will cover all non-exempt spending. The discretionary and entitlement sequesters will also "look back" to offset spending increases or revenue cuts that affected the prior fiscal year.

• **Discretionary spending caps.** Appropriations bills will have to stay within specific caps for defense, foreign aid and domestic discretionary spending for fiscal 1991-93; for fiscal 1994-95, the law sets overall discretionary spending caps. Bills exceeding the caps will be out of order for floor consideration. Each year these caps will be adjusted upward to account for inflation.

• **Deficit targets.** The law sets new, higher deficit targets for fiscal 1991-95. These targets will automatically be adjusted in fiscal 1992-93 to account for changes in the economy and technical estimates of the cost of entitlements. The president has the option of adjusting the deficit caps for economic or technical changes in fiscal 1994-95.

• **Pay-as-you go entitlements and revenues.** Bills containing increases in entitlement or other mandatory spending or reducing revenues must be deficit-neutral. They will be out of order for floor consideration, unless they are accompanied by offsetting entitlement cuts or revenue increases.

• **Supplemental appropriations and emergencies.** Supplemental appropriations enacted before July 1 that exceed spending caps will trigger sequesters 15 days after their enactment; the automatic cuts will offset the excess within the spending category in which the excess occurred. If requested to do so by the president, Congress could enact emergency appropriations, entitlement increases or revenue cuts without triggering sequesters.

• **Social Security and deposit insurance.** Social Security receipts and expenditures will no longer be included in budget calculations. Increased spending for deposit insurance activities — chiefly the savings and loan salvage operation — will not be allowed to trigger sequesters.

• **War and recession.** A declaration of war would still cancel the sequester process. Congress could still vote to cancel the sequester process in the event of a projected recession or measured economic growth below 1 percent for two consecutive quarters.

—John R. Cranford

Key Dates

Jan. 21	Notice of optional adjustment of deficit target for fiscal 1994-95.
First Monday in February	President submits budget request and economic forecast that will control budget activity for the following year; budget also includes OMB sequester preview (CBO sequester preview due five days earlier).
April 15	Congress completes action on budget resolution.
May 15	Appropriations bills may be considered in the House.
June 30	Congress completes action on appropriations bills.
July 1	Supplemental appropriations for the current fiscal year that exceed discretionary spending targets and are enacted before this date trigger 15-day post-enactment sequester.
Aug. 10	Notice of optional sequester exemption for military personnel.
Aug. 15	CBO updates sequester preview.
Aug. 20	OMB updates sequester preview.
Oct. 1	Start of the new fiscal year.
10 days after adjournment	CBO final sequester report.
15 days after adjournment	OMB final sequester report; president issues sequester order.
30 days later	GAO sequester compliance report.

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Under the new scheme, at least for 1991-93, the deficit could grow to huge proportions without forcing automatic spending cuts.

cap will bite hard, forcing more than $180 billion in spending reductions below the baseline (current spending plus inflation) through fiscal 1995.

Domestic spending, on the other hand, will be allowed to rise with inflation and will be given an added boost of more than $20 billion in budget authority spread over fiscal 1991-93. Congressional staffers described this as a White House-approved inducement for powerful Senate Appropriations Committee Chairman Robert C. Byrd, D-W.Va., to accede to the deal.

Byrd and his House counterpart, Jamie L. Whitten, D-Miss., had both gone into the budget negotiations looking for substantial increases in domestic spending.

The broad domestic spending boost was quickly translated into increases in a variety of programs that Democrats argued were unfairly crippled during the last 10 years, when Reagan and Bush administration policy-makers drove spending policy. The House Budget Committee distributed a list of 25 separate program increases for fiscal 1991, ranging from $6.7 billion in renewal of expiring housing assistance to $2.3 billion in obligation authority for highway spending to $400 million for the Head Start program.

Byrd and Whitten also won important assurances that automatic Gramm-Rudman spending cuts will not trouble them until at least fiscal 1994, as long as they stay within their preset spending caps.

For 1991-93, spending cutbacks cannot be ordered because of factors beyond the control of Congress, such as an economic downturn that lifts government spending or a technical estimate that inaccurately forecasts the money necessary to bail out failing savings and loans. The president can extend that "hold harmless" provision through the last two years of the budget deal, and analysts expect him to do so.

Even the automatic cuts likely to occur under the new law will be less fearsome than they are now. Under current law, a deficit that exceeds the Gramm-Rudman target triggers automatic spending cuts throughout non-exempt portions of the budget. While that could still happen in theory under the new law, it is extremely unlikely, given the new escape hatches for events beyond Congress' control.

More likely, only the spending category that exceeds the spending cap will be subject to a cut.

Hence, for example, domestic programs would not suffer if defense spending exceeded its limit — at least while the categories remained separate during the first three years of the deal.

Byrd and Whitten also managed to avoid changes sought by the White House to reduce congressional authority over spending, such as a line-item veto or enhanced rescission authority.

The White House and congressional Republicans won concessions as well. Through fiscal 1995, appropriators will not be able to raid defense or international accounts to boost domestic spending without facing a point of order in floor debate, which would require 60 votes to overcome in the Senate.

Gephardt described the deal as a fair trade. "I think both sides do better. Gramm-Rudman should work better, be more rational, be more realistic. And, on the other hand, [Republicans] know that for three years we're not going to cut money in one area and move it to another, which is something that they sought."

In one further concession to the White House, only the president will have the authority to determine that a particular supplemental spending bill can actually qualify as an emergency measure exempt from automatic spending cuts.

• **Mandatory spending.** Spending for entitlement programs such as Medicare will be put on a "pay as you go" basis, requiring that any expansion be paid for by a corresponding entitlement cut or revenue increase. Similarly, any tax cut must be paid for by a compensating tax increase or entitlement cut.

The chief benefit to Congress is likely to be an end to the sort of agonizing battle over reducing entitlement spending that occurred over proposed Medicare cuts in October.

Under the new law, there should be none of the current pressure to reduce entitlement spending simply to get the budget deficit down; any spending authorized by existing entitlement law will be tolerated without penalty.

An explicit congressional vote to change the law to expand an entitlement program such as Medicare without finding offsetting savings or revenue increases could trigger an automatic spending cutback across a wide range of non-exempt entitlement programs. But if Medicare spending balloons simply because more people meet the eligibility requirements, Congress and the budget will be held harmless.

The new law could also alter the balance of budget power between Congress and the White House and further limit the role of the Budget committees.

Congressional budget aides say the White House will pick up enhanced authority in this area because the new law requires OMB to determine the net budget impact of new entitlement legislation on a bill-by-bill basis much sooner than it does now. The practical effect will be to involve OMB much more directly in the legislative process, giving it increased clout.

But some congressional staff argue that OMB and the White House will lose more than they gain when they are stripped of their current authority to manipulate the economic forecasts and technical estimates that produce the final deficit number and the necessary Gramm-Rudman spending cutback at the end of the fiscal year.

One upshot of the new law is that the Budget committees will have less to do than they have in the past.

With limits already set for discretionary spending and with pay-as-you-go restrictions on entitlements, there will be no need to decide how much to trim the deficit. Instead, the Budget committees will wrestle with how to set spending priorities within the various spending caps, and whether and how to expand entitlement programs.

Appropriations committees already have their marching orders, and Budget committee staff say appropriators will likely feel less constrained to wait to hear from the Budget panels before getting to work.

"If the Congress wanted to, it could set the budget on autopilot," said one congressional budget expert. "It could be a very easy time." ■

New Rules of the Game

Major shifts in power within Congress and between Congress and the White House are likely under new legislation overhauling the congressional budget process.

BY LAWRENCE J. HAAS

The budget process wasn't at the top of anyone's list of priorities for the recent budget summit, at least not publicly. Process doesn't stir public emotions the way talk of raising taxes and cutting spending does.

But privately, a few key White House and congressional negotiators recognized its importance from the start and hoped to put in place a new process that would help to shape tax and spending choices in the years ahead.

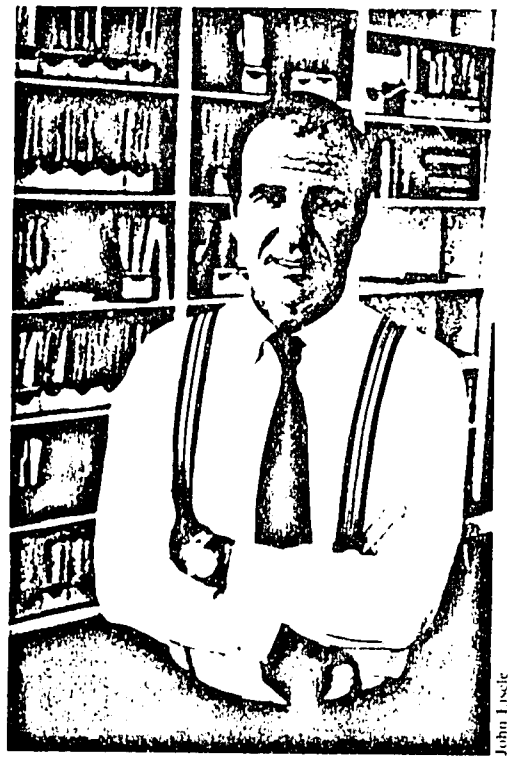
These new rules by which Washington will draft its budgets reflect the priorities of the negotiators—and, in particular, of Office of Management and Budget (OMB) director Richard G. Darman and Senate Appropriations Committee chairman Robert C. Byrd, D-W.Va.

What they have come up with is a new law that will shift budgetary authority from Capitol Hill to the White House, increase the power of some congressional committees at the expense of others, threaten to saddle business and local governments with some of the costs now shouldered by Washington and force interest groups to compete more vigorously than ever for scarce federal resources.

So secretive was the process by which the changes were drafted that weeks later, questions are still being raised about how they will work.

A few days before adjournment, as the Senate debated its deficit cutting package, Senate Majority Leader George J. Mitchell, D-Maine, introduced an amendment to change the budget process rules. Sen. Daniel Patrick Moynihan, D-N.Y., promptly took the floor to warn that "we are in the process of diminishing the legislative role of the Senate at the behest of the President."

Byrd, defending the work he helped craft, responded, "This Senator is not knowingly ever going to permit any shift of power from this branch, and if there is any Senator who thinks I will, let him stand and say so to me now, call my name."



John Fiscle

Economic Policy Institute president Jeff Faux New rules make it harder to shift priorities.

Moynihan may have exaggerated the impact of the proposals. But, unless numerous public and private budget experts are wrong, Byrd was on equally shaky ground in assessing how the proposals, which were very similar to what Congress finally enacted, would affect executive-legislative relations.

In changing the rules the government follows in acting on its annual tax and spending bills, policy makers have shifted power toward the White House—and particularly to OMB—and away from Congress. Just how extensive the shift will be depends on how aggressively OMB uses its new prerogatives and whether Congress, in turn, moves to rein OMB in.

The new budget rules move the focus of debate away from annual deficits, where it has been for a decade, and put it instead on the new statutory limits prescribed for spending increases and tax cuts.

And that change has set the stage for a realignment of fiscal authority among congressional committees, with panels that once were allies now likely to clash over policy and jurisdiction.

Just as important, the few White House officials, lawmakers and aides who developed the new budget rules took a budget process that was generally viewed as too complicated and made it even more so. *(See box, p. 2796).*

How complicated? Enough that the few congressional aides who worked on or were close to the drafting process have been busy trying to explain the rules to aides at other committees, private budget experts, lobbyists and reporters.

John Fuchs

Council on Education's David R. Merkowitz
He foresees a reduced role for Budget panels.

In early November, a Senate Budget Committee aide put out the word that he'd conduct two briefings on the new process for anyone who wanted to attend. At each briefing, about 150 congressional aides, budget experts, lobbyists and reporters took advantage of the opportunity, packing the committee's hearing room.

Other congressional aides were holding smaller briefings at about the same time. A Congressional Budget Office (CBO) staff member briefed about a dozen public and private budget experts; House Budget Committee aides held their own briefings.

SECRET DEAL

Part of the problem in understanding the new process is that on some provisions, the statute conflicts with a congressional report that's supposed to explain them.

The confusion is clearly linked to the secrecy surrounding adoption of the new rules. Although the budget process has been the subject of endless public hearings in recent years, this year's changes were drafted in private by a handful of individuals and approved after the barest minimum of public debate.

From the start of the budget summit last spring, President Bush had insisted that changes in the budget process must be part of the package. In the end, Administration officials succeeded in getting much of what the White House, and its Republican allies on Capitol Hill, wanted by playing key Democratic lawmakers off against one another.

The Administration strategy took shape in early September, when officials presented a package of budget process reforms to the negotiators who were meeting at Andrews Air Force Base, Md., just outside Washington. Senate Budget Committee chairman Jim Sasser, D-Tenn., responded by saying he wasn't interested in what the Administration was offering and preferred repealing the 1985 Balanced Budget Act altogether. Predictably, meetings among a subgroup of 6-10 negotiators produced nothing.

Administration officials then decided that they might get further by dealing with Byrd. Not only was Byrd, as the former Majority Leader and now as the Senate President Pro Tem, a power to be reckoned with, but he had repeatedly expressed interest in budget process changes during the long months of budget negotiations.

Late last year, the failure of some congressional committees to implement a fiscal 1990 deficit cutting deal had triggered an across-the-board spending cut—a "sequester," in the language of budget insiders—in domestic and defense programs under the jurisdiction of Byrd's Appropriations Committee. Byrd and his committee colleagues complained that these programs were hit twice—first, when they were held to fixed spending levels as part of the fiscal 1990 deal and, second, when the sequester kicked in.

This year, Byrd's lingering unhappiness gave Administration officials an opening; by agreeing to alter the process to protect appropriations from a double hit, they might, they thought, also win Byrd's agreement to other changes the White House wanted.

After the Andrews negotiations concluded, a series of private meetings began between Byrd, OMB director Darman, deputy OMB director William M. Diefenderfer III and House Budget Committee chairman Leon E. Panetta, D-Calif. Separately, the OMB officials and the Democratic lawmakers consulted with House Majority Leader Richard A. Gephardt, D-Mo., who chaired the overall budget negotiations.

In late September, the key figures reached a consensus on budget process changes as part of the negotiators' broader deficit cutting agreement. But a lot of work remained. Darman at that point made public a summary document that described the proposed process changes, but in ways that didn't reflect the consensus, Democrats involved in the negotiations said later.

The precise statutory language intended to implement the changes would prove critical. Here, too, the Administration tried its best to work with Byrd, and around Sasser. Administration officials cut separate deals with Byrd and Panetta, and made sure that the legislative language, drafted by House and Senate Budget Committee aides, reflected them.

Not surprisingly, the adopted changes implement the priorities of the White House, as translated by its OMB director, and the Appropriations Committees, as interpreted by Byrd. The losers were those whose representatives lost out in the deal making or weren't seated at the negotiating table.

OMB'S BASEBALL BAT

The new budget rules give OMB a vast pool of potential power. Since 1987, OMB has had the authority to calculate whether, based on its economic forecast and its "scoring" of the costs of new tax and spending laws, the budget would exceed the deficit target set by the Balanced Budget Act for the new fiscal year. If OMB said it would, across-the-board spending cuts would be triggered to cut the deficit to the required level.

But this amounted only to a one-shot, year-end threat to impose fiscal calamity by means of the across-the-board reductions. Until that point arrived, Congress relied on the CBO to keep score as the Senate and House acted on tax and spending bills.

The new process transforms OMB's year-end power into a continuing authority to keep the score on all tax and spending bills as they move through Congress. Armed with this and related powers, the White House would be able to block any legislation it opposes.

"What [OMB] really had before was the ability to beat Congress over the head with a telephone pole"—a powerful

though awkward instrument, a congressional budget aide said. "Now, it can beat parts of Congress over the head with a baseball bat."

OMB's gain, of course, means a loss of power for the CBO and for the staff of the Joint Committee on Taxation, the CBO's counterpart for tax legislation. With OMB's scoring of tax and spending bills made binding on Congress, the congressional offices are relegated largely to advisory roles in the budget process. This was evident to CBO officials, including director Robert D. Reischauer and assistant director James L. Blum, who tried unsuccessfully to persuade lawmakers not to shift such power to OMB.

Under any circumstances, OMB's new authority would be potent, if only because Members of Congress don't want to be viewed as supporting expensive new programs in an era of budget deficits. But these powers are enhanced by new limits imposed on all spending increases and tax cuts.

How OMB scores the 13 annual appropriations bills, for instance, will determine whether the Appropriations Committees have stayed within the separate spending ceilings set in fiscal 1991-93 for domestic, defense and international aid progams. An OMB conclusion that any of the three ceilings was breached would automatically trigger across-the-board cuts in programs within that category to bring spending below the cap. (For 1994-95, the law requires only that a combined ceiling for all three categories not be breached.)

These spending caps are already raising the hackles of liberal lawmakers and outside social activists. With separate ceilings for each of the three major categories locked in, they say, Congress has lost the flexibility to reorder priorities by shifting funds between the categories—from defense to domestic programs, for example. And this rigidity, they complain, comes at an odd time.

For one thing, the critics contend, the end of the Cold War offers opportunities to make deeper cuts in defense spending than the new budget agreement allows for the next five years. Moreover, they say, the limit on discretionary domestic spending comes at a time when public support for more such spending is growing.

"If you put these caps on . . . , you put a cap on our ability to make those kinds of public investments that I think there's almost a consensus that we need," said Jeff Faux, president of the Economic Policy Institute, a liberal think tank in Washington. At a time of looming recession and international upheaval, he said, "this whole [budget] process has to be one of changing priorities. So, I think it's a major obstacle to making the kinds of shifts in priorities that we need to make."

Paul A. Leonard, a senior research analyst at the Center on Budget and Policy Priorities in Washington, said, "I have already heard a couple of people mention that they are interested in going after the defense budget, making deeper cuts in the defense budget, and presumably in shifting those cuts into domestic investments."

BUTTER V. BUTTER

Though their anger is now directed at the new budget rules, lobbyists for domestic programs could turn on one another before long. Under the rules, domestic programs will compete for funds in 1991-93 only against each other. So the debate won't be between guns and butter but instead between different kinds of butter.

Lobbying strategies are likely to change. Lobbyists for a domestic program will be trying to learn as much as they can about other domestic programs so that they can argue that theirs is worthier of financing. In this zero-sum budget game, it will be every program for itself.

Richard A. Bloom

Urban Institute senior fellow Rudolph G. Penner
If OMB abuses its new power, "Congress will change it."

"It's going to mean that groups like ours are going to have to become knowledgeable, if not expert, in a lot of domestic areas that they don't know anything about," said Susan E. Rees, executive director of the Coalition on Human Needs, a Washington group that monitors the budget's impact on low-income programs.

"If these caps are held in effect," she said, "there's not going to be places to get increases in programs like health care and housing without raiding other programs. . . . And I don't think the low-income community is strong enough to go up against some of the other narrow interests. At the same time, we all have to be on our guard that those other kinds of interests are going to be raiding our kinds of programs."

This situation is not entirely new. In drafting a two-year budget deal in late 1987, President Reagan and Congress set separate spending levels for domestic, defense and international aid programs. Despite some conflicts, both sides generally adhered to the ceilings.

DIMINISHED ROLE

If that two-year deal is any guide, the Budget Committees may not like the new agreement. In drafting an annual budget resolution, which establishes the framework for later tax and spending bills, the Budget panels are supposed to set total spending for discretionary programs and suggest how the dollars should be allocated. Action then shifts to the Appropriations Committees, which draft the spending bills.

In 1988, however, the Budget Committees' work had been largely usurped by the two-year deal. In fact, when a budget resolution bogged down in a House-Senate conference committee, appropriators in both chambers showed how meaningless the exercise was by beginning to draft spending bills without one. The two-year deal had already established the boundaries for their actions.

With a new five-year deal now in place, the Budget Committees may not be left with much to do. "It seems that there's a considerably diminished role for the Budget Committee and there's a lot more power that flows back to the Appropriations Committee," said David R. Merkowitz, a former House Budget Committee aide and now director of public affairs for the American Council on Education.

There are more-specific reasons why the Appropriations Committees may like the new budget process. For one thing, the deficit cutting deal includes $38 billion in new spending authority for their domestic programs from 1991-93, and that sum is above what's needed to keep pace with inflation. The White House viewed these funds as a small price to pay for Byrd's acceptance of the changes in the budget process that it sought.

For another, the appropriators need not worry that their own inability to comply with spending caps will trigger across-the-board cutbacks in programs in their jurisdiction. No longer will they face the kind of double hit that they absorbed last year. Now, if the authorizing committees,

ADDING NEW LAYERS OF COMPLEXITY TO BUDGET

A budget process many critics had said was too complicated has become even more so, thanks to sweeping changes adopted by Congress and approved by President Bush.

Here are the major revisions to the 1985 Balanced Budget Act that will dramatically alter the way the budget will be drafted through fiscal 1995:

DISCRETIONARY SPENDING

The law sets up two kinds of spending ceilings for this and the next four years.

For 1991-93, it establishes separate ceilings for each of three categories of discretionary spending: defense, international aid and domestic programs. If Congress chooses to increase spending for any discretionary program, it must offset the increase by cutting spending for one or more other programs within the same category. If it fails to make an offsetting reduction, an automatic spending cut—a sequester, in budget jargon—would slice enough from all other programs in that category to bring spending to below the ceiling.

The defense category, however, does not include the costs of Operation Desert Shield in the Persian Gulf, which the law assumes Congress will finance separately.

The caps, in billions of dollars, are as follows (BA is budget authority, the amount Congress authorizes the government to spend in current or future years; O is outlays, the actual spending expected in each year):

	1991	1992	1993
Defense			
BA	$288.9	$291.6	$291.8
O	297.7	295.7	292.7
International			
BA	20.1	20.5	21.4
O	18.6	19.1	19.6
Domestic			
BA	182.7	191.3	198.3
O	198.1	210.1	221.7

For 1994-95, the new law establishes a single pot of money for all discretionary spending. The White House and Congress will have to decide how to allocate that money between the three spending categories. Spending above that over-all limit would trigger a sequester to bring spending down to that ceiling. Total discretionary funds for those two years, in billions of dollars, are as follows:

	1994	1995
BA	510.8	517.7
O	534.8	540.8

PAY-AS-YOU-GO SPENDING

Under the new law, Congress is required to offset the costs of any new entitlement spending programs and any tax reduction legislation.

If Congress creates an entitlement program or tax benefit that is not "revenue neutral"—is not financed by an offsetting tax increase or spending cut—it would then have to adopt a deficit cutting "reconciliation" bill to find the needed savings. Failing that, a sequester would cut enough from all other entitlements (except those, such as social security, that are already exempt from the "sequester" under the 1985 Balanced Budget Act) to make up the difference.

SEQUESTERS

Unlike the 1985 law, which called for a sequester in October of each year in which Congress failed to meet specified deficit targets, the new law creates a schedule under which sequesters can occur several times a year for discretionary programs and once a year for entitlements and tax cuts.

First, a sequester directed at budget-busting appropriations bills can be triggered, if required, within 15 days of the end of a session of Congress.

Second, a sequester can occur within 15 days of the enactment of such appropriations bills if the enactment takes place before July 1.

Third, if those appropriations bills are enacted after July 1, a sequester would be applied to spending bills for the next fiscal year, which begins on Oct. 1.

For entitlements and tax cuts, the law calls for a onetime review of all bills to determine whether they will, in total, increase the deficit. If they will, non-exempt entitlements would be sequestered at the same time as the end-of-session appropriations.

DEFICIT TARGETS

The new law sets deficit targets for the next five fiscal years. They are (in billions of dollars):

1991	$327
1992	317
1993	236
1994	102
1995	83

The targets will be applied differently in the first three years from the way they will be in the next two.

For 1991-93, the targets are not binding on the White House and Congress. Along with the spending caps for defense, international aid and domestic programs, they will be adjusted to account for changes in economic and technical assumptions.

For 1994-95, the President may adjust the deficit targets, if he chooses, for economic or technical reasons. If he doesn't adjust them, failure to reach those targets will trigger a sequester like that required under the 1985 budget law.

SOCIAL SECURITY EXEMPTION

Adhering to broad sentiment in Congress, the new law takes the social security trust funds out of the deficit calculations. As a result, the funds' growing surpluses will not be used in determining whether the government has met its annual deficit targets. That's a victory for those who complained that the trust fund surpluses were masking the budget deficit's true size.

The law also imposes a series of new hurdles to prevent the White House and Congress from reducing the trust fund surpluses by cutting payroll taxes on today's workers or by using the surpluses to finance new spending programs.

SCOREKEEPING

Furthering a trend that began when the Balanced Budget Act was revised in 1987, the Office of Management and Budget (OMB) has been given additional authority to tabulate the cost of tax and spending legislation.

Previously, OMB had the power to decide whether, based on the costs of all such legislation and other factors, a sequester was required. But the Congressional Budget Office and Congress's Joint Committee on Taxation had the duty of tallying the costs of each tax and spending bill as it moved through Congress. Now, OMB's cost calculations will be binding on Congress.

SUPPLEMENTAL APPROPRIATIONS

Before Congress can enact supplemental spending legislation that's not subject to the discretionary spending caps, the President must declare an emergency and Congress must agree to that declaration.

which have jurisdiction over entitlements and revenues, ignore deficit cutting requirements, those committees will face cutbacks in their own programs.

Here's where OMB's new scoring power could prove particularly important. New pay-as-you-go rules will force the authorizing committees to fashion revenue-neutral bills only—that is, bills that don't cause the deficit to rise. Because OMB gets to decide whether a bill meets that test, its cost estimates will shape policy to a significant extent.

Nevertheless, some budget experts predict, OMB may choose to wield this new scoring authority prudently: attempting to block programs that it opposes without invoking the bipartisan wrath of Congress.

Richard A. Bloom

Ex-House Budget panel aide Patricia A. Quealy In the new system, budget policy's already set.

"There's a lot of potential power" at OMB's disposal, said Rudolph G. Penner, a former CBO director who is now a senior fellow at the Urban Institute. The question, he said, is "whether it can be used aggressively and not have it provoke a revolt and have it taken away from them. . . . If it gets out of hand, Congress will change it."

The shift of power to OMB brings the budget process full circle. Before 1974, Congress didn't have much of a budget process at all. The President sent his budget to Congress early in the year, and each committee worked separately with OMB to fashion spending within that panel's jurisdiction.

With the 1974 Congressional Budget Act, Congress set up rules to counter the President's role: Congress would pass a budget resolution setting over-all tax and spending guidelines and use it as a blueprint to allocate spending among its committees.

Under the new law, with tax and spending limits set for 1991-95, Congress is relegated to its pre-1974 role. It will continue to adopt and send spending and tax bills to the White House, but it will lack the power to change the fiscal framework. Although Congress will continue to draft budget resolutions, the key numbers for those resolutions are dictated by the recent budget deal.

"In the new system, the budget policy has been established," said Patricia A. Quealy, the House Budget Committee's former chief counsel, who is now a special counsel in the Washington office of the Pittsburgh law firm of Eckert, Seamans, Cherin & Mellott, "and there's really nothing for Congress to do but send the bills to implement it. There's really no way to change the policy."

MYSTERIOUS SURRENDER

Why the Democrats, who control Congress, surrendered such power to a Republican White House remains a mystery. Explanations run the gamut from confusion to ignorance on the part of key negotiators. An aide to a Democratic negotiator was so flabbergasted when the proposed changes were discussed during the budget talks that he blurted, "I don't believe that you're going to do this." His comment was ignored.

With the new rules written in such secrecy, Democrats who weren't part of the summit negotiations had almost no chance to block them. A few tried. Rep. Marty Russo, D-Ill., who shares a townhouse with Panetta and two other House Democrats, expressed his opposition at meetings of House Democrats. His efforts went nowhere.

As other Democrats have started to understand the changes, reaction has ranged from anger to dismay. "I assume the champagne they couldn't drink for capital gains [tax cuts], they drank for this one," a House Democratic aide said of White House officials. "You're just handing away all your weapons. You're telling people that it is going to become more difficult to do the very things that Congress should be able to do."

Asked to predict how Members will react in the next Congress, an aide to another House Democrat said: "There's going to be unhappiness. People are going to say to the [House Democratic] leadership, 'How did you let this happen?' And certainly to Leon [Panetta] they will say, 'You pulled a fast one on us.' "

However OMB operates, the pay-as-you-go rules are likely to generate friction between the authorizing committees. At first blush, the House Ways and Means and Senate Finance Committees appear to be in the driver's seat. With jurisdiction over taxes, they are in a position to pay for new and expanded entitlement programs that are also within their purview. And, because they control such large entitlements as medicare, they could control most pay-as-you-go activity.

Other authorizing committees may ask Ways and Means or Finance to raise taxes to pay for their expanded spending, but the tax-writing committees can be expected to look first to their own programs. Some panels with jurisdiction over user fees may try to raise them to finance entitlement increases. Others may try to create new user fees.

Inter-committee conflict seems inevitable. Tax writers tend to guard their turf jealously, and none more so than Ways and Means chairman Dan Rostenkowski, D-Ill. When other committees try to wedge their way into the tax-raising arena, Ways and Means and Finance rise in opposition.

But it's easy to envision scenarios in which they wind up as losers in battles with other authorizing committees. If enough committees feel constrained by the pay-as-you-go rules, they may gang up on Ways and Means and Finance. By sticking together, they could help each other acquire the right to raise revenues in ways once closed to them.

Similarly, the Ways and Means and Finance Committees might be forced by House and Senate Democratic leaders to raise revenues. If the leaders wanted to push for a new spending program, they might pressure the tax writers to find the revenue for it.

If all that fails, Congress may continue a trend toward shifting the financing of new programs to sources outside the federal government, an aide to a House committee chairman suggested. Increasingly, Washington has been mandating that businesses, as well as state and municipal governments, perform such tasks as helping to clean up the environment or providing services to low-income Americans.

Businesses and local governments have complained loudly. But things may get worse for them, not better. If the congressional aide is right, Washington may tighten the screws and require states and localities to perform specific tasks as a condition of getting specific federal aid. Care for the poor, it could say, or lose your highway funds. ■

INTERNATIONAL ECONOMIC INSIGHTS, November-December, Institute for International Economics

The Budget Deal and the Trade Deficit

by William R. Cline

Eighteen months ago the prospects were bleak for resolution of either of the "twin deficits" — trade and budget — that have plagued the US economy since the mid-1980s. To be sure, there had been some progress. The decline of the dollar after 1985 had brought a boom in exports by 1987-88, and the trade deficit fell from a peak of $160 billion back to about $100 billion. The improvement was even larger than the $60 billion that met the naked eye, because in the absence of dollar correction, the external deficit was headed for $300 billion or more.

However, by mid-1989 the dollar had risen again from its late 1987 lows. Even without that rise, my projections indicated that the external deficit would be back above $150 billion by 1992 because of the exhaustion of beneficial exchange rate effects well before the trade gap had been eliminated, and because of the rising interest payments on accumulating foreign debt. With the strong dollar of mid-1989, the outlook was even worse: prospective trade deficits nearly $200 billion by 1992 were in the offing.

Today the prospects for the external sector are much improved. By the end of the third quarter, the dollar stood about 6 percent below its level in late 1987 (against industrial country currencies), and more than 10 percent below May, 1989. In addition, US growth has slowed to less than 1 percent for 1990 and probably no more than 1.5 percent for 1991. Slower growth means lower demand for imports. Even allowing for partial catch-up growth of 3.5 percent in 1992 before a return to steady 2.5 percent growth, and for oil at $25 a barrel, my projections indicate that the external deficit was already set to hold flat at about $100 billion annually over the next five years prior to completion of the new budget deal. The declines in the dollar and domestic growth contribute about equally to this change, and the prospect of higher growth in Germany after reunification provides a further boost. If the external (current account) deficit plateaus at $100 billion annually, it will ease to about 1.5 percent of GNP by 1995 — a major improvement from its 1987 peak at 3.5 percent of GNP.

The new budget agreement holds out the prospect of further correction of the external deficit, and presents a golden opportunity to lock in correction of the twin deficits while avoiding a recession. The package provides for $490 billion in budget deficit cuts over five years. The Congressional Budget Office baseline projections of July, 1990, anticipated annual deficits at about $170 billion over the next five years. The new package cuts the deficit by $40 billion in 1991 and about $150 billion by 1995. As a result, the fiscal deficit should fall from 3 percent of GNP in 1990 to nearly zero in 1995. Despite justifiable skepticism in view of smoke-and-mirrors budgetry in the past, these cuts are largely for real.

The budget package allows for deficit correction while avoiding recessionary spillover. A fiscal contraction of 3 percent of GNP over five years can be compensated by a boost in demand from two sources: private investment and net exports. Investment was a weak 14.5 percent of GNP in 1989. Just restoring the level gradually to its more normal rate of 16 percent of GNP would provide one-half of the stimulus needed to neutralize fiscal contraction. The other half would be achieved if real net exports rose about $15 billion annually. This outcome could be accomplished by a further decline of

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about 5 percent in the dollar. Modest monetary easing by the Federal Reserve would prompt this last bit of dollar correction and facilitate the recovery in investment.

Under this strategy, the nominal current account deficit would fall to about $60 billion annually by 1995, less than one percent of GNP. (Because of adverse trade price movements from dollar depreciation, the nominal trade balance would fall only about half as much as the real trade deficit.) This level would be sustainable with far less risk of protectionism and financial hard landing. Although complete elimination of the foreign deficit would be preferable, and achievement of a fiscal surplus of over 1 percent of GNP might be desirable to strengthen America's anemic saving and investment, adjustment of the twin deficits would be largely achieved. At long last, internal and external adjustment of the US economy is within hailing distance.

Dr. Cline is a senior fellow at the Institute for International Economics.

THE WALL STREET JOURNAL THURSDAY, NOVEMBER 29, 1990

Bush's Budget Deal Made the Deficit Bigger

By Martin Feldstein

The recent budget deal is even worse than it looks. It is correctly seen as a political disaster for President Bush and a reversal of the policy of reducing the marginal tax rates that distort incentives. What is less well understood is that it still leaves massive future budget deficits. And, while public attention focused on the political drama of the budget negotiations and on the prospects of higher tax rates, the budget negotiators quietly killed the Gramm-Rudman sequester process. The new budget legislation therefore contains no automatic procedure to put pressure on politicians to shrink future deficits, no matter how large they become.

Of course that's not how the budget negotiators portrayed their handiwork. They projected an 80% reduction in the annual budget deficit, to about $60 billion in fiscal 1995 from $327 billion in the current 1991 fiscal year. In reality, though, these figures bear no relation to the government's current or future borrowing needs.

The budget deal actually implies an increase in the government's annual borrowing between now and 1995. And if the need to accumulate a Social Security fund to meet future benefit obligations is taken seriously, the annual budget shortfall actually increases by $70 billion between 1991 and 1995.

RTC's Role

This year's negotiators have surpassed all previous achievements in the art of fanciful budget accounting. More than half of the supposed deficit reduction comes from inappropriately including changes in the Resolution Trust Corporation's working capital in the estimated deficit. Borrowing by the RTC is, however, fundamentally different from other kinds of government spending. Since the RTC is now borrowing to acquire failing thrifts and to pay off insured depositors, its borrowed funds return immediately to the capital market and have no financial or macroeconomic effects. Yet the budgeteers counted the RTC borrowing as enlarging the 1991 deficit by nearly $100 billion.

And since the government hopes that in a few years the RTC will be generating net revenue by selling the assets of the thrifts that it has acquired, the budget projects $45 billion of RTC repayments to the Federal government in 1995 and therefore lowers the 1995 deficit by $45 billion. The swing from RTC borrowing of $100 billion this year to RTC repayments of $45 billion in 1991 creates the illusion of a $145 billion deficit improvement.

The other major reason for the projected fall in the budget deficit is the overly optimistic assumption that real GNP will grow at an average of 3.3% a year between now and 1995 and that both nominal and real interest rates will fall sharply (with the three-month Treasury bill rate declining to 4.2%, implying a real rate of only 1.4%). More realistic economic assumptions—one percentage point less real growth per year and one percentage point higher interest rate in 1995—would add more than $160 billion to the government's borrowing needs in 1995.

The government's total 1991 borrowing needs, net of the RTC borrowing, are $230 billion. Excluding the RTC "repayments" of $45 billion and correcting for the overly optimistic economic assumptions ($160 billion of extra taxes and reduced interest costs), the budget agreement raises the government's total borrowing needs to $305 billion in 1995.

The federal government's total 1991 borrowing needs are $230 billion. The budget agreement raises the government's total borrowing needs to $305 billion in 1995.

These calculations adopt the new government budget accounting convention of completely ignoring the annual surpluses of the Social Security program. The legitimate case for doing so is that the government needs to accumulate a real Social Security trust fund to meet the future surge in benefits when those who are now in their forties begin to retire. To accumulate such a fund, the Social Security surplus must add to national saving and not just finance larger budget deficits.

The implied 1995 deficit of $305 billion is not the best measure of the impact of the federal government on the capital markets. Since the annual surpluses of the Social Security program are used to buy bonds that would otherwise have to be sold to the public, that Social Security surplus must be offset against the rest of the budget deficit in order to calculate the government's current net borrowing needs from the rest of the economy.

The Social Security surplus is projected to rise to $125 billion in 1995 from $70 billion in 1991. Reducing the projected total borrowing needs by the Social Security surpluses implies that the government's net borrowing needs are likely to increase to $180 billion in 1995 from $160 billion in 1991.

Thus even if we ignore the government's need to increase national saving by accumulating a real Social Security trust fund, without further legislation the government's future borrowing will absorb more than 2% of GNP or about one-third of the net saving of the private sector. During the 1980s the U.S. was able to adjust to the high level of government borrowing by a major capital inflow from abroad. But that capital inflow has already declined in the past three years—to less than 2% of GNP from a peak of 3.5%—and it is likely to go on falling. Without that capital inflow, the projected government borrowing will mean higher interest rates, a lower level of investment in plant and equipment and therefore lower productivity and economic growth.

The decision to repeal the Gramm-Rudman sequester process means that there will be no pressure to force the administration and Congress to deal with these deficits. In its place is a new mechanism to limit spending on annually appropriated programs and to require that any legislated increases in the projected costs of entitlement programs are matched by new sources of tax revenue. But there is no part of the new budget process that focuses on the deficit as such and that forces the politicians to respond to the revenue shortfalls or spending overruns that will inevitably occur without new legislation. The original Gramm-Rudman process was far from perfect, but by forcing Washington to focus on the deficit it no doubt helped to shrink the size of the deficit.

How can the necessary deficit reduction be achieved? The recent budget negotiations show that it is politically unrealistic to expect any further cuts in the so called domestic discretionary programs. Despite the president's concessions on taxes and defense, his negotiators could obtain no net reduction at all in the real per capita levels of the annually appropriated nondefense programs. The inability to negotiate any net cuts in this $200 billion assortment of programs reflects both the realities of special interest politics and the success of the Reagan administration in shrinking this spending to a lower share of GNP than at any time in the past three decades.

The public's reaction to the budget negotiations also shows the futility of trying to raise taxes on middle income voters. It will be politically tempting to some members of Congress to renege on the 1986 agreement to reduce top tax rates in exchange for a broader tax base. The recent budget deal already includes one step in that direction—the rate for some individuals will jump to more than 33% from 28%. It would be a mistake to go further. Higher taxes on successful managers, entrepreneurs, scientists and investors would weaken incentives in a way that hurts the overall growth of the economy.

Another undesirable option for deficit reduction is further drastic cuts in defense spending, already projected to fall below 4.5% of GNP in 1993 and to continue declining in future years. By 1993 defense outlays will be at the lowest share of GNP in a half century and less than half of the GNP share in the peacetime years between the end of the Korean War and the start of hostilities in Vietnam. A new American isolationism could provide a rationale for further cuts in the defense budget but with long-term dangers for world peace and stability. Moreover, although there is now a reduced threat from the Soviet Union, it is important to bear in mind that the Soviets still have more than 5,000 ballistic missiles capable of reaching the U.S. as well as massive conventional weapons, that they are continuing to develop their SS-20 missiles and are refusing to reduce their production of Backfire bombers.

Preserve Tax Reform

The greatest domestic challenge now facing the president is to avoid the debilitating effects of continued budget deficits without replacing the fundamental tax reforms of the 1980s with socially divisive tax increases or permitting unilateral disarmament through the defense budget. The solution must lie in restructuring Medicare and Social Security to focus benefits more on those with low incomes, and in redesigning environmental policies to substitute for existing wasteful regulations the use of pollution taxes or permits that can raise revenue while actually improving economic incentives. It's certainly not too soon for the administration to start work on developing these options.

Board of Contributors

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THE WALL STREET JOURNAL TUESDAY, DECEMBER 4, 1990

Love That Budget Package

By Herbert Stein

The federal budget program adopted in October, after five months of effort, is a paradox. On the one hand, it is an act of intelligence, responsibility and courage. On the other hand, these qualities were hardly visible in the process from which the program emerged. About the messiness of the process I suppose there is no disagreement. I would like to explain why I think the outcome was nevertheless a success.

How one evaluates budget decisions depends on what one considers the major national problems that budget decisions might help to solve. I look at the budget decision from the standpoint of the following view of the nation's priorities.

I think a major problem is that too much of the national output is devoted to consumption—including medical care—by people who are not poor. As a corollary, too little is devoted to investment, including education, and to provision for the poor. The key requirement of a good budget policy is that it should help to correct this misallocation of the national output. This should be done in ways that would interfere as little as possible with incentives to efficient production or other socially desirable activities.

There have been several obstacles to the kinds of budget policy these goals would indicate. Most important is that they require transfer of income from the not-poor population, which is the largest part of the voting population. Two other obstructions are fetishes that block out discussion—"Balance the Budget" and "No New Taxes"—and the unwillingness of government, particularly Congress, to give up its discretion by making binding commitments.

Aid to the Poor

Given these views of the problem, it is clear why the 1990 budget package looks like a success to me.

1. The tax increases and some of the expenditure cuts included in the package will have their main effect in reducing the disposable incomes of the part of the population that is not poor and, as a consequence, in reducing its consumption expenditures.

2. Programs of assistance to the poor have been strengthened through increasing the earned income tax credit, child care provisions, and extension of Medicaid benefits to a larger number of poor children.

3. The incentive effects of the revenue increases and expenditure cuts are generally beneficial. Most of the revenue comes from increases in excises on cigarettes, alcoholic beverages and gasoline. Reduction in the share of the national income devoted to producing and consuming those products will be helpful from the standpoint of health and safety. The increase in the deductible under Medicare should have some effect, although small, in limiting the use of unnecessary medical services. The increase in the marginal rates of income tax for upper income taxpayers probably works against economic growth and efficiency, but the increase is small and so are its likely effects.

4. For the next three years, cutting the defense budget in order to find money for non-defense expenditures is ruled out.

5. For the next three years, perhaps longer, the possibility of a budget "crisis" resulting from a conflict between the sum of individual outlay decisions and an aggregate deficit ceiling, threatening an across the board sequester, is greatly reduced. The aggregate deficit ceiling will be adjusted to take account of several factors that would not have been taken into account when the individual outlay decisions were made: changes in economic assumptions, changes in technical estimates, overruns in the costs of the savings and loan rescue, and designated emergency expenditures, such as those for Operation Desert Shield.

Also, the enforcement of separate caps on major parts of the budget should keep overruns in one sector from throwing the whole budget into turmoil. What was always a basic defect of Gramm-Rudman-Hollings, that Congress had committed itself to a rigid deficit target without even the beginnings of an agreement on the revenue and expenditure requirements of meeting the target, has been partially corrected.

6. Another nail has been driven into the coffin of the idea that balancing the budget is the natural rule of budget policy. Nowhere in the description of the plan does the number zero appear as its result. The whole program is described in terms of the magnitude of the deficit reduction to be achieved, not in the magnitude of the deficit to be achieved.

Moreover, at least two definitions of the deficit, both of them obviously "man made," are used to describe the program. The description of the deficit outcome implicit in the program has become enormously complex. In these circumstances, when "the deficit" has no unique meaning other than what someone decided it should mean, the idea of balancing the budget as the natural standard of policy must lose its intuitive appeal. The package may be the beginning of a new and more sensible way of looking at fiscal policy in the aggregate.

7. The political inhibition against discussing tax increases has probably been relaxed. A significant part of the Republican leadership, including the president, has acknowledged that there are purposes for which a tax increase is desirable. Subsequent expressions of remorse cannot restore its virginity on that score. Moreover, almost every member of Congress who voted for the tax increases was re-elected. On the other hand, 1990 election results in several states were clearly expressions of revulsion against increases of state taxes, and a certain segment of the Republican Party seems more determined than ever to make "No New Taxes" its (only?) platform.

The tax issue is unlikely to come back at the federal level for several years. Under the budget control procedures included in the 1990 package, revenue from tax increases cannot be used to pay for additional discretionary expenditures, but only to finance increases in mandatory expenditures (mainly Social Security and Medicare) or reductions in the deficit.

More Revenue

Of course, like everyone else I can say that this was not my ideal budget package. There are expenditures that I would like to see increased—for education, for public investment and for assistance to the poor—whose increase is made more difficult, although not ruled out, by the new cap on discretionary domestic expenditures. I believe that more revenue could have been raised in better ways than by increasing marginal rates of income tax, and if those rates were to be raised I would have preferred that to be done overtly rather than under a complicated though fairly transparent disguise. Desirable changes in Social Security were not even considered.

But on the whole the package was, in my opinion, much better than we had any reason to expect and much better than the common opinion of it today.

A former chairman of the president's Council of Economic Advisers, Mr. Stein is an American Enterprise Institute fellow. A longer version of this article will appear in the January-February 1991 issue of The American Enterprise.

Board of Contributors

Too much of the national output is devoted to consumption—including medical care—by people who are not poor and too little is devoted to investment, including education, and to provision for the poor.

WASHINGTON POST, October 31, 1990

Robert J. Samuelson

As the Dollar Drops

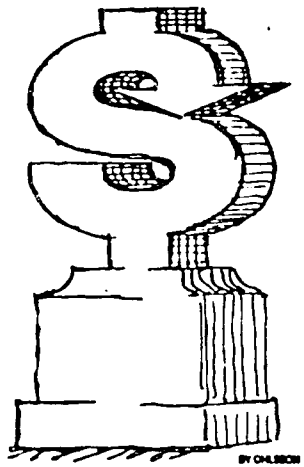
If you talk to Richard Studer, you'll get a good picture of the economy's disputing present—and also its brighter future. Studer runs an Ohio company that produces plastics-making machinery. Business is down, and the company has laid off 100 of its 800 workers. The bright spot is exports. They're up and represent about 15 percent of orders. There's the future: the U.S. economy should soon emerge as a powerful export machine.

Remember the chatter about us becoming a nation of hamburger flippers? The idea was always outlandish, but now the economy is moving in just the opposite direction. It's shifting from growth led by the service sector to growth led by rising exports. Service industries that overexpanded in the 1980s—real estate, banking and retailing—are retrenching, while the dropping dollar should spur exports. The change is one reason why the economy is teetering on the edge of a recession.

The bad news is that the service slump is currently overwhelming export expansion. In the past year, the economy has grown a meager 1.1 percent. That hasn't been fast enough to prevent rising joblessness. The unemployment rate in September was 5.7 percent, up from 5.3 percent a year earlier. Many economists now expect a recession, which is typically defined as at least six months of declining output.

The good news is that any recession may be cushioned by the effects of a lower dollar. Since 1985—when it reached its recent high—the dollar has declined roughly 50 percent against other major currencies. Consider the impact on Studer's machinery. Among them are extruders, which can make everything from plastic pipes to drinking straws. The least expensive extruder costs $25,000. With today's exchange rate of about 1.5 deutsche marks (DM) to the dollar, that machine costs 37,500 DM in Germany (plus transportation). But in 1985, the exchange rate was nearly 3.4 DM to the dollar. A $25,000 machine then cost roughly 85,000 DM.

Wham! The dollar's depreciation makes U.S. manufactured goods enormously competitive in world markets. The export boom has already begun. Between 1985 and 1989, exports jumped from $219 billion to $364 billion. But the boom has stalled in 1990, because the dollar's exchange rate rose somewhat last year. The dollar's recent decline reverses that trend and restores the price competitiveness of U.S. exports. In a poll, the National Association of Manufacturers found that 52 percent of executives expect higher exports in 1991; only 10 percent expect lower.



The trade deficit, now running at about $100 billion annually, should drop. Economist William Cline of the Institute for International Economics in Washington thinks it could vanish by 1995. Not only should exports rise, but imports won't be as competitive. Studer already notices the change: "The Germans in particular . . . [are] not as aggressive in pursuing orders."

The idea of welcoming a weaker currency may seem subversive. A cheaper dollar isn't all sweetness. Traveling abroad is costlier for Americans, while visiting the United States is less expensive for foreigners. In 1989, foreigners spent more in the United States ($44.5 billion) than Americans spent abroad ($43.5 billion) for the first time since World War II. More fundamental, the decline in our trade deficit will increasingly force us to live within our means.

What has allowed us to live beyond our means is the dollar's role as the main global money used for trade and international investment. We buy imports with our own currency, and foreigners often hold the dollars rather than sell them for DM, yen or francs. In the early 1980s, foreign demand for U.S. investments (stocks, bonds, real estate and companies) was so great that the dollar's value rose sharply. It is this rise, which fostered the trade deficit by putting U.S. manufacturers at a competitive disadvantage, that is now being reversed.

The dollar's drop signifies that, on foreign exchange markets, there's more pressure to sell than buy. Our trade deficit means that we're still spending much more abroad than we're earning. Overseas investors have satisfied much of their appetite for U.S. investments. The narrowing of the gap between U.S. and foreign interest rates has also reduced the lure of American securities.

In 1984, a U.S. Treasury bond paid a 12.5 percent interest rate and a comparable German bond paid 8 percent. By August 1990, the U.S. and German rates were nearly equal at about 9 percent. American and Japanese rates have also moved closer. The costs of reunification have pushed up German interest rates, and Japan raised rates to dampen land and stock speculation. Increasingly, the DM and yen serve as global currencies. Investors don't automatically want to hold dollars.

Predicting exchange rates is notoriously risky, but the dollar could drift lower. Economist Nicholas Sargen of Salomon Brothers, the investment banking firm, thinks the dollar could hit 1.4 DM and 110 to 115 yen by mid-1991. (A dollar now equals about 129 yen, down from about 260 in early 1985.) A further decline, as long as it doesn't happen too fast, is not especially dangerous.

Just what happens to the economy now is anyone's guess. The outcome of the Persian Gulf crisis could quickly change things for better or worse. What's less murky is the connection between the health of the U.S. economy and foreign economies. The severity of any U.S. recession will depend heavily on what happens in Europe and Asia. Slumps overseas that cut demand for our exports would compound the damage. A spasm of foreign protectionism could also hurt us. One message here is not to fight the U.S. slowdown with protectionism. If it prompted retaliation (as seems likely), it would do more harm than good.

A dropping dollar is not an economic panacea. It merely gives U.S. producers a price edge in international markets. But price isn't everything. There's also product quality and reliability, aggressive salesmanship and good service. In the 1990s, American industry will have an opportunity to create its own brighter future. Whether the opportunity is seized or squandered depends on the country's Richard Studers.

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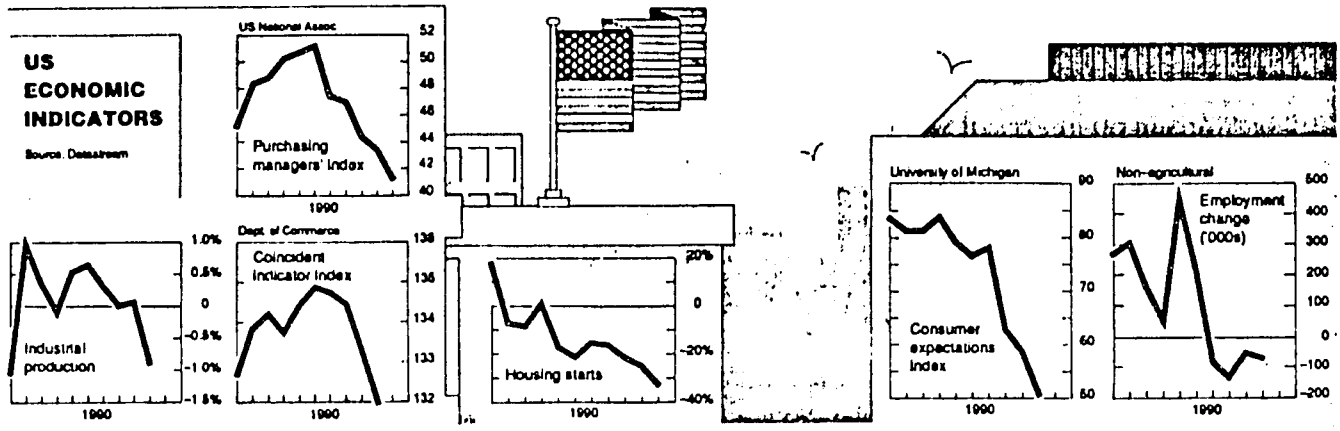

It's termed a 'downturn', not a 'recession' – yet, says Michael Prowse

Cracks deepen in the US economy

The debt laden US economy defied both its critics and gravity during the 1980s. But it now appears to be sinking rapidly. Nearly every recent economic indicator – from consumer confidence to industrial production and employment – is signalling a sharp deterioration in business conditions.

Policymakers are still refusing to use the dreaded word recession but almost everybody agrees the economy has entered what Mr Alan Greenspan, the chairman of the Federal Reserve, dubs a "meaningful downturn".

But the likely duration and severity of the downturn remain hotly disputed. Mr John Sununu, the White House chief of staff, predicts a short and mild recession, quipping in private that it "will be over before most economists acknowledge that it has begun". Such optimism is supported by the Organisation for Economic Co-operation and Development's latest assessment of the US economy. While highlighting medium term structural problems, this foresees nothing worse in the short run than a sharp slowdown in the rate of growth.

Others, however, worry that an unintended tightening of credit, popularly dubbed a "credit crunch", will interact with chronic problems in sectors such as real estate and precipitate a full blown recession perhaps approaching in severity the 1973-75 and 1981-82 downturns.

The Federal Reserve signalled its concerns about credit tightening this week by announcing a cut in banks' reserve requirements, the first such change since 1983. This was designed to boost banks' profitability and encourage increased lending. Mr Nicholas Brady, the treasury secretary, has repeatedly urged banks not to abandon their good customers while promising far reaching reforms of the beleaguered banking industry.

The Fed has also gradually lowered interest rates in recent weeks despite the exceptional weakness of the dollar and fears that the US's overseas creditors might withdraw funds.

Forecasters of all stripes agree that predictions are particularly hazardous at present. Not all indicators point to decline: durable goods orders, for example, remain fairly strong even allowing for erratic items. The economy, moreover, has changed structurally in the past decade with service industries assuming greater importance. Computer models have not fully caught up with the changes nor do they cope well with "balance sheet" effects such as falling asset prices which have not played a key role in previous post war recessions.

Economists are also keenly aware that the outcome of the Gulf crisis, while critical for the US economy, remains unpredictable despite yesterday's announcement by President Saddam Hussein that all foreign hostages were free to go home. If peace initiatives succeed, oil prices could sink back below $20 and improve the outlook for growth and inflation, but if hostilities prove unavoidable, oil prices could soar to $80 a barrel.

The only certainty is that the economy, having bobbed about for most of the year, began to weaken rapidly this autumn. The important indicators of possible recession include:

- **Purchasing managers' index**: This broadly based and closely watched gauge of industrial conditions is the first important indicator to be published each month. In November, it fell more than two points to 41.3, the lowest level since May 1982. A reading below 50 indicates that the manufacturing economy is declining, a reading of below 44 that the whole economy is contracting. The index has been falling since June and has been below 44 for two months.
- **Leading indicators**: The composite index fell 1.2 per cent in October, the fourth successive monthly decline. The coincident index of economic activity has also fallen for four months. Such persistent weakness is a strong but not certain indicator of recession.
- **Industrial production**: The fall of 0.8 per cent in October was sharper than expected. But what really made alarm bells clang was the fact that declines were registered in almost every sub sector of industry. The press release was a sea of minuses.
- **Consumer confidence**: Very sharp falls in October have carried over into November. The widely followed University of Michigan index registered its biggest fall for 40 years. Confidence is now nearly as low as during the 1981-82 recession although consumer spending itself is holding up rather better.
- **Employment**: Private sector employment and hours worked both dropped markedly in October. Initial claims for unemployment insurance have moved significantly higher in recent weeks. Had November employment figures are expected today.
- **Housing starts**: Real estate has been in recession in many parts of the country, notably the north-east, for at least a year. But the 6 per cent decline in starts in October was unusually large. There were also signs of weakness in California, which had been more buoyant than the east coast.

The consensus view is that the recession did not begin until September or October. In last week's testimony to Congress, for example, Mr Greenspan said the economy had been expanding at a moderate rate prior to Iraq's August 2 invasion of Kuwait. This had a substantial adverse impact, raising prices and reducing business and consumer confidence.

Other economists, however, while accepting that the Gulf crisis aggravated the downturn, say the economy peaked much earlier. Mr Geoffrey Moore, the director of the Centre for International Business Cycle Research at Columbia University and a member of the official panel which dates recessions, believes this downturn may have begun as early as June. This is when total employment, industrial production, real income and sales, and the coincident index of economic activity peaked, he says.

Forecasters now expect GNP to fall this quarter, although estimates of the annual rate of decline vary from under 1 per cent to about 3 per cent

Most forecasters now expect Gross National Product to fall this quarter, although estimates of the likely annual rate of decline vary from under 1 per cent to about 3 per cent. Most see the weakness extending into the first half of next year but few anticipate a prolonged and severe downturn comparable to the recessions of 1973-75 and 1981-82. These lasted about 16 months and involved peak-to-trough declines in GNP of 4.5 per cent and 3.5 per cent respectively.

The likely duration of this recession is put at well under a year with GNP falling by no more than a total of about 1½ per cent. Some economists regard this as an overestimate, arguing that recent cuts in production are precautionary rather than a response to collapsing consumer demand, and will be reversed early next year.

The consensus view that any recession will be fairly shallow reflects an attempt to balance several positive and negative factors. In its upbeat assessment, the OECD drew attention to the relative stability of the "core" inflation rate – in other words the headline rate minus erratics such as oil and food – and the leanness of business inventories.

The deep recession of the early 1980s was precipitated by the sharp monetary tightening ordered by Mr Paul Volcker, then Fed chairman. The crackdown was needed because the US faced the threat of double-digit inflation. In the absence of a Gulf war, no such threat exists today. Interest rates are being lowered rather than raised. There is thus no reason, say optimists, to expect a sudden collapse of economic activity.

The sharpness of the 1981-82 downturn also reflected a rapid build up of inventories or unsold goods. Savage production cuts were the only way to clear them away. But US industry now employs more sophisticated stock control technology and watches demand trends more closely.

The inventory to sales ratio is accordingly near to an historic low, having trended down for eight years. The leanness of inventories, claim optimists, makes sharp production cuts unlikely, the recession will therefore be modest. The argument, however, is not entirely persuasive. Better technology means that fewer inventories are needed even in good times. And a declining inventory-to-sales ratio in the early 1970s did not prevent the severe 1973-75 downturn.

Indeed, Mr Rudolf Penner, the former director of the Congressional Budget Office, recalls that in November 1973 tight control of inventories provoked a similar mood of misplaced confidence. A little later the economy fell over a cliff.

A third alleged ground for confidence is the strength of exports, which accounted for more than 80 per cent of growth in the first half of this year. However, the export turnaround of recent years was due as much to the rapid expansion of overseas markets as the fall in the dollar. The US's Anglo-Saxon trading partners – Canada, the UK and Australia – are now in recession while growth is faltering in much of the rest of the world including parts of continental Europe. Exports in any case account for only a small portion of US GNP.

Pessimists can cite some apparently compelling reasons for expecting a more serious recession. The large budget deficits spawned by the Reagan years of "voodoo economics" (to use Mr George Bush's expression) have eliminated any scope for fiscal relaxation. Indeed, the White House and Congress have just agreed a five-year programme of tax increases and spending cuts.

Monetary policy is also constrained by the dollar's weakness and the need to keep America's external creditors happy. However these constraints can be exaggerated. The Fed is likely to respond to further economic weakness by lowering interest rates again, even if this causes the dollar to depreciate. And creditors cannot object too loudly because a really deep US recession is in nobody's interests.

But the largest source of concern remains the fragility of the banking system and the extraordinarily high level of personal and corporate indebtedness. The ratio of private and public debt to GNP rose sharply throughout the 1980s and on some calculations now approaches levels last seen in the 1930s.

The risks here are difficult to quantify. The OECD, rather bravely, has tried to calm nerves. It says worries about corporate debt are overdone because they ignore corresponding rises in the market value of equity. And it says banks' balance sheets are not so weak as to suggest an impending "credit crunch".

The Federal Reserve, however, seems perturbed. Mr Greenspan has said that many types of company are now experiencing difficulties obtaining financing. And the statement accompanying Tuesday's cut in banks' reserve requirements said that the unintended tightening of credit conditions was exerting a "contractionary influence on the economy".

The Fed would clearly do its best to counter the kind of chain reaction of defaults that wrecked the US economy in the 1930s. But it is already discovering that in a recessionary climate, monetary relaxation can sometimes be as ineffectual as "pushing on a piece of string", to use Keynes's memorable phrase.

Financial fragility is a serious worry. But given modern understanding of how economies work, an unnecessary deepening of the present downturn on this score should be avoided. However, America's burden of debt – private, public and external – will constrain growth in the medium term. It may also scupper the White House's hopes of a speedy recovery from recession. That could dent Mr Bush's prospects of re-election in 1992.

NEW YORK TIMES, December 19, 1990

Is Uncle Sam Getting Stiffed?

By Jim Sasser

WASHINGTON

Early next year, the Pentagon will ask Congress for at least $20 billion in additional funds for Operation Desert Shield. That's just to keep the peace. A full-scale shooting war could cost the U.S. from $1 billion to $2 billion per day. At that rate, all of the $41 billion in deficit reductions we achieved in the budget agreement would be wiped out in a single month.

Though economic issues are clearly of lesser moment when weighed against the lives of thousands of young Americans, the economic consequences of war demand attention.

There is a heavy dose of irony in the specter of America mobilizing for a war to protect our economic self-determination and then sinking into economic quicksand beneath the cost of the operation itself.

Some gulf allies are deadbeats.

All of which poses a fundamental question: Where are the financial contributions of our key allies, especially those who have more to lose than we do from a disruption of Persian Gulf oil?

Overall, the Bush Administration, preoccupied with forging international support for the use of American force in the gulf, has given scant attention to the question of who will pay. It has shown little interest in alerting the public to this issue and has exerted minimal pressure on our allies to pay up.

Japan relies on the Persian Gulf for some 70 percent of the oil it uses to sustain its $3 trillion-a-year economy. Its leaders reluctantly pledged $4 billion to the gulf effort — $2 billion in military assistance and $2 billion in foreign assistance.

As of Nov. 30, the Pentagon reported that its Major Foreign Contributors' Responsibility Sharing Program had received from Japan only $374 million, 40,000 Sony Walkmen and a few Toyotas.

Unified Germany arguably has more to gain from stable oil prices and a reliable new world order than any other industrialized nation. Nonetheless, Bonn has offered just $800 million, and, to date, we have received only $330 million of that sum.

A more glaring case still is Saudi Arabia, whose royal family asked the U.S. to protect that nation's immense oil reserves. A safe Saudi Arabia has been able to increase oil production in a tight market and realize a windfall profit of some $150 million a day. That's at a time when Americans are paying $80 million more per day for our gulf oil imports than we did prior to the August invasion of Kuwait.

The Saudis originally promised $3 to $5 billion in cash and in-kind contributions. So far, they have contributed only $987 million in cash and matériel — about 6.5 days' worth of their windfall oil profits.

Clearly, something is out of joint. America's share of the cost simply doesn't match our share of the international risk.

The Administration announced this week that it will seek $5 billion in additional foreign aid support from the allies to help Turkey, Jordan and Egypt offset the economic losses they have suffered since the crisis began. That seems a fair and generous course. In the meantime, Secretary of State James Baker should press the delinquent allies to pay their debts to the Desert Shield fund and not to accept "the check's in the mail" as an answer.

Every nation with a definable interest in the Persian Gulf should make a contribution that is commensurate with its interest. With our NATO allies and, especially with Japan, we should make this question a centerpiece for any future trade discussions. Moreover, we now have sufficient leverage in Saudi Arabia to simply demand a greater contribution from that country.

If we don't insist on that, our orchestra of nations against Saddam Hussein is virtually a one-man band. □

Jim Sasser, Democrat of Tennessee, is chairman of the Senate Budget Committee.

NEW YORK TIMES, October 3, 1990

No, the U.S. Isn't in Decline

By Joseph S. Nye Jr.

CAMBRIDGE, Mass.

What will be America's power in the post-cold-war world? Before the Persian Gulf crisis, "declinists" argued that our position will continue to worsen. "Revivalists" believed that our problems can be corrected and that we will remain the leading power.

Six weeks before Iraq invaded Kuwait, the Yale historian Paul Kennedy, a leading declinist, wrote: "The drop in cold war tensions has caused a reduction in the value many people put on military power ... the one measure of power in which the United States has a clear advantage over other countries."

The crisis has proved such thinking wrong. Military power was critically important in preventing Saddam Hussein from gaining control of 40 percent of world oil reserves and veto power over global economic growth. The crisis showed that the Soviet Union's decline as a superpower has not diminished the value of America's military card.

Still, force has been only half the answer. America's success in mobilizing an international coalition against Iraq rests on more than military force, and shows that we retain a broader range of power resources than any other country.

Our position in a post-cold-war world rests on hard and soft power. Hard power is based on military and economic might. Soft power — the ability to co-opt rather than command — rests on intangible resources: culture, ideology, the ability to use international institutions to determine the framework of debate.

It was crucial to get our military's hard power to Saudi Arabia quickly. It was equally important to have the soft power to shape U.N. resolutions that defined Iraq's entry into Kuwait as a violation of international law, calling for enforceable sanctions.

The gulf crisis shows our strengths.

If the U.N. failed to respond to such aggression, the prospects for international order would be weakened and the U.S. and others would face a bleaker future. We cannot police the world alone, but if we do not take the lead, others are unlikely to do so.

Skillful crisis management, however, is only half the leadership challenge the Administration faces.

Mr. Kennedy warns that empires in decline were able to use their militaries for massive projection of force: Spain in 1634 in the 30 Years War, Britain in 1900 in the Boer War. His economy analogy is faulty.

Spain was suffering an absolute (not relative) economic decline from 1620 to 1680. By 1900, Britain's economy had slipped to third largest in the world. America, for all its problems, remains the world's largest economy, with the highest level of absolute productivity; our share of world product has held constant for 15 years.

American decline, however, could occur through a long accumulation of political decisions favoring consumption over investment. Ultimately, our hard and soft power resources depend upon soundly addressing such domestic issues as the budget deficit, savings rate, educational system and condition of our cities. Military strength depends on a strong economic base. Cultural and ideological appeal depends on maintaining a healthy and open society.

President Bush has said the U.S. "has the will but not the wallet." The opposite is closer to the mark. Politicians regularly use the deficit as an excuse to evade responsibility. The U.S. is rich but acts poor. Our problem stems not from inevitable economic decline but from 80's political choices that increased Government spending while providing a tax cut.

The Gulf crisis, which has pointed up West Germany's and Japan's one-dimensional power, shows that the declinists have greatly exaggerated the rise of these countries, and have underestimated U.S. strength in hard military and soft coalition-building power resources.

If, however, our leaders avoid real domestic reform and investment in the sources of hard and soft power, they may make the declinists' fallacious case come true eventually. □

Joseph S. Nye Jr., author of "Bound to Lead," directs the Center for International Affairs, at Harvard.

WALL STREET JOURNAL, October 22, 1990

A U.S. Recession Will Have Global Impact

Global View

By George Melloan

"No man is an island entire of itself, every man is part of the main," wrote the 16th-17th-century poet John Donne. In an interdependent world, no country is an economic island either. That raises a question: How will the recession that now threatens the U.S. affect the rest of the world?

On this issue, the principle of global economics breaks down. Nations have widely divergent laws and policies that come to bear on economic efficiency. For that reason, all will be affected to different degrees and in different ways by the slowing of the American colossus. Everyone will feel some pain, given the fact that Americans import nearly a half trillion dollars in goods and services annually and consume some 25% of the world's total production. If the recession is shallow and brief, some vigorous national economies may be largely unscathed. But on balance, a U.S. recession is tantamount to world recession or at least reduced world-wide growth.

Whether the U.S. actually is entering a recession is, of course, still undetermined. A recession is officially defined in the U.S. as two consecutive quarters of negative economic growth. Some economists are saying that will happen in the third and fourth quarters of this year, although the latest industrial production numbers announced last week were stronger than expected. But even if there is no recession there will be very little U.S. growth in 1990.

The world economy was slowing even before the third quarter. By last May, the International Monetary Fund was predicting world-wide economic growth of only 1¾% in 1990, a drop-off from 1989's 3%. Some countries, Germany and Japan for example, remain healthy. Others, such as Sweden and New Zealand, have been feeling a pinch for some time.

A September Morgan Stanley analysis predicted Japan's 1990 growth at 4.6%, off only slightly from last year's 4.9%. German growth was forecast at 4%, exactly the same vigorous rate achieved in 1989. None of this means that those two countries—Japan in particular—are invulnerable to an American slowdown. It only means that as of now they have a good head of steam.

The countries likely to be the most vulnerable to global recession are easy enough to identify. By and large, they are the countries that already have serious disabilities, usually as a result of large tax burdens that are being used to finance social programs or industrial subsidies or both. In short, their policies have reduced their economic efficiency by penalizing the productive and rewarding the unproductive.

The world's foremost horrible example of failed policy is that great glob of statist absolutism, the Soviet Union, which was capable of putting itself in the tank without benefit of world recession. It certainly won't find it any easier to climb out now that the world economy is slowing. To the contrary, its deep-seated incapacity to produce will contribute to global malaise.

Even some nominally capitalist or mixed-economy countries will be under greater pressure to revise growth-destroying practices. National policies in Europe are very much a mixed bag despite limited economic integration in the European Community. As mentioned here last week, the good news is that 10 of the 12 EC nations, plus Austria, now are part of a hard-currency bloc built around the German mark. The United Kingdom has just become the newest member. Countries that have been in the European Monetary System for some time are reaping the fruits of reduced inflation, primarily because low inflation stimulates efficient capital investment. They are stronger as a result.

But all are not equally strong. France is only now beginning to acquire some of the industrial muscle that Germany has been building for years, and it still carries a very high tax burden that makes it vulnerable to economic slowdowns. Italy and Spain are growing but have not yet reduced inflation to an acceptable level. The U.K., with a high inflation rate, has much work to do before its industrial plant is restored from the ravages of postwar socialism, even though Maggie Thatcher has achieved an enormous improvement through privatization in her 11 years in office.

Nonetheless, the countries mentioned above are in a better position to weather a U.S. recession than they were during the sharp, brief U.S. decline in 1982. The European Community is more integrated and its industries have been forced into greater efficiency by increased competitive pressure.

Yet the weak spots in Europe are much in evidence, too. Some, such as Yugoslavia, Greece, Portugal and former communist countries, have been chronically weak. There are others that only recently have begun to feel the effects of longstanding policy errors.

The Scandinavian countries are a case in point. Sweden and Norway, non-members of the EC with large social spending burdens, are especially vulnerable to recession. Sweden succeeded for a time as the prototypical welfare state because government was wise enough not to interfere with a vigorous private manufacturing sector. But now, with taxes consuming 55% of total production—compared with only 44% even in highly taxed France—the system's top-heaviness is showing. Its economy has been limping for some years, and inflation, reduced somewhat for a time in the late 1980s, is a serious problem again. A recession may require some urgent revisions of the Swedish welfare-state model.

Norway and Denmark have similar problems, but not as serious in part because their tax burdens are somewhat less. Norway will reap benefits from the oil-price balloon and Denmark enjoys membership in the EC. But their underlying weaknesses will become more evident in an economic slowdown.

The U.S. has been the locomotive of the world economy in the 1980s, registering nearly eight years of growth. But Congress once again is trying to switch the country's agenda to redistribution from growth. Rising inflation, high taxes on capital gains, a successful political assault on marketers of high-yield bonds—who were providing risk capital to innovative growth industries—and the federal maladroitness that has enfeebled the savings and loan and banking sectors all have combined to stifle investment and growth. Government regulation, brought under some control in the 1980s, has been on the rise again, adding a further burden to production.

The only bright side of all this is that recessions have their uses. If countries that have carried welfare-state policies to a self-defeating extreme are forced to revise their thinking, they will be the better for it. U.S. voters, restive over the *opera buffa* in Washington, may retaliate politically, persuading politicians that "tax, tax, spend, spend" no longer has its old magic. Industry world-wide will have to seek further efficiencies to compete.

No economy is an island, and recovery for the global economy will depend on the sum of its parts, especially that big part called the U.S. If the U.S. recognizes that responsibility, it hasn't been very evident lately.

After the excesses of the 1980s, the US financial sector faces a period of expensive rehabilitation, write Martin Dickson and Alan Friedman

Hung-over from a decade-long party

Frightened and hung over from a decade of intoxicating excess, the US financial system is approaching 1991 in a more fragile state than has been the case for many years – and the malaise threatens severe repercussions for the economy and corporate competitiveness.

Historians will probably see 1990 as a significant turning point after the credit excesses of the 1980s, the year when some of the nation's richest and most famous were transformed into villains or laughing stock. Mr Michael Milken, Drexel Burnham Lambert's junk bond king, is on his way to jail. Mr Donald Trump, the real estate developer, is living at the mercy of his bank creditors.

But 1990 saw only the beginning of a cleansing process that is likely to continue during the first half of this decade and could be extremely painful, involving big bankruptcies and balance sheet restructuring across corporate America and a shrinking of the financial industry that services it.

For the US has entered a recession with its financial system in remarkably poor structural shape for this point of the business cycle. Its lending institutions, weighed down by runaway overheads, mounting problem loans and overvalued real estate assets, are squeezing credit, while its corporate sector is ending eight years of economic growth with its debt burden extremely high.

The cleansing process is likely to continue during the first half of this decade and could be extremely painful

The most powerful signs of these problems are in the commercial banking sector, where failures are expected to rise and a wave of mergers is likely in a drive to slash operating costs. But what is most remarkable about the present crunch is the very wide range of institutions affected.

- The savings and loan industry is in a crisis that could cost the US taxpayer some $500bn over the next 20 years.
- The insurance industry is suffering from assets of questionable value – junk and real estate – at a time of excess capacity and a cyclical trough on the property/casualty side, and a life business which is being squeezed by some fancy new policies written in the heady days of the 1980s. Although the industry overall remains sound, insolvency fears persist.
- In the corporate sector, bankruptcies and defaults on debt were on a sharply rising trend long before the recession set in during the autumn.
- In the real estate market, there is an overhang of property held by the Resolution Trust Corporation (RTC), the federal agency that is meant to clean up the S&L mess. Values have been plunging.

Dr Henry Kaufman, the New York pundit who repeatedly forecast in the 1980s that the credit boom would lead to a bust, senses vindication: "America has had credit woes before, but at no time since the 1930s have they been so oppressive or involved as wide a range of participants."

Wall Street, which has never fully recovered from the 1987 equities crash, is in the throes of a second wave of retrenchment following the collapse of the junk bond market at the start of this year, a sharp fall in takeover business, and reduced commissions on new issues of securities.

Another 40,000 jobs could go over the next two years, bringing to 80,000 the number lost since 1987, and reducing employment in the industry to about 180,000.

But Wall Street was hardly alone in creating the credit binge. Commercial banks, concerned at the diminishing profitability of many of their established lines of business, threw themselves into lending to real estate and highly leveraged takeovers.

With hindsight the craze seems as foolish as had been the earlier race into Latin American sovereign debt – and only compounded difficulties left by the previous lending wave.

After starting in recession-hit New England, serious loan problems are now hitting hard at the big New York banks, such as Chase Manhattan and Citicorp, where there have been savage staff cuts, mounting bad debt reserves and slashed dividends.

"There is a lot of truth in the fear," says a senior banker in New York, "but there is also a lot of hysteria. One big problem is that US bank regulators are so hostile to us."

Many bankers criticise tough regulators for having compelled them to classify more loans as non performing; this, they say, hastened the credit crunch during 1990 by making lenders excessively cautious.

Two months ago Mr Robert Clarke, the Comptroller of the Currency, warned bankers that they were losing credibility with Wall Street, Washington and the general public. Mr Clarke told the bankers they needed to shape up, return to basics and stop cutting corners. It was an unpopular speech among the bankers themselves, but many analysts say Mr Clarke was spot on.

The Federal Bank Insurance system is meanwhile running out of money and faces an estimated $9bn outlay for rescues during the 1990-91 period. Put simply, federal regulators are bracing themselves for a string of bank failures, beginning in the north-east. Moreover, it seems they are prepared to allow several medium sized institutions to go to the wall.

A moderately severe scenario was sketched recently by Mr David Cates, chairman of W Ferguson, the Washington based bank consultants. Mr Cates examined how the 13,000 institutions in the US banking system would fare if they were to write off 30 per cent of all non performing assets as of the end of June 1990, including 6 per cent of commercial real estate loans. His model supposed that loan loss provisions would be rebuilt to 1% per cent of total loans.

The result of this analysis is that some 1,500 banks would have equity to asset ratios of less than 2 per cent, or half the regulatory minimum. These banks would account for 34 per cent of the industry's total assets and even if only one third of these banks failed the net bail-out costs to the Federal Insurance fund would reach $60bn, or more than seven times the level in 1988 and 1989.

Mr Martin Barnes, of the International Bank Credit Analyst, a respected forecasting consultancy, is also gloomy: "There is no hope of an early decline in loan losses. Problem loans lag the economic cycle and therefore will escalate in 1991. Major bank failures are likely next year and the number of money centre banks will shrink."

All of the top money centre bank chairmen – including Mr John Reed of Citicorp, Mr Tom Labrecque of Chase, Mr Walter Shipley of Chemical and Mr John McGillicuddy of Manufacturers Hanover Trust – have acknowledged the possibility of large scale mergers as the sector's shake-out proceeds.

Unfortunately, there is no indication that the worst underlying problems will dissipate quickly. For example, the commercial real estate market is deemed by top industry executives to be so weak that it could remain flat for up to five years. The deterioration of the north-eastern economy is so severe that a growing number of leading New York executives from banking, the media, advertising, retailing and other sectors speak in private of a possible "contained regional depression".

With few exceptions, corporate America is likely to face tumbling profits during the first half of 1991 and a scarcity of capital for new investments, and for growth by acquisition.

What merger activity there is looks likely to be dominated by two trends. One is strategic takeovers aimed at rationalising cost structures and combining market share – although in recent months several such deals have failed because banks have been reluctant to provide finance. The other is bids from abroad, encouraged by the weak dollar and the cheapness of US corporate assets.

The largest and most successful US industrial groups may continue to push into Europe, but the financial services industry, especially the commercial banks, is likely to continue its retreat from the international stage.

Thus much of US business could find itself financially weak and turning in-ward at the very moment when it is in danger of being squeezed by Europe and Japan.

It is not that the US financial system is about to collapse, but the convergence of structural problems suggests that recovery from the present recession will not be quick. The decade-long financial party is over, but the bill is only starting to be paid.

US Needs in the High-Tech Age

This month, the National Academy of Engineering will publish a study titled "National Interests in an Age of Global Technology." The report looks at the implications of the globalization of technology for the U.S. economy. An excerpt follows:

The increasingly global character of corporate technical activities has made it essential that policies aimed at developing and better managing the nation's technical endowments be outward looking — consistent with an international policy framework that fosters and structures technological competition, cooperation and exchange among nations and firms.

Ultimately, the nation's ability to capture a fair share of the benefits of the global technical enterprise will depend primarily on the extent to which private corporations operating within its border seize the opportunities presented by the emerging global technology base. Their success or failure, however, will be conditioned by the extent to which U.S. policy-makers recognize the interdependence of domestic and international policies that influence technology development, diffusion and commercialization.

There is an obvious need for continued efforts to liberalize world trade as well as greater public and private involvement in the international standards-setting process and in the quest for a more effective international intellectual property rights regime. Yet, these high-profile concerns are distracting policy-makers from equally important issues raised by the rapid growth of foreign direct investment and transnational corporate alliances and technical networks over the past decade.

The most important challenges to U.S. foreign economic policy relate to national disparities in the treatment of foreign direct investment and competition policy.

• The United States should seek to forge a multilateral consensus regarding the mutual obligations of multinational corporations and their home and host governments.

The discriminatory treatment of U.S.-owned corporations appears to be a fact of life in Japan and to be increasing in Western Europe. Nevertheless, discriminatory policies are not consistent with global economic and technological realities and may be counterproductive in the long run.

Such policies would be detrimental to U.S. national interests. Given the extent of U.S. global technological interdependence, and the many contributions of the U.S. subsidiaries of foreign firms to the U.S. economy and technical enterprise, it is particularly important that the U.S. market remain open to foreign direct investment and that, as far as possible, such open-market policies be reciprocal.

There are many troubling issues raised by the recent growth in foreign control over U.S. industrial assets and the extent to which foreign multinationals draw upon the U.S. research enterprise. It is time for a more multilateral approach to foreign direct investment — an approach that acknowledges the pervasive character and positive contributions of foreign direct investment in an effort to arrive at mutually beneficial "rules of the game" for both transnational corporations and their homes and host countries.

Good corporate citizenship is becoming ever harder to define as the operations of U.S. and foreign-owned firms become increasingly transnational. An aggressive U.S. effort to forge a multilateral consensus regarding the mutual obligations of multinational corporations and their host governments would do much to reduce tendencies toward technology-oriented protectionism worldwide as well as expand international technology exchange.

• U.S. policy-makers should strive for greater uniformity in antitrust policy at the international level.

There is mounting pressure on policy-makers throughout the industrialized world to reinterpret national antitrust law or competition policy to fit the realities of global competition and avoid disadvantaging their indigenous firms in the global marketplace.

Nevertheless, in the context of the current surge of foreign direct investment and the proliferation of transnational corporate alliances and mergers, often in already highly concentrated industries, unilateral approaches to antitrust regulation pose two major hazards.

On the one hand, relaxation of antitrust requirements by the world's leading economies may increase opportunities for monopoly abuse in certain industries and actually impede technological advance.

Although there is little evidence of anti-competitive behavior in manufacturing and service industries at the international level, alliances among former competitors in certain industries and the rising barriers to market entry as a result of the spiraling cost of technical advance create an environment in which anti-competitive behavior is increasingly credible.

Despite the possible benefits of interfirm collaboration, it is essential to uphold competition as a major driver for technological advance and structural adjustment.

On the other hand, there is some evidence that national competition or antitrust laws may impede cross-border mergers and acquisitions that do not undermine competition. Such policy-induced obstacles to international competition may also impede technological advance and economic growth.

Both the danger of anti-competitive abuse by global companies and the costs of "protectionist" antitrust regulation emphasize a growing need for greater international cooperation in antitrust policy. Multilateral discussion of this issue within the General Agreement on Tariffs and Trade and the Organization for Economic Cooperation and Development warrants greater attention and resolve from all industrialized nations, including the United States.

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ENVIRONMENT BULLETIN

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Global Environment Facility

WORLD BANK, UNEP AND UNDP TO JOINTLY MANAGE MULTILATERAL FUNDS FOR ADDRESSING GLOBAL ENVIRONMENTAL PROBLEMS

Initiating an effort to tackle environmental problems of a global scale, the World Bank is exploring the possibility of a Global Environment Facility (GEF) that will focus on four areas: protection of the ozone layer, reduction of greenhouse gas emissions, protection of biodiversity and protection of international water resources.

Impetus for the concept has been provided by the establishment of an Interim Multilateral Fund to finance the phasing out of chlorofluorocarbons (CFCs), a follow-up under the Montreal Protocol of 1987. The deliberations of the Intergovernmental Panel on Climate Change (IPCC) are also providing a framework to address the problem of greenhouse gas emissions in the coming decades. The 1992 United Nations Conference on Environment and Development is expected to galvanize other parallel initiatives to address global environmental problems.

The GEF is a pilot program which will focus on these issues through the early provision of additional grant and concessional finance for technical assistance and investment programs in developing countries. It envisages a tripartite collaboration between the United Nations Environment Programme (UNEP), the United Nations Development Program (UNDP), and the World Bank, with each organization building on its comparative advantages: UNEP disseminating information among member countries, monitoring treaty implementation, and coordinating research and data gathering; UNDP undertaking pre-investment and feasibility studies; and the World Bank administering and managing project implementation.

Meetings in Paris

The international community has recognized that additional grant finance is required to enable developing countries to take policy actions to counter environmental problems of a global nature. Without these additional resources, developing countries would have to divert scarce funds from national programs, including attempts to deal with urgent environmental problems at the national and local level.

At two meetings in Paris, Bank donors held preliminary discussion on "Funding for the Global Environment." Seventeen donors, UNEP and UNDP met on March 15-16, 1990. At a second meeting, on June 11-12, donors, UNEP, and UNDP, as well as representatives from Brazil, India, and Zimbabwe, discussed in greater detail possible frameworks for program design, organizational arrangements, and governance.

Protecting the Ozone Layer

International collaboration on actions in the four priority areas has progressed furthest in the case of protection of the ozone layer. At the June 27-29, 1990

(continued on p. 3)

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ENVIRONMENTAL DISPLAY AT ANNUAL MEETINGS

Global and regional environmental information is the main topic of a visual display, prepared by the Environment Department, that will be on view at the 1990 Annual Meetings.

The display will present systems used for gathering environmental information and monitoring change over time. The systems include the Landsat and SPOT satellites and aircraft used to acquire high and low altitude aerial photography. The central photos show new satellite acquired images of the vegetation of the continents, the density of ocean waters, and a four-year display of changes in the Antartic ozone hole.

Each of the four regions will have a 10ft. panel displaying significant environmental issues or activities. The Africa region's panel presents the vegetation for that continent as recorded for each month of the year. This information is derived from weather satellites, and is available to any country.

The Europe, Middle East and North Africa region concentrates on environmental concerns identified in the Environmental Program for the Mediterranean. Both problems and successes in environmental management within the region are presented. Cases representing industrial, land use, archaeological, mining and disposal concerns are shown.

The Latin America and Caribbean region's panel concentrates on the biodiversity found in the region. Examples of rare and commonly found species of plants and animals as well as some examples of land use and water resources are shown. A Landsat image forms the central theme of the panel, and all the ground photo examples were gathered from the area of the satellite image.

The Asia region is represented by maps and photographs based on a land resource management project in the Arun River Watershed in Nepal. A land use map, prepared for the project, outlines the watershed, and photographs of conditions found in the watershed depict the coop[illegible] of the local people in resolving land management problems.

The 50ft. display has been sponsored and prepared by the Environment Department with the cooperation and assistance of the regional environment divisions.

Global Environment Facility
(continued from p. 1)

meeting in London, in which the Bank participated, an agreement was reached to establish--for a period of three years--an Interim Multilateral Fund, aimed at providing developing countries grant financing for the incremental costs they will have to incur in complying with their obligations under the Montreal Protocol. Initially to be set at $160 million, it could increase to $240 million if India and China sign the Protocol. The fund will be implemented through a tripartite arrangement involving the World Bank, UNEP and UNDP.

Carbon Dioxide and Other Emissions

At the Noordwijk Conference on Atmospheric Pollution and Climate Change in November 1989, representatives of 67 countries adopted a Declaration calling for: (1) the industrial countries, which are mainly responsible for greenhouse gas emissions, to take the lead in terms of domestic action; (2) a recognition that targets for emissions reduction by the developing countries not compromise their economic growth and development objectives; and (3) priority be given to actions, such as energy conservation that are also clearly justified on standard economic criteria.

While there is discussion on the establishment of an international convention for controlling carbon and other greenhouse gas emissions, the progress has not moved as far as in the case of CFC emissions. An IPCC study on the scientific evidence concerning the probable extent and consequences of global warming will be reviewed at the Second World Climate Conference in November. Once this is completed, negotiations on a framework convention on climate change are expected to begin.

Protection of Biodiversity and Marine Pollution

Another area of global concern is protection of biological diversity and prevention of rapid deforestation. During the pilot phase, the GEF is expected to provide developing countries with additional resources to improve conservation of these resources.

Some of the problems associated with the pollution of international waters are also proposed to be tackled through GEF finance. The World Bank is already supporting regional efforts such as the Environmental Program for the Mediterranean. Further actions of a global or regional environment character to be addressed include contingency planning for marine oil spills, prevention of ship and industrial waste dumping in international waters. Some of these projects are expected to be identified for GEF finance.

—Vijay Jagannathan

Congressional Research
Service
12-06-90

The Environment as a Foreign Policy Issue

by Curt Tarnoff

SUMMARY

Environmental issues have become a significant factor in U.S. foreign policy. Several developments explain their growing prominence. The nature of environmental problems increasingly involves cross-border issues and, in the form of ozone depletion and potential climate change, they are perceived as global threats. Scientific findings indicating an environmental threat have led to growing media attention, public concern, and entry of the issue to the political agenda. Finally, many believe that the dominant security agenda of the cold war is being replaced by other issues, such as economics and the environment.

Many question whether the United States is equipped institutionally to deal with issues that encompass both domestic and international concerns. At this time, decisionmaking appears to be *ad hoc* in nature. Others believe that, in the on-going race between heads of state to be the "greenest," the Administration is not doing enough to sustain the United States as a leader on environmental issues internationally.

Most environmental relations between the United States and other industrial countries have been conducted in the form of friendly competition for leadership and in terms of seeking cooperative measures to resolve problems. However, there is growing friction between the United States and its allies over specific agreements on pollution controls. Environmental assistance to Eastern Europe and the Soviet Union is viewed by many as a way to facilitate political stability and increased trade opportunities.

Environmental issues are likely to have an impact on U.S. relations with developing countries. The United States may increase its attempts to influence the environmental policies of developing countries through the use of aid conditionality and sanctions. Developing countries, sensitive to intrusions on their sovereignty, have begun to ask for increased economic assistance in return for adoption of conservation policies and programs. They may also demand that the United States alter its own domestic environmental policies before attempting to constrain their economies with environmental restrictions.

The following questions arise concerning U.S. foreign environmental policy. What kind of multilateral environmental institutions should the United States support, and how much funding should the United States provide to such organizations? What kind of bilateral economic assistance program would respond best to developing-country environmental problems, and what funding can the United States provide? What priority should environmental concerns have *vis-a-vis* other important policies regarding Third World development, international narcotics, and domestic concerns? The Congress is currently seeking to address these and related issues.

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Passing the environmental test

A project proposed for IDB financing must pass through an extensive series of tests: technical, financial, institutional, legal, etc. In each case, the potential borrower must show—and the IDB must certify—that the project will meet strict criteria designed to ensure its success.

One further test of a project's feasibility was added earlier this year with the inauguration of a system for evaluating the environmental impact of proposed operations. Drawing on a decade of Bank experience in the field, the system formalizes and refines proven IDB procedures, and most importantly, applies them to all operations—project loans, sector loans, global credit and technical cooperation—considered for Bank financing.

"Projects will always have environmental impacts," says the chief of the IDB's Environmental Protection Division, Marc Dourojeanni. "Our object is to minimize the negative impacts."

Mr. Dourojeanni defines, an environmental impact is any direct or indirect modification of a natural or man-made ecosystem. In the construction of a road through a forest, for example, direct impacts include felling trees and disrupting drainage systems; indirect impacts would include deforestation from subsequent colonization, conflicts over land use, dislocation of native cultures, and the introduction of diseases.

At the heart of the new IDB system is the environmental impact assessment (EIA). This document examines the impacts—direct and indirect—that a proposed project would have on renewable natural resources, natural habitats, human settlements and on society as a whole. The EIA proposes measures to correct any problems and these measures are then considered for inclusion in the project's feasibility study and final designs. As such, the EIA is a problem-solving tool, presenting decision makers with alternatives from which to choose.

The system is designed to solve environmental problems efficiently and economically. Integrating environmental protection measures into the project design minimizes their cost and makes disruption of the construction timetable unlikely.

Levels of impact. The EIA process begins at the IDB when a country or project team, supported by the Environmental Protection Division, classifies a proposed project. The classification is subsequently reviewed by the Bank's Environmental Committee. This committee, which is composed of senior Bank managers, is subsequently presented with a summary of the EIA and the mitigation and protection plan for approval.

'Projects will always have environmental impacts. Our object is to minimize the negative impacts.'

All projects fall under one of four categories:

Category I: Operations designed specifically to improve environmental quality, e.g. watershed management, air pollution reduction, and environmental education. *These generally do not require an EIA.*

Category II: Operations with no direct or indirect environmental impact, such as education programs, vaccination campaigns and dissemination of appropriate technology information. *An EIA is not required.*

Category III: Operations with a moderate environmental impact. Examples are construction of potable water systems, rehabilitation of infrastructure, small-scale irrigation. *An EIA is required for the project or individual project components.*

Category IV: Operations that may have significant negative environmental impacts, such as new road construction, large hydroelectric development, large-scale irrigation works, mining, toxic waste disposal, etc. *A detailed EIA is required.*

The potential borrower is responsible for preparing the EIAs as part of the project's prefeasibility and feasibility studies, often with the help of IDB technical cooperation.

All EIAs include input from the local population. The public must be informed of the EIA results, and views about proposed recommendations must be solicited.

The EIAs will lead to benefits that extend long after the project is completed, particularly in the area of institution strengthening. According to Mr. Dourojeanni, 90 percent of environmental problems—and all project difficulties, for that matter—stem from bad project administration and ineffective institutions. The EIAs frequently call for the creation of an agency or unit to carry out the protection measures, or programs to train staff of existing agencies.

'Completely routine.' The EIA concept may still strike many as new and arcane, concedes Mr. Dourojeanni, but it is here to stay. In fact, all international financial agencies require EIAs in some form or other. Each of the IDB's borrowing countries has environmental legislation on the books, which in many cases includes environmental impact legislation.

"The IDB is not requiring anything other than what the countries already demand of themselves," said Mr. Dourojeanni.

"In 10 years," predicts Mr. Dourojeanni, "environmental impact assessments will have become completely routine."

—the editor

WASHINGTON POST

WEDNESDAY, DECEMBER 26, 1990 A25

Thomas E. Lovejoy

Applying Third-World Debt to the Environment

Energy and economics have once again upstaged the environment. The United States has struggled with its own budget while the Middle East crisis and rising oil prices exert pressures on our economy and those of many in the developing world. It is true that a wiser energy policy here and elsewhere would have partly sidestepped those problems. Yet at the moment it is hard to see how environmental problems—particularly the soaring ones of tropical nations as well as those that have festered behind the Iron Curtain—can receive their due.

The solution, at least in part, involves the crushing international debt itself and the mechanism known popularly as the debt-for-nature swap. These swaps capitalize on the discount at which debt of many nations sells on the secondary market. One of the first such swaps involved purchase at 35 cents on the dollar of sovereign debt of Ecuador by two U.S conservation organizations, the World Wildlife Fund and the Nature Conservancy. In a process prearranged by Fundacion Natura in Ecuador the debt was then donated to that foundation. Fundacion Natura in turn took it to the Central Bank for conversion to bonds at face value in local currency. The income was and is used for protection of national parks and reserves, environmental education and related activities.

Billions upon billions of dollars of debt had already been converted in similar fashion for commercial purposes such as factory construction. This was one of the first such uses of the mechanism for socially beneficial purposes. At least eight countries (Bolivia, Costa Rica, Ecuador, Philippines, Dominican Republic, Madagascar, Poland and Zambia) have been involved so far.

Debt for nature alone is not the solution to the debt problem. Nor is it the solution by itself to all environmental ills. It is not uneconomic: it both pays for things that need to be done and can generate economic productivity itself, e.g. national parks and tourism. The inflation bugaboo, partly reduced by the elimination of the hard currency obligation, is further reduced when conversion is not just to cash but rather to interest bearing instruments.

Swaps have sometimes been seen as invasions of sovereignty. This reaction springs from ongoing concerns about the United States telling developing countries what to do, as well as from antiquated notions that environment prevents development, when instead it is the base for sustainable economic activity. And perhaps the term debt-for-nature swaps smacks of some ecological version of the Louisiana Purchase? In reality, the swaps are simply financial resources provided for environmental activities that a country finds hard to afford but wants to do anyway.

The administration's Latin American Initiative on debt and trade includes debt for nature as an integral part. Once certain economic conditions are met, the United States will engage in major debt-for-nature swaps with bilateral debt. Dollar obligations will be converted into local-currency environmental trusts.

Many are worried about the tough conditions required before environmental trusts can be created. These conditions are: an IMF agreement; a World Bank structural adjustment loan; if necessary, reform toward an open investment regime; and a satisfactory agreement with commercial bank creditors. There is a little point in a bill that will yield few resources late. Perhaps presidential discretion or a way to approach the problem incrementally is the solution. Rep. Nancy Pelosi (D-Calif.) even has suggested the environmental trusts themselves be made a condition.

Swaps provide for environmental activities a country finds hard to afford.

Others are concerned that debt will be reduced only to the level the country is currently paying. The counter argument is that their obligations will be reduced and in 15 years will be paid off. Some organizations have justified concerns about the environmental effects of new economic activity. Predictably, economic interests have tried to broaden the trusts to include development in the classic as opposed to sustainable sense. There seems little point in that, this money already has been used once for development.

Most important to remember is that this is probably the only chance for significant amounts of bilateral debt to be devoted to the environment of the countries in question. When major amounts of bilateral debt are forgiven (as recently proposed for Egypt), an important chance to do something for the environment is lost forever. When debt is restructured, the secondary market discount is reduced, and the leverage required for swaps dwindles. Debt for environment should be an integral part of debt restructure. The opportunity to do that for the first time is here.

The writer is assistant secretary for external affairs of the Smithsonian Institution.

Executive Summary

September 28, 1990

The United States General Accountin
Office

Purpose

Growth in industry, agriculture, and transportation over the last several centuries has resulted in the increase in "greenhouse" gases, which may produce long-term and perhaps dramatic changes in global climate. The results of this increase may be higher sea levels and changes in agricultural productivity and in ecosystems.

In response to a request by the Chairman, Environment, Energy, and Natural Resources Subcommittee, House Committee on Government Operations, this report

- describes what is known and not known about greenhouse gases,
- examines the strengths and limitations of estimates of enhanced global warming, and
- identifies possible policy responses.

Background

Gases, such as carbon dioxide, methane, chlorofluorocarbons (CFCs), and nitrous oxide are building in the atmosphere, where they trap heat and cause the earth to warm. This phenomenon is enhancing the natural greenhouse effect that maintains the earth's current average temperature at about 60 degrees Fahrenheit.

To understand the effect of increases in greenhouse gases, scientists use complex computer models, known as general circulation models, to analyze future climate changes. Four federal agencies operate or fund such models: the Department of Energy (DOE), the National Aeronautics and Space Administration (NASA), the National Oceanic and Atmospheric Administration (NOAA), and the National Science Foundation (NSF). Additional research on global climate change is conducted primarily by these agencies and the U.S. Department of Agriculture, the Environmental Protection Agency (EPA), and the U.S. Geological Survey. Funding devoted primarily to research in climate change by these seven agencies was over $660 million in fiscal year 1990. The administration's budget for fiscal year 1991 proposed increasing funding to over $1 billion.

Results in Brief

Industrial and agricultural activities are causing the atmospheric concentrations of some greenhouse gases to exceed historic levels. Without action now, these concentrations are expected to grow, although the rate of increase is uncertain. From their review of computer modeling results, most climate scientists agree that the climate's response to this growth will be an increased average temperature over the next 100

rather than waiting for better information, policymakers may minimize potentially harmful changes to the environment.

Developing a worldwide strategy to slow global warming will be economically and politically contentious because it will involve a decreased reliance on fossil fuels, which currently provide over 75 percent of the world's energy. Fossil fuel consumption can be reduced by improving the efficiency of energy use or by replacing fossil fuels with alternative energy sources, such as solar or nuclear power.

In preparing for global warming, policymakers must therefore weigh the risk of more adverse impacts by delaying action while they wait for additional scientific information against prematurely taking costly actions that may prove unwarranted. Nevertheless, it has been argued that actions can be taken now to reduce greenhouse gas emissions that will have other benefits, such as lessening dependence on foreign oil and improving air quality.

WRI
PUBLICATIONS BRIEF

DECEMBER 1990

DRIVING FORCES: MOTOR VEHICLE TRENDS AND THEIR IMPLICATIONS FOR GLOBAL WARMING, ENERGY STRATEGIES, AND TRANSPORTATION PLANNING

by James J. MacKenzie and Michael P. Walsh

Our aggravated assault on the atmosphere is one of our century's most damaging environmental legacies, and our love of cars has a lot to do with it. Ozone depletion and global warming both threaten undesirable changes over coming decades, and both are exacerbated by motor vehicles. Meanwhile, the Persian Gulf crisis is driving home a more immediate threat—the economic and security risks of continued dependence on Mideast oil, much of which is used in transportation.

Cars and other vehicles have long been linked to smog and other urban pollution, but the part they play in the larger complex of atmospheric and energy ills we now face is often overlooked. Thanks to human activities, greenhouse gas concentrations have been rising rapidly in recent decades. According to a growing scientific consensus, current emission trends could effectively double the atmosphere's preindustrial greenhouse gas composition as early as 2030.

Although there are remaining scientific uncertainties, most scientists agree on the range of consequences that would follow such atmospheric change. The global average temperature would rise between 1.5 and 4.5 degrees Celsius—and perhaps twice that much in the midlatitudes where most industrial countries lie. Rising sea levels would threaten wetlands, exacerbate coastal erosion and flooding, and increase the salinity of estuaries and aquifers. Rainfall patterns would change, leading to severe droughts in the heartlands of continents where today's prime farmland lies. Tropical storms would pick up intensity. And many unmanaged ecosystems would be lost, driving today's already disturbing species extinction rate even higher.

The prodigious air pollution produced by gasoline-powered vehicles contributes to all the environmental threats linked to the atmosphere. The expected doubling of the global motor vehicle population from today's 500,000,000 to one billion early in the next century means that sweeping change is needed to protect Earth's atmosphere. In the near term, decreased pollution and increased fuel economy can limit the damage, but the only safe option for the long term is transportation based on nonpolluting technologies and non-fossil fuels.

MOTOR VEHICLE DAMAGE TO THE ATMOSPHERE

Carbon dioxide, still the leading greenhouse gas, accounts for about half the global warming that's in store. The atmospheric concentration of carbon dioxide has risen 25 percent over preindustrial levels—and is now rising by 0.5 percent a year, so the curve is not only going in the wrong direction, but also getting steeper. In 1987, the most recent year for which complete data is available, burning fossil fuels for energy accounted for two thirds of all anthropogenic carbon dioxide emissions, and deforestation and other land-use changes produced most of the rest. The share produced by motor vehicles—which emit about 19 pounds of carbon dioxide per gallon of gasoline consumed—is gradually increasing. Motor vehicles now account for about 14 percent of carbon dioxide emissions from fossil-fuel burning worldwide and 25 percent of U.S. emissions.

CFCs—widely used in mobile air conditioning—account for some 14 percent of anticipated global warming. They also deplete the protective stratospheric ozone layer, which causes further warming by increasing ground-level ozone. Even a moderate loss in stratospheric ozone leads to higher ozone levels near the ground because more ultraviolet radiation gets through, speeding up the production of smog. One out of every eight pounds of CFCs produced in the United States is used in—and eventually emitted by—motor vehicle air conditioners.

Methane accounts for 13 to 18 percent of expected warming. The main human activities that produce meth-

ane are growing rice, raising livestock, burning wood and plant refuse, producing and burning fossil fuels, and burying garbage in landfills. Natural sources of methane include termites, bogs, swamps, other wetlands, and, perhaps, the warming of the frozen Arctic tundra. Methane's atmospheric concentration—now rising at about 1 percent a year—has more than doubled since preindustrial times.

Nitrous oxide (commonly known as laughing gas) accounts for about 6 percent of the expected warming and also helps deplete the stratospheric ozone layer. Its sources are uncertain but probably include agricultural fertilizers and the burning of biomass and coal.

Ground-level ozone, the principal ingredient of smog, accounts for a few percentage points of global warming. Its concentrations have doubled over the past century and are now rising by 1 percent per year in the Northern Hemisphere. Motor vehicles are a major culprit, since ozone is produced when sunlight "cooks" tailpipe emissions. Besides contributing to the greenhouse problem, ozone can damage health by causing eye irritation, coughing and chest pain, headaches, upper respiratory illness, asthma attacks, and reduced lung function. Smog, already widespread and pervasive, looks to be a long-term problem in many areas of the world unless pollution controls are greatly tightened.

Carbon monoxide, though not itself a greenhouse gas, amplifies the warming effect by removing a molecule that would otherwise scrub methane out of the air and by helping to produce smog. Global concentrations of carbon monoxide—a particular peril to people with heart disease—are rising by 0.8 to 1.4 percent per year. In the United States, where some 85 major metropolitan areas don't meet the national air-quality standard for carbon monoxide, motor vehicles produce 70 percent of these emissions.

MOTOR VEHICLE TRENDS

In 1950, there were about 53 million cars on the world's roads, 76 percent of them in the United States. Four decades into the transportation boom, the world's motor vehicle population exceeds 500 million—more than 400 million cars and 100 million trucks, buses, and commercial vehicles—and it is expected to reach one billion by around 2010. Europe (including Eastern Europe and the Soviet Union) and North America each have slightly more than one third of the world's motor vehicles, with the other third divided among Asia, South America, Oceania (Australia, New Zealand, and Guam), and Africa, in that order. With the rapid growth in motor vehicles over recent decades has come similar growth in urban smog, air pollution, acid rain, and traffic congestion.

About 80 percent of the nearly 48 million vehicles manufactured in 1988 were produced by the top 14 manufacturers and most of the rest by about 30 other manufacturers. This market concentration could facilitate an international drive toward reducing transportation's environmental repercussions since large-scale technological change could theoretically be achieved through negotiations with relatively few corporations. In 1988, North America-based companies accounted for 34 percent of worldwide motor vehicle production. Japanese companies produced 29 percent of the world's vehicles, Western Europe 25 percent, and Eastern Europe 7 percent. Consequently, the industrial world's pollution control and fuel economy standards greatly influence vehicle performance worldwide. If standards in the United States, Japan, and Europe were tightened, other manufacturers would probably follow suit, especially would-be exporters. Moreover, car designs of the leading manufacturers exert a lasting influence since the developing world's vehicle fleet contains many second-hand imports from industrial nations.

Globally, vehicular carbon dioxide emissions rose on average by 3 percent a year between 1971 and 1987, for a total increase of 63 percent. U.S. emissions—which stood at a staggering 48 percent of the global total in 1971—had increased almost 30 percent by 1987, but were outpaced by more rapid growth elsewhere. Emissions of other OECD (Organization for Economic Cooperation and Development) countries rose by 70 percent and those of non-OECD nations by 120 percent. Emissions from developing countries, now about 30 percent of the worldwide total and rising by 3.5 percent a year, will continue growing as a share of total emissions. If worldwide growth continues at anticipated rates and our current fossil-fuel technology doesn't change, efforts to control global climate change will prove increasingly difficult.

INTERNATIONAL EFFORTS TO IMPROVE FUEL EFFICIENCY

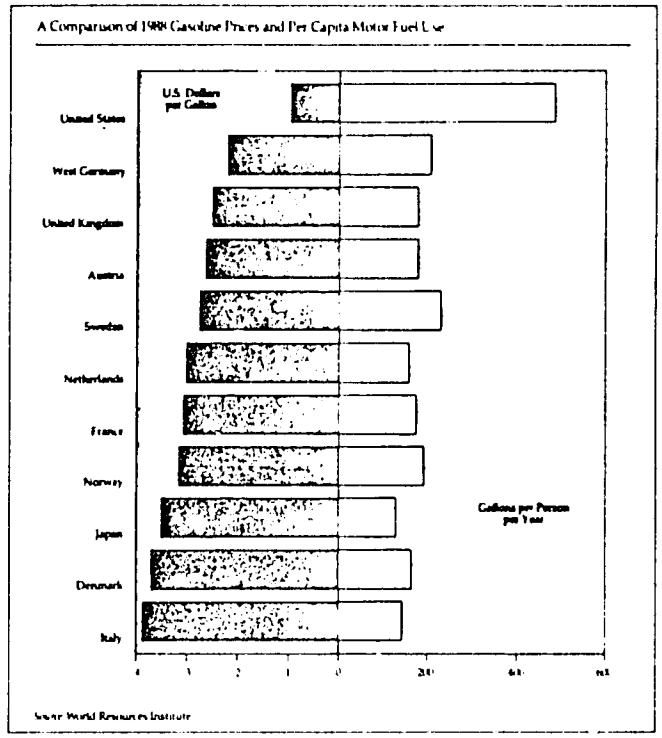
Prospects for future growth in vehicular carbon dioxide emissions must be viewed against ongoing efforts to improve fuel efficiency in new vehicles—efforts that vary widely from one country to another. The United States, which has had mandatory fuel efficiency standards since 1975, required new cars to get at least 27.5 mpg in model year 1985, as measured by EPA tests (which are thought to overestimate on-the-road fuel efficiency by over 15 percent). Federal standards were relaxed by the Reagan administration in model years 1986, 1987, and 1988 and restored slightly by the Bush administration in 1989, resulting in a 1989 new-car standard of 26.5 mpg. With the industrial world's least efficient cars, the United States had a long way to go, but managed to double new car efficiency between 1974 and 1988, making new American cars almost as efficient as cars of the same weight in other countries. Although *new-car efficiency*—as measured by EPA—has increased to about 28 mpg, the on-road fuel efficiency of the *entire auto fleet* has risen by only 50 percent, to about 20 mpg.

Data released by the U.S. Environmental Protection Agency suggest that the fuel-efficiency wars of the late 1970s gave way to horsepower wars after world oil prices collapsed during the 1980s. Throughout the decade, manufacturers stepped up horsepower, which translates into lower gas mileage and higher carbon dioxide

CAFE STANDARDS

Vehicle manufacturers are required to test a portion of the vehicles destined to be sold in the United States so that a fuel-consumption figure can be assigned to each product line. From these figures, a sales-weighted average fuel-consumption figure is calculated for all the passenger cars produced by each manufacturer. Fuel consumption calculated this way must fall below the level specified for the appropriate model year. Based on the combined city/highway fuel consumption figures, these required performance levels are known as Corporate Average Fuel Economy (CAFE) standards. Since the 1979 model year, the program has been expanded to cover light-duty trucks as well as passenger cars.

There are substantial financial penalties for failure to meet the CAFE requirements. A manufacturer whose fleet's average fuel consumption does not meet the CAFE standard is fined $5 for every 0.1 miles per gallon that each vehicle exceeds the standard—but fines may be offset by credits accrued in other model years.



emissions. Although it's too soon to tell what long-term effects the current Persian Gulf crisis will have on gasoline prices, prudence dictates getting back on the road to energy efficiency regardless of what world oil prices are doing.

Compounding the efficiency problem has been the switch by many American consumers from cars to light trucks and vans, which average only 20 mpg (24 mpg for imports), compared to 28 mpg for new cars. In 1989, 3.3 million light-duty trucks were sold, fully one third the number of automobiles sold. Then too, more people are driving trucks to work and fewer are taking public transportation. Between 1969 and 1983, commuter trips on public transportation fell from 8.4 percent of all commuting to 5.8 percent, while commuter trips in trucks rose from 8 to 15 percent. Over the same period, the percentage of commuters using cars fell from 83 to 78 percent.

Real gasoline prices in the United States declined during the late 1980s, dropping to a 38-year low in 1988. Small wonder that sales of larger, more powerful, less efficient cars and trucks are booming: at least until recently, price signals were telling new-car buyers that fuel is cheap and plentiful and they were acting accordingly.

By contrast, European governments have tended to rely on higher fuel prices to encourage fuel efficiency. To date, no European country has mandated efficiency improvements, but several manufacturers have voluntarily increased efficiencies. Sweden has specified fuel-efficiency standards, averaged over all cars produced in a given year, that each manufacturer is expected to meet. In 1990, the Swedish new-car fleet average is about 31 mpg, compared to the U.S. counterpart's 28 mpg. Even without regulatory programs, Europeans use only about half as much motor fuel per capita as Americans do, in part because fuel prices are higher and more public transportation options are available. Thanks to high energy taxes, most European motor fuel prices are two to four times as high as U.S. prices. *(See Figure.)*

Like the United States, many other nations that had improved automotive fuel economy during the 1970s and 1980s backslid somewhat when oil prices declined. In Japan, for instance, the national government had mandated automotive fuel efficiency improvements of 6 to 11 percent over 1978 levels by model year 1985. But fuel economy has since eroded: in 1988, the average Japanese new car got only 27.3 mpg, compared to 30.5 mpg in 1982.

RECOMMENDATIONS

Reducing the threat of global warming will require major reductions in greenhouse gas emissions. The EPA estimates that to stabilize atmospheric carbon dioxide concentration at current levels, global anthropogenic carbon dioxide emissions must be reduced by 50 to 85 percent below current levels.

Applied worldwide, vehicle pollution controls and efficiency improvements could for several decades mitigate the climate impacts arising from gasoline-powered motor vehicles. American and European experience during the past two decades shows that the dual goals of low pollution and high efficiency are not only compatible, but also mutually reinforcing. Still, if the number of vehicles and miles driven continues to grow at today's rates, benefits that are within grasp today could be out of reach tomorrow. The key to protecting the future is an international drive toward rapidly transforming transportation along these lines:

1. ***Improve New-Vehicle Efficiency.*** New-car fuel

efficiency fell along with world oil prices during the late 1980s. What effect, if any, the current Persian Gulf crisis will have on prices over the long term remains to be seen, but better gas mileage is crucial to slowing the rate at which carbon is added to the atmosphere. Greatly improving new-vehicle fuel efficiency and encouraging the phaseout of older cars and trucks would do much to reduce vehicular carbon dioxide emissions. Fortunately, much of the technology needed to produce more efficient vehicles has already been demonstrated in ultra-efficient "concept" cars that get up to 100 miles per gallon of gasoline.

2. ***Make Transportation More Efficient.*** Convenient, affordable public transport would cut carbon dioxide emissions and also break up traffic gridlock, cut road fatalities, and make the air more breathable. Policies that encourage commuters to use van and car pools, buses, trolleys, and trains and discourage driving alone to and from work would make an enormous difference. There would still be plenty of urban traffic, but better management could keep it moving—and thus save energy.

3. ***Cut Other Greenhouse Gas Emissions.*** Half of all new cars have state-of-the-art pollution controls, but the car population boom has cancelled out reductions in per-car pollution. Requiring advanced pollution controls on *all* vehicles would for a few decades limit growth in carbon monoxide, hydrocarbon, and nitrogen oxide emissions—all of which contribute indirectly to the greenhouse problem. Cradle-to-grave controls on CFCs—the most potent greenhouse gases, and ozone-destroyers to boot—are especially needed.

4. ***Create the Green Car of the Future.*** Technical improvements in petroleum-powered vehicles can help for now, but they will not be enough over the long haul. Ultimately, the world needs non-polluting vehicles that run on something other than fossil fuels, and the mass production of such vehicles ought to become a high priority in the United States, Japan, and Europe—the three leading auto-makers. Mercedes-Benz and BMW have already produced hydrogen-powered vehicles for research use. General Motors is now selling an electric van, and Chrysler's electric mini-van could roll off the assembly lines as early as 1993. Limited fuel storage restricts the range of today's hydrogen- and electricity-powered cars, but stepping up research could overcome such constraints.

The daunting environmental problems facing manufacturers and policymakers will require a revolution in technology and thinking as profound as the one that heralded the advent of mass-produced mechanized transportation early in this century. Manufacturers will come under increasing pressure to produce petroleum-powered vehicles that are cleaner, more reliable, and more fuel-efficient, and at the same time develop new kinds of pollution-free vehicles. Meeting these goals will require large capital outlays, hard to contemplate when pressure for change arises not from market forces but from public policies aimed at controlling climate threats whose most severe impacts lie somewhere in the distant and uncertain future. Fortunately, the global motor vehicle industry is so concentrated that technological change can diffuse readily if need be: indeed, if only ten manufacturers and their subsidiaries improved vehicle design, global pollution would be dramatically reduced.

The challenges posed by climate change are unprecedented, but the path to meeting them is reasonably clear. The only important unanswered question is whether nations will have the foresight to act now to curb these threats, or whether they will ignore them until the underlying forces of climate change overwhelm us and our capacity to adjust.

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Growing addiction to fossil fuels

Vandana Shiva

The dominance of the North in setting the international political agenda has allowed climate-related problems to gain prominence in recent years. Problems of more immediate concern to the Third World, such as desertification and endemic famine in sub-Saharan Africa, have received little attention.

The threat to the global atmosphere has built up over the past few centuries as a result of industrial activity, largely in the North. The North and South, therefore, have had a very unequal role in the creation of the greenhouse effect, yet the North is unwilling to take extra responsibility for cleaning up the atmosphere, proportionate to its cumulative contribution.

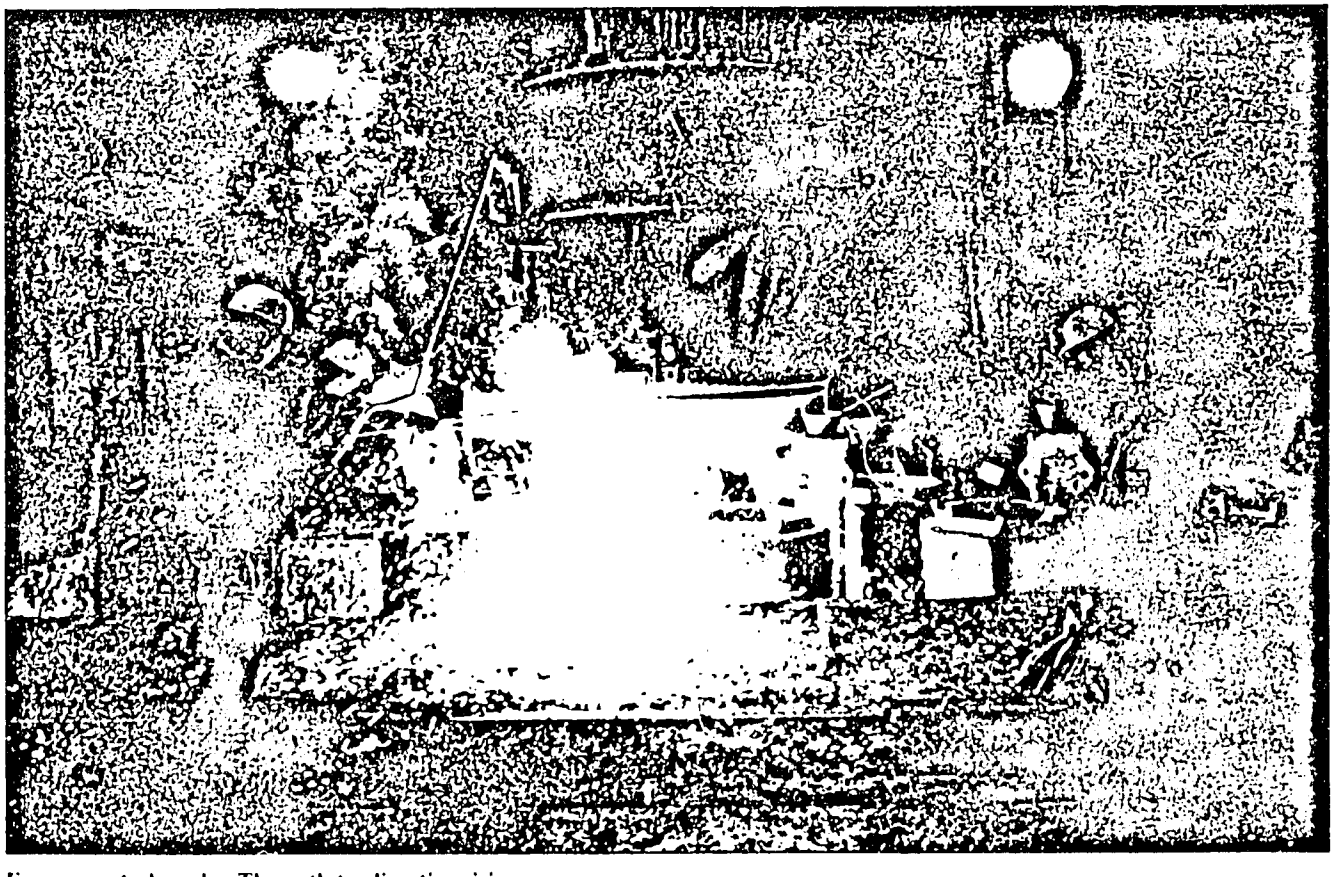
Attention has been focused more on the projected future contribution by Third World countries than on past and present contributions by the industrialised North. The Third World sees discrimination behind the implied prescription of uniform sharing of the costs, when it has not been an equal partner in generating them.

Expensive and ill-conceived advice from the North has also caused irreversible erosion of energy-prudent lifestyles and forced the Third World to follow it on the path to climatic crisis. Fossil-fuel addiction, which has spread from the North to the South in the past few decades through the process of "development", has both cultural and material aspects.

Culturally, it is assumed that lack of dependence on fossil fuels is indicative of a "backward" and "primitive" economy. International development experts and agencies continually advise Third World governments to make an energy transition into the fossil-fuel era of "modernity". Renewable sources of energy, and economies based on them, are declared unproductive.

A popular text book on development in the 1960s stated that Indian "production is achieved through human and animal, rather than mechanical power. Most agriculture is unproductive; human or animal manure may be used, but chemical fertilisers and pesticides are unknown."

The proposed alternative — of pumping carbon dioxide into the air from diesel-run tractors and pumpsets and releasing nitrous oxide from fertilisers in the name of increasing productivity — was a guaranteed prescription for adding to the greenhouse effect.



Tibor Tavlor Panos Pictures

European steel works: The path to climatic crisis

There was, in fact, nothing intrinsically more productive about an agriculture which uses fossil fuel for energy and fertiliser inputs. Indigenous and traditional food production practices use about half a calorie of clean renewable energy to produce one calorie of food, while fossil-fuel based, mechanised and chemical agriculture methods use about ten calories of polluting, non-renewable energy to produce one calorie of food.

The tractor and automobile as a symbol of progress, and the plough and bullock cart as a symbol of backwardness, was part of the cultural transformation associated with development. The greenhouse crisis is forcing us to look again at these symbols, through the ecological prism. It is forcing us to make visible the hidden subsidies and environmental and social costs which allowed unproductive systems to be perceived as productive, and energy waste to be viewed as an indicator of efficiency and development. The threat to survival posed by global warming can help shift the ill-conceived measure of progress in terms of energy consumption to a more ethical and ecological concept of progress which is linked to energy conservation.

Economically, the aid agencies of the North have basically supported their own companies and businesses through aid and development-finance for the Third World. Aid for fertilisers and tractors, for transportation and mega-energy projects, was primarily meant to provide the foreign exchange to purchase machinery and equipment from the industrialised countries and to finance engineering and other services,provided by experts from these countries. It has been estimated that for every dollar of aid Third World countries receive, three dollars of business is generated for the industrialised countries.

How does one distribute responsibility for the creation of greenhouse gases by these internationally-financed energy projects? Can we leave out international bank loans when we worry about the growth of fossil fuel consumption in the Third World? How much of the growing energy demand in the Third World is propelled by the profit imperative of the North?

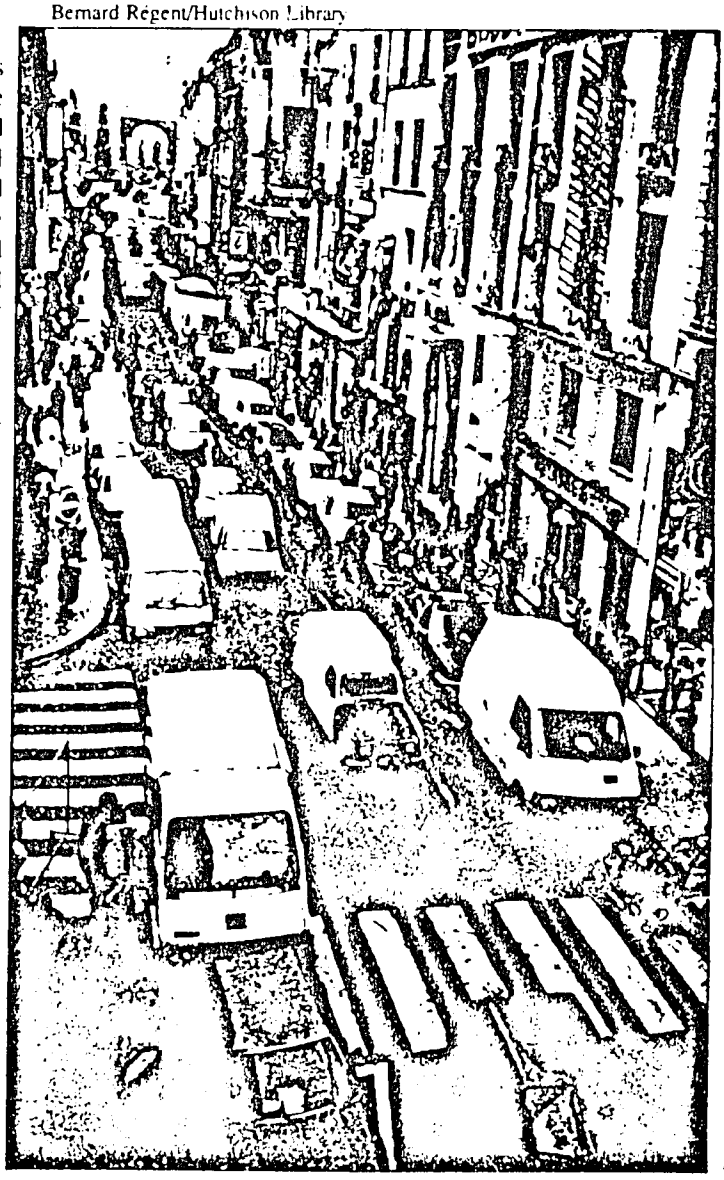
Tropical deforestation, another first division media issue and climate-related bugbear, is also being used by the North to dictate terms to the South. Like the expansion of fossil fuel energy systems, tropical deforestation is driven by the needs of the North to finance capital-intensive projects and to have access to cheap raw materials. Amazonia is disappearing not because of the local inhabitants and their needs but to supply charcoal and smelting iron for export. The forests of Southeast Asia are disappearing to supply tropical hardwood to Japanese and European markets.

As commodity prices fall and debt burdens spiral upwards, the Third World is increasingly trapped in the vicious cycle of exporting more to earn less.

Finally, any solution to global warming will have to involve a long-term solution to the debt crisis. Debt is a major obstacle to the Third World conservation role that Third World citizens and the global ecological crisis are demanding. The Northern financial system is directly responsible for the debt crisis, through pushing bad loans and unjust interest demands on the Third World. As economist John Kenneth Galbraith has written: "Such loans, given by foolish banks to foolish governments for foolish purposes, generally are not — and perhaps should not — be repaid."

The process that is crippling the economies of the poorer countries is intimately linked to the process that generates the economic strength of the industrialised North. This inverse relationship, reflected in debt and unequal trade, cannot be maintained in a search for sustainability. A common future cannot emerge from economic and ecological apartheid. This apartheid must first be removed.

Bernard Régent/Hutchison Library



Paris traffic: Fossil-fuel addiction

Vandana Shiva works for the Research Foundation for Science and Ecology in Dehra Dun, India.

Exposing hypocrisy at all levels

Gurmit Singh

Malaysian environmentalists are in two minds over global warming. They are convinced that global action is required from everyone — including themselves and their government — yet they are confronted with the inherent injustice of being asked to pay the price for the irresponsible actions of the elites, especially those who now constitute the "developed countries".

And they are caught on the horns of a dilemma when their government condemns the US and Britain for being hypocritical about reducing fuel consumption while it proceeds to log even vital water catchments.

Global warming can be tackled only be exposing the whole gamut of hypocrisy at all levels — among nations, within nations, among activists and in the mass media. We need to address the full facts frontally, but getting the facts is itself an issue, of human rights as well as of power politics.

The luxury of time is not with us. But while every individual counts, the most profligate consumers of natural resources, from timber to fossil fuel, can make the most difference. The onus for meaningful action is on those who continue to reap the most fruits from the industrial revolution. The Americans, British, Germans, Australians and others of the North must practise what they are beginning to preach. Only then would it be just and meaningful for the Malaysians, Brazilians, Indonesians, Indians and Kenyans to curb their desire to catch up.

Humans need to learn to be humbler, to act as one of many species inhabiting the Earth rather than the superior species which lords it over Nature. The current value systems that dominate science and technology, as well as the development ethos, need to be changed drastically, otherwise global warming and climate change cannot even be slowed.

There is a certain feeling of impotence about the issue: is it already too late? Whatever radical measures we take today cannot prevent the globe from warming but may only reduce the rate of increase: what difference will any Malaysian sacrifices make?

But the challenge remains for concerned citizens of all countries to

Who will feel the heat?

Because of uncertainty over the timing and climatic effects of a consistent rise in global temperature (see page 12), accurate assessment of the potential impact on particular regions, countries or groups of people is still impossible.

The most straightforward extrapolation is the direct effects of a rise in sea-levels. A one-metre rise would affect 360,000 kilometres of coastline. The UN Intergovernmental Panel on Climate Change (IPCC) estimates that the cost of providing protection against such a rise would be $500 billion over the next century. Without action, it says, some island countries would become uninhabitable, tens of millions of people would be displaced, many freshwater supplies would be contaminated, and much productive land lost. Jodi Jacobson of the Worldwatch Institute has forecast that a one-metre rise "may result in the creation of 50 million environmental refugees."

Most directly at risk are flat, low-lying countries like Bangladesh and the Guyana coastline, Pacific islands such as the Marshalls and Kiribati, archipelagoes like Indonesia and the Maldives and the often densely-populated deltas of the Ganges, Nile, Mekong, Indus, Niger, Irrawaddy, Yangtse, Hwang Ho, Orinoco and Amazon.

For agriculture, possible increases in crop yields from higher levels of carbon dioxide must be weighed against the likelihood of an increase in pests and weeds and, more significantly, against drier soils as a result of higher temperatures. The IPCC says "increased drought risk represents potentially the most serious impact of climate change on agriculture." It warns specifically of possible "severe effects" in Brazil, Peru, the Sahel, southern Africa, the Maghreb, western Arabia, Southeast Asia, the Asian parts of the Soviet Union and China.

Fisheries, which account for about a fifth of the world's supply of protein, are also vulnerable to climate change through changes in ocean temperature, salinity, turbulence and currents.

Many important fish breeding grounds are found in shallow coastal zones, around coral reefs and in mangrove swamps. But few predictions have been made on the adaptability of marine ecosystems to global warming. The authors of one comprehensive review note that "tropical fisheries may be the most difficult to evaluate because of the lack of good data ... Our lack of understanding of these ecosystems and the potential human impact of their disruption makes this gap very significant."

Little attention has been focused on the health implications of global warming but the effects could be far-reaching: a hotter, wetter world, says the IPCC report could put large populations at risk by shifts in the patterns of vector-borne and viral diseases. Many disease-carrying organisms survive and multiply more rapidly in warmer or more humid weather.

The boundaries of plant and animal habitats will change and ecosystems will alter. Species unable to adapt or migrate in time will face extinction.

Some changes may be beneficial, others may be dealt with by planning, sound management and investment. So the most serious effects are likely to be felt by the poorest countries, and the most vulnerable groups in those countries.

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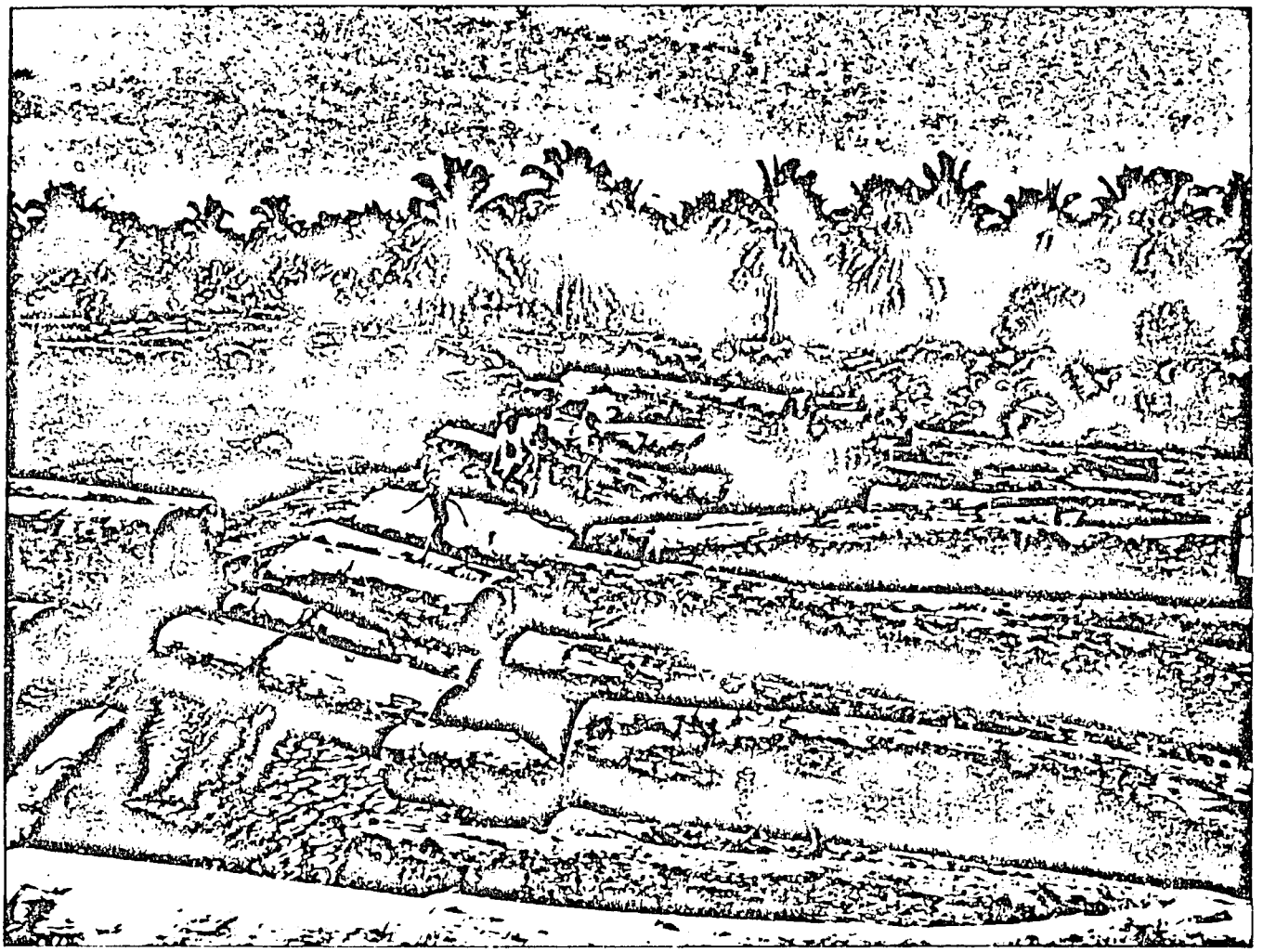


Ron Giling/Panos Pictures

Malaysian timber: Political controversy, but no thought of warming

mobilise their collective power to get immediate action from politicians and industrialists. We must be willing to make fundamental changes to the socio-economic and political structures that dominate human society and its exploitation of Nature.

This point was driven home during a recent conversation in the Malaysian state of Sarawak, one of the country's main sources of timber exports. Although some were annoyed with Western criticisms of logging practices in the state and foreign "glamorisation" of the native forest people, a number were seeking ways of controlling deforestation. Yet only a couple of local politicians realise the implications for global warming of this local environmental issue, which is the subject of much political controversy.

Similarly, the report of an International Tropical Timber Organization mission to Sarawak failed to address the impact of deforestation in the state on global warming (though it recommended a 30% reduction in the annual cut).

Global warming, however, was identified as a major item in the Malaysian environmental agenda for the 1990s drawn up at an Earth Day workshop organised by the country's Environmental and Conservation Network. It urged Malaysians to "refrain from all activities that contribute directly or indirectly to this problem." It also called for positive action in the energy and forestry sectors.

The Environmental Protection Society Malaysia is very concerned about global warming and will try to improve its efforts to raise public consciousness on this issue, despite the media constraints it has faced since 1987.

At the same time, it is hoped the Malaysian Government will translate its commitment to the Langkawi Declaration on the Environment, passed at the Commonwealth Heads of Government Meeting in Kuala Lumpur in 1989, by initiating positive action on the national level. Unshackling and encouraging the mass media would be a good start.

Another positive contribution would be the reorientation of national development policies along the path of sustainability, in keeping with commitments made at the UN. Rhetoric will have to be transformed into concrete action on the ground. And public participation should be made a reality, not something to be alluded to only during a general action.

Gurmit Singh is the president of the Environmental Protection Society Malaysia.

Executive Summary

Agroforestry has come of age remarkably during the past 10 to 15 years. However, the lack of a synthesized 'package' of technical and socio-economic information on agroforestry is a serious drawback in channeling development assistance to agroforestry projects. The objective of this report is to fill this gap. By reviewing the scientific information currently available, the report seeks to establish the scientific basis and principles of agroforestry and to evaluate field research on agroforestry practices; it also discusses the economic and socio-cultural aspects of agroforestry, as seen by a 'non-expert'. A comprehensive bibliography is appended to the report.

The emphasis in this report is on Africa, but extensive use is also made of experiences from other parts of the developing world to ensure that the report is applicable to all tropical regions. It is addressed primarily to agroforestry practitioners — both foresters and agriculturalists — of the World Bank and similar development-support agencies. The major findings of this report are summarized here.

1. Agroforestry is widespread in almost all ecological and geographical regions of the tropics. The large number of agroforestry systems can be grouped according to certain structural and agro-ecological criteria. Although the socio-cultural aspects of these systems may vary from one geographical region to another, and the level of intensity with which the systems are managed may differ, those operating in areas with similar ecological conditions tend to have structural similarities, so that it is possible to identify a few distinct agroforestry practices that constitute the bulk of diverse agroforestry systems. The agro-ecological and structural analysis of agroforestry systems and practices provides a useful framework within which to develop approaches aimed at improving indigenous systems.

2. The oft-repeated suggestion that agroforestry holds considerable promise as a practical land-management alternative for maintaining soil fertility and productivity is based on the assumption that trees and other vegetation improve the soil beneath them. Trees add organic matter, nutrients and growth-promoting substances to soils, they help reduce soil loss from erosion, and they improve the physical and chemical properties of soils. However, they may also have some adverse effects on soils. The net effect of all these factors will depend upon management and location-specific factors.

3. Nitrogen-fixing trees are a most promising group of agroforestry components. Because they are able to fix atmospheric nitrogen and contribute nitrogen via leaf and litter fall and root turnover, they have a dominant role to play in maintaining soil fertility. Few direct measurements of nitrogen fixation by tropical trees have been made, but the literature does identify some species capable of fixing 50-100 kg N/ha per annum when grown in agroforestry systems. In terms of the nutrient requirements of crops, the potential of nutrient input through leaf litter could be considerable. Another important way in which trees improve soils is through nutrient cycling. Unlike nitrogen fixation, which is an input into the soil, nutrient cycling involves the turnover of nutrients already within the soil; this includes the translocation of nutrients from soil layers which are beyond the reach of annual crops or pasture species. There is also a growing recognition of the importance of roots in agroforestry systems, both as components of primary production and in soil-fertility maintenance. The challenge here is to maximize the

beneficial effects of root and mycorrhizal systems, whilst reducing tree-crop competition for moisture and nutrients. Clearly, there is a need for more knowledge about all the soil-related benefits of agroforestry.

4. The above-ground interactions between plants in mixed systems are usually viewed as competitive, but some complementary interactions have also been reported. There is scientific evidence to support the contention that photosynthetic efficiency may be greater in a mixed system, comprising structurally dissimilar components, than in a monocultural system. An obvious additional advantage is that mixed systems produce a greater variety of products than monocultural systems.

5. Although agroforestry research is constrained by unclear methodologies and the sheer multiplicity of factors to be taken into consideration, some promising research projects are under way in the tropics. Most of them concentrate on alley cropping (and other forms of hedgerow intercropping), and plantation crop combinations. A detailed examination of the rapidly growing amount of information on alley cropping shows that, on the relatively infertile alfisols in humid and subhumid regions, this practice helps maintain reasonable levels of soil fertility. It is a low-input practice, rather than a no-input practice; that is, to obtain the best results there must be some fertilizer input. In most cases, alley cropping allows crops to make more efficient use of fertilizers than is the case in monocropping systems. However, in the semi-arid tropics and other dry areas, alley cropping is unlikely to significantly improve soil fertility. In extremely acidic soils, the relevance and success of alley cropping depends on the extent to which inputs such as fertilizers are used. An additional constraint of alley cropping is the relatively high labor requirement. In general, it is clear that while some areas would benefit from alley cropping, others would not.

6. Where plantation crops are grown under monocultural systems, available solar energy and soil resources are not utilized to the fullest extent. By growing agricultural crops with plantation crops, greater use is made of these resources. Several shade-tolerant and economically useful plants can be grown between or under a plantation crop during different stages of its growth. Many of the plantation crop combination practices currently in use illustrate the potential of this form of agroforestry. However, the particular ecological requirements for the growth of plantation crops impose a limit on the use of these practices.

7. The environmental benefits of agroforestry, other than soil-related factors, include microclimate amelioration. In many parts of the tropics there is widespread use of windbreaks and shelterbelts. Windbreaks can also provide other benefits, such as poles and fuelwood.

8. Although a large number of traditional agroforestry systems have been reported, only a few have been scientifically studied, and hence there is inadequate scientific understanding of such systems. The little research that has been done indicates the scientific merits of these time-tested systems and points to several possibilities for improving them.

9. Agroforestry is considered to be a sound and potentially promising strategy to address some of Africa's land-use problems. The use of an ecological approach could be a basis for developing appropriate agroforestry designs. Four broadly homogeneous ecozones can be demarcated for agroforestry development in sub-Saharan Africa: the upland plateau of southern Africa (unimodal); the highlands of eastern and central Africa (bimodal); the semi-arid lowlands (the Sahelian zone); and the humid lowlands of West Africa. This report suggests the broad agroforestry approaches that, with appropriate site-specific modification, could be applied in all regions, as well as specific approaches for each region. Two particular issues that are relevant throughout sub-Saharan Africa are: the integration of agriculture, forestry and wildlife

management through buffer-zone agroforestry; and the use of under-exploited food-producing trees and indigenous knowledge in agroforestry design.

10. Economic studies of agroforestry have been carried out on a rather ad hoc basis and are generally *ex ante* analyses, based on assumptions, rather than *ex post* analyses based on field data. This is mainly because of the dearth of experimental station and on-farm data. Moreover, in many studies the focus tends to be on the long-term economic benefits of the main components of agroforestry systems, with little documentation on short-term benefits and by-products. Nevertheless, the limited information that is available does provide some indication of the economic advantages and limitations of agroforestry in a variety of situations. Now that methodologies for economic analyses of agroforestry projects are becoming available, more detailed studies, based on field results, can be expected. Socio-cultural issues also need to be analyzed if new agroforestry technologies are to achieve wide acceptance by farming families.

Several important conclusions emerge from this review.

- Agroforestry systems are many and varied, as are their functions, roles and outputs.
- There is ample scientific evidence to indicate that the benefits to be derived from agroforestry could be considerably increased by appropriate scientific intervention.
- Scientific studies in agroforestry have been very limited, and thus the potential of agroforestry remains vastly under-exploited.
- The main scientific foundation of agroforestry is the multipurpose tree. The success of agroforestry will depend upon the extent to which the productive, protective and service potential of multipurpose trees is understood and exploited (through research) and realized (through development and extension efforts).
- The current trend in agroforestry development shows an imbalance between large-scale development projects and inadequately low levels of research and educational support.

INDONESIA

FORESTS, LAND AND WATER: ISSUES IN SUSTAINABLE DEVELOPMENT

EXECUTIVE SUMMARY

Sustainable Development

Environment and Development

1. Environment and development are intertwined. The sound management of natural resources, including forests, soils and water, is a prerequisite to economic development; and economic development, in turn, is necessary for good environmental management. Economic development and associated education, industrialization and urbanization will be the major factors slowing population growth, reducing pressures to convert marginal lands to agriculture, providing the capital to reduce pollution, and permitting the planned, rational use of natural resources. If growth is pursued without due regard to its immediate impact on the environment and natural resource base, it can jeopardize longer term development. But sound resource management in the absence of economic growth is not feasible in countries where poverty and population increases are major contributors to resource degradation.

2. The concept of sustainable development acknowledges the importance of economic growth, but it differs from previous concepts of development in its recognition that natural resources are finite and that the wasteful use of resources today will cause an unnecessary sacrifice of income and wealth in the future. With this in mind, a sustainable development approach encourages looking beyond immediate preoccupations in order to detect unsustainable practices in their early stages when they are easier and less costly to address. Linked to this strategy is the view that forests, land and water have important ecological functions not easily measured in economic terms, and the belief that new knowledge and growing shortages will increase their future value. Given these premises, a sustainable development approach tries to keep open as many options for future choice as possible, and it urges caution when considering any undertaking with irreversible environmental costs.

3. Those who support policies based on sustainable development acknowledge the strong incentives for both governments and individuals to maximize short-term gain. They recognize that the need for quick returns affects policies in countries at all levels of development and is particularly pressing in poor countries which have serious economic and social problems. For this reason, advocates of sustainable development encourage a broad development of awareness about the implications of current rates of natural resource utilization. They also support a broad participation in future choices and in the distribution of any future benefits from sound resource management.

FINANCIAL TIMES, December 19, 1990

Leslie Crawford explains moves to safeguard Chile's forests against excessive exploitation

Too much of a chip feast

The towering hills beside the southern Chilean port of Puerto Montt are, on closer inspection, made of wood chips. In a few days they will disappear into the vaults of a Japanese freighter, only to be replaced by more hills for export.

Puerto Montt's artificial landscape is the product of an industry that did not exist five years ago. The business is dominated by Japanese corporations such as Mitsubishi, C-Itoh and Daio Papers, which could not resist the temptation to exploit Chile's vast temperate forests and open door policy towards foreign investors.

The voraciousness with which the Japanese have plundered Chile's virgin forests – exporting almost 2m tonnes of wood chips last year – has provoked a national outcry. The country's growing environmentalist lobby is concerned that protected species, such as the Araucaria pine which can live up to 2,000 years, are being shredded in seconds.

The sawmills have also drawn the attention of Chile's Forestry Corporation, Conaf. "The problem is that the Japanese buy logs from small landowners, who are cashing in on this lucrative new business with scant regard to its environmental impact," says Juan Moya, a forestry engineer at Conaf.

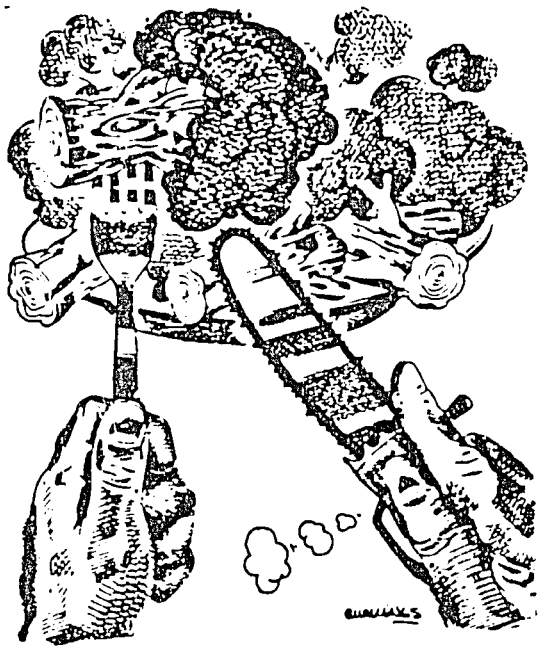
In theory, the felling of native woods requires the prior approval of Conaf, but Moya says his corporation does not have the manpower to police Chile's 7m hectares of virgin forest. He estimates that more than one-third of the wood that reaches the sawmills is felled illegally.

The Japanese companies will not give interviews to foreign journalists or answer written questions on the ecological impact of their activities. But they are gradually relenting under a barrage of adverse publicity.

Conaf recently extracted a "policing tax" of $1 per tonne from the sawmills that will help the corporation step up its war against clandestine fellings. Part of this money may be invested in a satellite surveillance system.

The sawmills have also agreed to hand over information on their suppliers.

Conaf is currently drafting new regulations for the "rational and controlled" use of virgin forests. "With responsible management there is no reason why native forests should not be exploited commercially," says Moya. He believes that they could even be given a new lease of life with the selective felling of diseased or overmature trees and modern conservation techniques.



However, the forthcoming regulations have Chile's small landowners up in arms. Guillermo Guell, president of Corma, the private sector's wood corporation, regards any new restriction on the forestry business as an unjustified attack on private property. "We live off the forest, so we don't need anybody to tell us how to look after it – least of all trendy ecologists sitting in Santiago apartments," he says.

Guell blames the controversy over the wood chip business on environmental groups, which he refers to as "European and American neo-colonialists, how dare they come to tell us what to do with our forests."

Yet with the exception of the Japanese, multinationals investing in Chile's booming forestry and cellulose industry have chosen not to touch native forests. They have either bought, or introduced, "man-made" plantations of radiata pine and eucalyptus.

"Virgin forests are a no-go area. It is just too hot a political issue," says Alberto Rubinstein, the head of Shell's forestry division.

Jose Luis Lopez, the representative of Carter Holt Harvey's interests in Chile, says: "We only use man-made forests. They are more cost-efficient and we believe in the conservation of native species."

Stora Europe's biggest paper and pulp manufacturer, is currently investing in radiata pine plantations in southern Chile which will eventually supply a planned 450,000 tonnes per year cellulose plant. The total investment, in a joint venture with Chile's Celulosa Arauco, could reach $1.2bn.

"Stora will not go near native forests," says Gustavo Romero, the company's general manager in Chile. "It is too dangerous to tamper with such a fundamental part of our ecosystem."

Carter Holt Harvey, Shell and Stora have invested over $1.4bn in Chilean forestry over the past five years – buying plantations, building sawmills and cellulose plants. Chile's unbeatable comparative advantages for growing radiata pine, and the government's generous reforestation incentives, have created this foreign investment surge. Exports of timber, cellulose, furniture and wood chips now total $800m a year, and are are set to double by the turn of the century.

Simpson Paper of the US is constructing a $587m pulp mill in association with Chile's largest paper manufacturer, the Compañia Manufacturera de Papeles y Cartones. Fletcher Challenge of New Zealand and Pathfinder Investments of the US are also in Chile.

The most recent arrival is Switzerland's Attisholz Holdings, which wants to build a $90m kraft paper mill in the south.

All have pledged to incorporate the latest environment-friendly technology in the treatment of pulp mill effluents.

The magnitude of their investments is another factor that singles them out from the Japanese. "Japan may be Chile's second biggest trading partner," says Lopez, "but they have few investments in Chile." It only takes between $5m and $13m to set up a sawmill, and the export of wood chips doubles the return on the original investment in under a year.

Lopez is worried that the unchecked growth of wood chip exports could eventually tarnish the image of the forestry industry as a whole. But Rubinstein sees some positive developments in the behaviour of Japanese corporations. "Mitsubishi is beginning to buy eucalyptus plantations," he says.

Daio Papers recently announced a 10-year investment programme to reforest 250,000 hectares with eucalyptus and build a pulp mill and wood chip plant. Rubinstein is heartened by their decision to invest in renewable natural resources. "It shows they are finally responding to environmental concerns," he says.

Environment Working Paper #37
World Bank Sector Policy and Research Staff
by Henry Peskin with Ernst Lutz
August 1990

A SURVEY OF RESOURCE AND ENVIRONMENTAL ACCOUNTING IN INDUSTRIALIZED COUNTRIES

Abstract

Several industrialized countries have explored or are in the process of developing alternative methods to account for the economic implications of environmental degradation and resource depletion. There is a general perception that the conventional national accounts reflect environmental and resource changes poorly and thus may generate estimates of income levels and growth that are not sustainable. Because of their often severe resource and environmental problems, similar concerns are being expressed in the developing world. Should these countries decide to undertake their own programs in resource and environmental accounting, they may benefit from the experience being gained in the industrialized countries.

The purpose of this report is to survey accounting efforts in several industrialized countries and to evaluate them to the extent possible, with the understanding that many of the programs are in their initial stages and are, thus, undergoing continual revision. All the approaches surveyed can be classified into four groups. The first approach involves the identification of pollution-abatement and other environmental expenditures. This approach characterizes official efforts in the United States, although similar statistics have been prepared in France, Germany, and the Netherlands. A second approach is to account for flows of and changes in the stocks of resources using physical units of measure. Most of the Norwegian resource accounting activities are along these lines. Similar physical accounts also exist in France. A third approach is to adjust GNP and NNP by subtracting out the value of natural resource depletion. This technique has been applied in Indonesia by Robert Repetto and his associates at the World Resources Institute. Similar activities are underway in China and Costa Rica. Finally, there are approaches that attempt a comprehensive resource and environmental accounting in both physical and value terms. Early Dutch efforts and the approaches of Peskin and of staff members of the U.N. Statistical Office fall into this category.

These various accounting approaches are described in terms of how they respond to perceived deficiencies in the standard economic accounts. Problems of implementation are also identified. The report then focuses more directly on the various country efforts and, in particular, their objectives and their data needs.

The principal findings of the survey are as follows:

1. Most approaches attempt to address one or both of the two major functions of conventional national accounting (performance measurement and data framework).

2. Regardless of the intent of the various approaches, they may better succeed in addressing one function more than the other. Thus, each approach should be judged on its actual as much as its intended outcome.

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3. The approaches differ significantly in their complexity and coverage.

4. The differences in complexity and coverage reflect not only the relative emphasis on the two major functions of national accounting but also different policy objectives.

5. While the approaches may have different structures, reflecting their different emphases and policy objectives, they may be similar in their data requirements. Thus, extensive debate over the relative merits of each approach, as a prerequisite to implementation, may be unnecessary or even counterproductive.

6. Because of missing information--especially regarding data development costs--it was not possible to determine the cost-effectiveness of the various country efforts and the implications of these efforts for policy-making.

Because many resource and environmental accounting programs are still in their initial stages in the industrialized countries, there is, at present, little applicable experience that can be immediately transferred to developing countries. However, the findings suggest that, should a developing country wish pursue its own program of resource and environmental accounting, it need not make a firm commitment to any particular accounting approach before data development begins. Data collected to support an initial approach most likely will support alternative choices in the future and may be valuable for other purposes as well. A final decision regarding framework or system design and the depth to which the approach is implemented should reflect a comparison of the individual country's policy needs with the resources it can devote to data development.

WASHINGTON POST, December 30, 1990

Jessica Mathews

The Year They Mulched Christmas Trees

The biggest environmental news of 1990 may turn out to have been its weather, the hottest ever recorded. But it will be several weeks before computers churn out the final measurements of 1990s global average temperature. Until then, notable events and trends of the past year size up like this.

Best: The United States' predicted solid waste crisis may be averted before it is fully upon us. Recycling is bursting out all over. From paper, plastics and magazines to Christmas trees, American consumers and corporations are tackling our mountains of garbage, most of which still goes to nearly full landfills.

In city after city, consumer participation in new recycling programs far exceeded predictions. Seattle recycled 37 percent of its waste in 1989, well on the way to its 60 percent goal in 1998. The city even makes "Seattle beige," a recycled latex paint. Recycling of newsprint was held back by a shortage of de-inking plants, but with the new capacity under construction in 1990, production will double by 1992. Exciting new technology developed this year for recycling magazines means that 30 percent to 40 percent of them could be recycled by mid-decade, up from less than 5 percent today.

Spurred on by consumer demand, some of the country's largest corporations are actually showing leadership. "We have identified a new consumer need not to feel guilty," said Procter and Gamble. While that hardly sounds inspiring, P&G Chairman E. L. Artzt told his shareholders this year that the United States can reduce its solid waste stream by an extraordinary 70 percent, and P&G will plan accordingly. The company, which already markets some of its products in 100 percent recycled plastic containers, plans to help develop large-scale municipal composting to replace landfills (in which almost nothing biodegrades), and said it would develop fully compostable disposable diapers.

Pepsi and Coca Cola simultaneously announced plans to market their sodas in recycled plastic bottles. McDonalds, under constructive pressure from the Environmental Defense Fund, abandonned its "clamshell" packages in favor of paper. By that single step the company reduced its volume of garbage by 90 percent and the national market for foam packaging (still made with atmospherically damaging chemicals) by 8 percent.

Oh yes, about Christmas trees. The Swedish retailer Ikea does a brisk business renting rather than selling trees. Upon return the trees are turned into mulch, which is given to the renter.

Fastest: The French TGV train continued to smash world speed records, beating 320 mph on May 18, confirming that the goal of commercial speeds of about 225 mph are achievable with conventional "steel wheels on steel rails" technology. At that speed, Boston and Washington are each one hour from downtown New York, and San Francisco less than 2 hours from Los Angeles. Europe plans a network of 19,000 miles of high speed rail lines by 2010.

Slowest: Congress completed a comprehensive rewrite of the Clean Air Act as the elapsed time clock neared 10 years. Former president Reagan gets most of blame, with House Commerce Committee Chairman John Dingell (D-Mich.) a solid second.

Missing: Almost half a year into its third oil crisis, the country seems not to notice that not having a national energy policy is costly. Among the questions yet to be addressed: What is the tolerable upper limit of U.S. dependence on oil imports? Fifty percent (about where we are today), 90 percent, lower? Is it wise to be the only industrialized country in the world that does not tax gasoline heavily? Have the others got it right, or do we? What are the economic consequences of an energy productivity level half as high as Japan's and Western Europe's? Are we willing to use price signals to improve energy efficiency, or should we rely solely on unpopular regulation?

Quote of the Year: We have a hands-down winner by J. R. Spradley, member of the U.S. delegation to a conference on climate change, addressing members of the delegation from Bangladesh. "This is not a *disaster*, it is merely a *change*. The area won't have disappeared, it will just be under water. Where you now have cows, you will have fish."

What to Watch for in 1991: The Bush administration plans to announce its version of a national energy strategy early in the year. Whether Congress can deal coherently with it is an open question. The endless energy battles of the 1970s have left lasting bruises on Capitol Hill. Members are loath to approach the subject again. The Democratic Party in particular lacks leadership—policies and influential spokesmen for them—on energy.

U.S. policy on greenhouse warming is a closely related question. In February the White House will host the first negotiations of an international global warming regime. Together with the Soviet Union, the United States is the only remaining industrialized holdout against targets to limit its carbon dioxide emissions. If U.S. policy doesn't shift, expect repercussions. The new world order is not only being shaped in the Persian Gulf.

New on the agenda next year will be how to come to grips with national over-reliance on the automobile. Environmental, energy, regional land preservation, urban neighborhood and other interest groups have finally realized that none of their various goals can be met without a more balanced approach to transportation. Look for an unprecedented attack on the Highway Trust Fund and related federal policies.

"Recycling is bursting out all over."

Commentary

Ecological Issues Come in All Colors

■ Environment: Mainstream groups are turning to issues affecting ethnic communities, and there is growing minority participation in the movement.

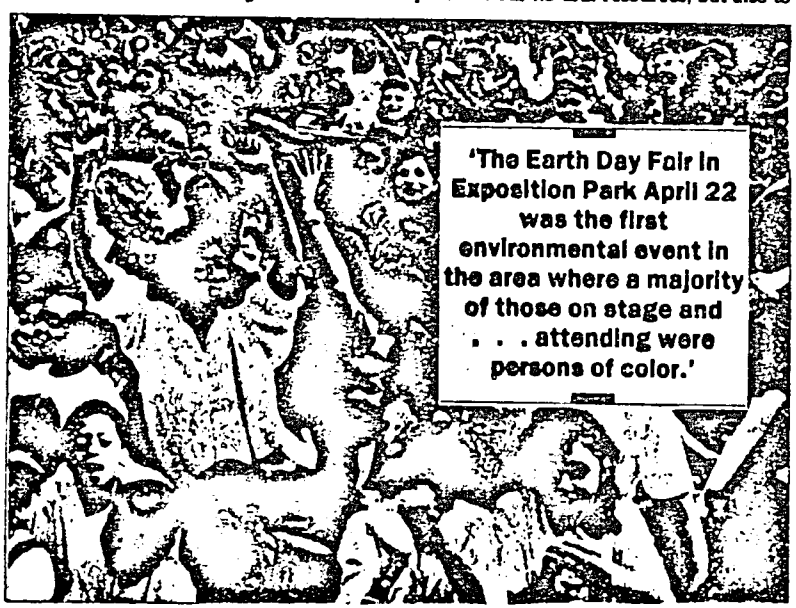
By TOM SOTO

It has often struck me, as an environmental activist, that out of the hundreds of people I marched with against a nuclear power plant, or sat with in a boardroom protesting a decision where economics overruled the environment, I was in most cases the only Chicano and often the only person of color present.

The irony of this is that pollution *does* discriminate—in effect, it observes racial and economic lines and is considerably worse in the disadvantaged areas and ethnic communities of Southern California. Some people say that the environmental movement is racist and elitist. This is not at all true. Granted, the average income of a Sierra Club member is $76,000 per year and the World Wildlife Fund's annual budget of $50 million is more than most county health-care programs. But organizations like these are now turning to grass-roots activities, applying their resources to assist in developing land-use and environmental issues affecting ethnic communities.

The Earth Day Fair in Exposition Park on April 22 was the first environmental event in the Los Angeles area where a majority of those on stage and of the 30,000 people attending were persons of color. This was ample evidence that the environmental movement is entering a new era.

This is how the movement should be structured, reflecting the need not only to preserve our natural resources, but also to restore the quality of life in the urban environment. In a county that is quickly moving close to an ethnic majority, it is crucial that the environmental movement penetrate and become assimilated into the ethnic communities of the region.



'The Earth Day Fair in Exposition Park April 22 was the first environmental event in the area where a majority of those on stage and . . . attending were persons of color.'

These groups will not only seek preservation of rivers and forests, but will struggle to preserve park space; pursue dialogue with land-use decision-makers to prevent insensitive developments; and mobilize communities to protest proposed developments that may have negative impact on health as well as the environment.

With the emergence of an urban environmental movement, the philosophy of conservation is appropriately expanding to include development. Inner-city communities are increasingly demanding the right to influence the landscapes of their neighborhoods.

Environmental issues are going beyond traditional economic and class lines. We now understand that an incinerator in East Los Angeles not only impacts the local community but the whole air basin. As more of these trans-class issues are identified and developed, we will also witness the marriage of Westside environmental support to Eastside issues and an increase of ethnic community participation in the mainstream environmental movement.

A case in point is Eastside support for Proposition 128, or "Big Green," the Environmental Protection Act of 1990. Backed by such Latino leaders as state Sen. Art Torres (D-Los Angeles) and Los Angeles City Councilman Richard Alatorre, the ballot measure is spreading concern about the environment in ethnic communities. Proposition 128 has support from groups like Mothers of East Los Angeles, which, in cooperation with the Natural Resources Defense Council, has filed a lawsuit to prevent construction of the proposed Vernon incinerator.

There has also been a strong show of support for politicians from both Westside and Eastside who oppose the Vernon and East Los Angeles incinerators as well as projects involve major land-use decisions, with large-scale environmental and health impacts. These types of development are not wanted in the community; they don't provide the type of jobs needed to enhance the local economy.

In order to ensure a thriving economy that is environmentally sound, we must develop a common ground on urban environmental issues. The modern environmental movement must consider the social and economic impacts of environmental regulation on the ethnic community. In return, a whole new constituency will form to strengthen the movement.

Tom Soto, a board member of the Coalition for Clean Air and of the Los Angeles chapter of the League of Conservation Voters, was Earth Day director for Los Angeles.

THE NEW YORK TIMES INTERNATIONAL SUNDAY, OCTOBER 28, 1990

Women's Group Seeks Environmental Role

By MARVINE HOWE

Alarmed by the deteriorating health of the planet, women from around the world have come together to demand a bigger role in all levels of decision-making on the environment and development.

In a four-day session that ended Monday, 50 women met at the United Nations Church Center to establish a worldwide network for bringing their agenda into the environmental debate. Their immediate goal is equal representation at the United Nations Conference on Environment and Development in Brazil in 1992.

The international committee includes leading environmentalists like Vandana Shiva of India; Wangari Maathai of Kenya, a grass-roots organizer; Dr. Rosalie Bertell of Canada, an environmental health specialist, and radical environmentalists like Claire Greensfelder of the Earth Island Institute in California.

Women have been "invisible in policy-making on environmental and development issues," said Bella Abzug, a founder of the Women's Foreign Policy Council, the meeting's sponsor. The participants put together a plan to mobilize their local constituencies and lay the groundwork for their own congress in Miami in November 1991, the Brazil conference in 1992 and other efforts over the next decade.

'A Real Learning Process'

Although they came from diverse cultures in Latin America, Africa, Asia, Europe and North America, the women had little difficulty in reaching a general consensus on their basic goals, principles and plan of action. They differed mainly in style, with some of the more radical campaigners fiercely attacking governments viewed as anti-environmentalist.

Libby Bassett, an American environmental consultant, said the congress did not become a regional debate or a struggle between the first world and the third. She described it as "a real learning process in which we worked out an alternative way of planning the planet."

The plan of action sets these main goals:

¶Full participation by women in environment policy at all levels.

¶Freedom of choice in family planning.

¶Redefinition of development on the principle that investment must not destroy the environment.

¶Increased education and information on the environment and development.

¶Protection of natural systems.

¶Development of a code of earth ethics.

The conference took health as its central theme, inspired by the work of Dr. Bertell, who heads the International Institute of Concern for Public Health, based in Toronto. For the last 12 years, Dr. Bertell has helped organize communities and individuals whose health is threatened by industrial and military pollution.

> Healthy development is 'keeping the natural systems in balance.'

"Everybody agrees that the environment is sick — the Earth and air, water, forests — and that what we want is a healthy, balanced environment," said Chodchoy Sophonpanich, president of the Thai Environmental and Community Development Association

Maria Eugenia de Cotter, director of the Arias Foundation of Costa Rica, said that healthy development means "keeping the natural systems in balance, whether it be the human system or the ecological system."

Tamar Eshel, a former member of the Israeli Parliament, said that up to now, women have been out of the environment policy process. She felt that this would change now, adding that her own government had asked her to report on the results of the meeting.

Brief reports from the industrialized and developing world on the health of the environment were equally grim.

"What we have today is maldevelopment, wealth and poverty," said Dr. Rosina Wiltshire of the Caribbean Conservation Association in Barbados "This distorted concept of development will ultimately lead to the destruction of the planet."

In Thailand, people either don't know or don't care about environment, Ms. Sophonpanich said. She stressed that many laws have not stopped deforestation, either at the hands of businessmen or villagers.

In India, economic development has not improved the quality of life, said Vanaja Ramprasad, a consultant on ecology. "New technologies have increased food production but the majority cannot afford to buy."

"In Africa we have no choice; we know we're doing the wrong thing but what else can we do?" said Gertrude Mongella, a member of the Central Committee of Tanzania's governing party. She said impoverished women were among those who routinely exploit the environment, cutting down trees for firewood, growing tobacco, allowing overgrazing and using pesticides.

"Even if there's a woman at the top, they can still destroy environment very thoroughly," said Bernadette Vallely of the Women's Environment Network in Britain. She pointed to a crisis in the country's health service, as well as acid rain, poverty and high levels of pollution.

Concern over "the war of resources" was voiced by Perdita Huston, an American writer on women in development. Noting that most natural resources are found in the third world, particularly in the south, she warned that "the world is heading for a real south-north confrontation."

But Ms Maathai, founder of Kenya's Green Belt tree-planting movement, cautioned, "It's easy to accuse the north, but they have brothers in the south who make it possible to exploit our resources." She said that members of local power elites must be made aware of "threats to all forms of life, even the butterflies."

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Environmental Policy and The Public Revenue in Developing Countries

Abstract

By Dennis Anderson
The World Bank, Environment Dept.

The paper analyzes approaches to environmental policy in developing countries. It reviews the policies of taxing pollution and the alternatives of regulating it, and the roles of public and private investment in environmental improvement. By reference to a wide range of environmental issues, it shows that the 'tax approach' to environmental policy will generally be the better instrument in many circumstances, regulation (e.g., of toxic wastes) in others, public investment (e.g., in afforestation and soil conservation) in others, and sometimes a combination of the three. However, the developing countries would be better served by following the tax and investment approaches to environmental policy in most situations, rather than the regulatory route that the industrial countries have followed (often exclusively) over the past century.

The paper also reviews issues to be addressed in the implementation of policies: their effects on efficiency and growth, on income distribution, on employment and earnings opportunities, and on trade and investment; the macro-economic context (stability being crucially important for the implementation of successful policies); their administrative requirements; and, not least, their financial requirements and 'affordability'. An underlying theme is that policies can be designed to be both socially beneficial and environmentally beneficial. Indeed, this should be the primary aim when setting environmental standards and deciding on the instruments of policy to be used to meet them. Areas for future research are also discussed.

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Democratic Change in Africa

Herman J. Cohen, Assistant Secretary for African Affairs

Address to the African American Institute, Washington, DC, November 8, 1990

I am pleased that the African-American Institute has offered me the opportunity to discuss "Democratic Change in Africa."

This is, indeed, a time of positive change in Africa, and not only in the realm of politics. Africa is changing its economic orientation and its approach to international relations. All of these changes are mutually reinforcing and all are supported by the US government, as well as by Africa's many friends among the American people.

Democracy and market economics have made huge gains throughout the world in the past few years, and their triumph has helped to create a new climate in international relations, a climate of cooperation and deepening commitment to collective security. Economically, Africa began to move toward free-market policies even before the peaceful revolution in Eastern Europe. Positive political change had a headstart in Eastern Europe and Latin America, but now Africa, too, has responded to the global rebirth of hope for freedom.

Some African countries began to abandon the outworn statist economic model as early as 1985. Now, almost 30 African countries have embarked on an economic transformation by implementing structural reforms designed to place them on the path to sustained economic growth. Throughout the continent, nations are beginning to foresee the benefits of decentralizing their economies.

As Secretary Baker noted in his remarks to OAU [Organization of African Unity] heads of delegation at this year's UNGA [UN General Assembly], US support for Africa's economic transformation has been continuous and substantial. For example, several years ago we placed our development assistance on a grant basis. And we already have forgiven more than $800 million in old economic assistance debt owed by African countries implementing economic reform programs.

But we believe that sustained, self-generated economic growth can take place only in a political environment that allows people to have confidence in their government and their future.

Africans, too, have come to realize that development and democracy go hand-in-hand, and that is one of primary reasons for the wave of democratic reform that is sweeping the continent today. As the 1990 OAU summit communique pointed out, Africa's economic transformation depends on the "participation of our peoples in the process of government. We accordingly recommit ourselves to the further democratization of our societies and the consolidation of democratic institutions in our countries."

Of course, the linkage between democracy and development is not the only reason that African countries are rejecting authoritarianism and turning to pluralism.

Africans Have Early Start on Democracy

Democracy had a foothold in Africa even before the recent stunning events in Eastern Europe. Botswana, The Gambia, Mauritius, and Senegal are longstanding examples of African pluralism. Their success and the success of Namibia's multi-party elections, as well as the collapse of the authoritarian one-party model throughout Latin America, the Pacific Rim, Eastern Europe, and the Soviet Union itself, have inspired other African countries to take another look at their political systems.

In some countries, wise leaders realized that the authoritarian model was bankrupt, that it acted to inhibit rather than promote economic growth, to exacerbate rather than diminish ethnic tensions. These leaders chose to become architects, rather than victims, of change.

But in most cases, the impetus for change came from below. It came from the workers and the unions, the clergy and the churches, the students and the universities. In short, it came from the people of Africa.

Like people everywhere, Africans want and need freedom. And they want what the one-party model has so singularly failed to provide: government based on the equality of all groups rather than dominance by or favoritism toward one; leaders interested in national development rather than the limited perspectives of patronage politics; economic policies that promote rather than preclude individual enterprise.

It is, of course, too early to predict whether Africa's movement toward political pluralism will continue, or even whether the gains made so far can be sustained. But I believe that there is cause for optimism because the impetus for change has come from the people. And now that change has begun, the people are likely to keep the pressure on.

Pace of Change Is Rapid

The pace of democratic change in Africa over the past year and a half has been remarkable. And it continues to accelerate. Independent Namibia was born as a democracy. Gabon already has held multi-party legislative elections. Nigeria, Africa's most populous state, continues to move toward the restoration of civilian democratic rule, with national elections scheduled for 1992. Benin, Mozambique, and Angola have renounced Marxism-Leninism in favor of multi-party democracy. Many other African states, including Cape Verde, Cote d'Ivoire, Guinea, Lesotho, and Zambia are undertaking or actively considering democratic reforms. The list goes on, and it gets longer almost by the day.

The debate within Africa on the correct path of democracy often emphasizes the issue of tribalism.

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Sudan Facing Impending Food Crisis

Jeffrey Davidow, Acting Assistant Secretary for African Affairs

Statement before the Subcommittee on Africa, House Foreign Affairs Committee, Washington, DC, October 25 1990

Events in the Middle East and stories of an impending food shortage have focused attention recently on Sudan. I would like to discuss first the food crisis, since it will have an immense human impact. This is a matter of extreme concern for us. We brought our Ambassador to Sudan, James Cheek, back to Washington 2 weeks ago to discuss this very issue.

We are now at the end of Sudan's rainy season, which precedes Sudan's main harvest in November. It became apparent in mid-August that the rains this year were failing badly over many areas of the country. As a result, the harvest will be substantially below normal. The precise extent of the deficit cannot be stated until the harvest is finished in November, but rough estimates are that the harvest will be at least 500,000 tons, and perhaps as many as 1 million tons, below normal. At that upper limit, 8-9 million people across Sudan would be at risk. This would include the 3 million people displaced by the civil war and fed by the UN-sponsored Operation Lifeline Sudan (OLS) relief effort, as well as some 400,000 refugees receiving international assistance.

We, the other donors, and the United Nations have raised this issue with the government of Sudan. We have told the government, in the most forceful terms, that a major emergency is pending, that it can be handled only by a coordinated international relief effort, and that Sudan must request such an effort. Our Ambassador in Sudan has raised this directly with [head of state] Lt. Gen. [Umar Hasan Ahmad] al-Bashir, and we have raised it with numerous other government officials.

The government apparently is aware of a problem but has downplayed its magnitude. The government has requested a food assistance program from the United States for next year at the level of $150 million ($100 million Title I/Loan and $50 million Title II/Grant). This would be channeled through the government for distribution or sale. What the government has not done is to request a food relief program, which would involve the donors, the United Nations, and various non-governmental organizations that would get the food to elements of the population most in need. Our estimate is that if 1 million tons of food are needed, 300,000 tons could be moved through the relief network to reach those most in need, and the remaining 700,000 tons could be moved through the normal Sudanese commercial distribution network. A relief program will be necessary to prevent wide-spread starvation in Sudan next year.

US Government Response

The United States is not waiting, however, but has begun planning to deal with the emergency. As I said, we have told the government what it must do to energize an international response. We have been in contact with other donors and the United Nations. We are prepared to supply up to 100,000 tons of relief food, plus additional food for commercial distribution, subject to budgetary limitations. What I must emphasize, however, is that the needed relief program will not be possible unless the government of Sudan agrees to such a program and takes the practical steps to facilitate it.

I know that you are familiar with the history of OLS, which has managed, with great difficulty and at great expense, to move relief food into southern Sudan. Khartoum's attitude toward OLS has ranged from ambiguity to outright hostility. The government has harassed non-governmental organizations, interfered with relief flights, and, just last month, bombed a number of relief sites in southern Sudan, an action which we protested vigorously. The government must do better in 1991. If it doesn't, we will not be able to move the amounts of food needed. We also will need cooperation from the rebel Sudanese People's Liberation Army (SPLA).

OLS moves a substantial amount of food into southern Sudan from Kenya and Uganda. We intend to continue to move food in this fashion and to increase the amount, but it cannot be a substitute for a nationwide program. At the most, cross-border food could reach perhaps a quarter of those in need. In addition, logistical difficulties will put a cap on the amount of food that could be moved in this way.

Sudan and the Gulf Crisis

Let me turn to the impact on Sudan of the Middle East crisis. The al-Bashir administration has had a friendly relationship with Iraq since it came into power in June 1989. Since then, Iraq has provided military assistance to Sudan. As Sudan's traditional sources of military assistance dried up, the Iraqi connection became even more important. We believe it was this military assistance that led Sudan to its current ambiguous stance on the Iraq/Kuwait issue.

Specifically, Sudan has refused to condemn Iraq for its occupation of Kuwait. Sudan insists on characterizing the issue as an inter-Arab dispute that should be settled by the Arab states without outside interference and has said that outside forces have no

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Testimony of

Roger P. Winter

Director, the U.S. Committee for Refugees

on

War and Famine in Sudan

Before a hearing of

The U.S. House of Representatives

Committee on Foreign Affairs

Subcommittee on Africa

October 25, 1990

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Thank you very much, Mr. Chairman, for considering the views of the U.S. Committee for Refugees (USCR) on war and famine in Sudan at this hearing of the Subcommittee on Africa. Your hearing is timely. Although this Subcommittee has been fully responsible and highly proactive during the last few years regarding human rights and humanitarian issues in Sudan, never before have so many Sudanese been at such palpable risk.

In August and September, I visited the region, out of USCR's concern that famine of biblical dimensions was building in Sudan, while Operation Lifeline Sudan (OLS), the international community's major mechanism for responding to the relief needs of displaced and war-affected Sudanese civilians, was nearing collapse.

On one leg of my recent trip, I visited the flatlands beneath the vibrantly green hills of western Ethiopia, where Mickey Leland and his colleagues died fourteen months ago. There, into three camps run by the United Nations High Commissioner for Refugees for up to 400,000 refugees from Sudan, small numbers of new refugees are now arriving with skeleton children. Consistently, while I explored with them the conditions in their home areas and of those left behind, the refugees would repeat to me, "They will come; there is no choice."

I must tell you in all sincerity that I am scared. In Sudan today, we are confronting the possibility of preventable human death on a massive scale. The framework for responding has dramatically deteriorated in the last year.

If we wish to save these lives, there is little wiggle room, there are few choices. In this testimony, the U.S. Committee for Refugees will propose that the international community, led by the United States, give the highest priority to the following concrete means of getting assistance to the people of Sudan, with or without Sudan government approval:

° Begin a U.S.-led diplomatic effort to achieve the same sort of economic embargo against Sudan as is now in place against Iraq--not to punish Sudan for its support of Iraq, but to pressure the regime to permit an adequate relief operation;

° Expand the capacity of cross-border operations from Kenya and Uganda and extend them deeper into Sudan;

° Open new cross-border channels from other contiguous countries, such as Ethiopia.

These recommendations must be considered in light of four points I would like to make this morning, based on what I have seen and heard so recently:

1. The looming humanitarian disaster in Sudan dwarfs any other in the world today. Up to 11 million people in Sudan's north, south, and west are at risk of starvation due to the twin plagues of civil war and drought.

2. This predicament is not entirely an accident of nature. The choices of governments and other parties are largely responsible for the level of vulnerability we now face. Choices we and others have made have not helped. However, the government of Sudan has so far proven to be the greatest obstacle to meeting the relief needs of affected civilians.

3. We shouldn't write off a single Sudanese civilian. The goal must be to put in place a comprehensive, humanitarianly neutral relief effort to reach them all. While working on that goal, which politically will not be easy to achieve, practical initiatives that meet portions of the need must be undertaken.

4. The United States should fundamentally reconsider its policy on Sudan. The world has changed immeasurably in the last two years, yet the U.S. approach to Sudan seems too rooted in the past to really confront Sudan's need for peace and development.

The Humanitarian Disaster in Sudan Is Real

"Sudan is not a poor country by African standards: average income per-capita is comparable to Kenya. There are many Sudanese millionaires. There is, however, a gross maldistribution of income. Sudan contains within it some of the poorest people in Africa." (War in Sudan, Peace in Sudan Group, June 1990).

Eleven million of Sudan's poorest people are now at risk of starvation. They are essentially powerless, largely southerners displaced by the civil war and small farmers and other rural people in the west and north affected by drought and consequent deteriorating agricultural conditions. The attached map, adapted from an October 1 map produced by AID's excellent Famine Early Warning System, shows that the population at risk is essentially nationwide.

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About half of the at-risk population is war-related, and half drought-related--but the two forces are interacting to produce the level of vulnerability. This contrasts somewhat with the at-risk population in 1988, which was made up primarily of war-affected southerners, of whom a quarter-of-a-million died.

Already, thousands of people in Sudan are in motion in a search for food, most to urban areas such as El Obeid, Juba, and Khartoum. However, as delineated in a recent USCR report (Khartoum's Displaced Persons: A Decade of Despair, August 1990), the government of Sudan has shown clear hostility to displaced southerners moving to Khartoum. It has sought to relocate many farther south, viewing them as inimical to the Islamic character of Khartoum. This fact, combined with the to-date poor response by the government to the at-risk population, will likely mean that some portion of those affected who are in government-controlled areas may migrate to sectors controlled by the Sudan People's Liberation Army (SPLA). While food conditions in the SPLA zone are not good, competent relief operations do exist in that zone. Others of those affected may make the major, life-threatening trek to became refugees in a contiguous country. At present, about a half-million Sudanese are refugees, largely in western Ethiopia and northern Uganda.

An undetermined, but not yet large, number of starvation deaths appear to have occurred already.

Human Choices Have Been a Major Factor

Actions by the government of Sudan have been a major factor in creating today's disaster.

The current government came to power on June 30, 1989, by military coup. It overturned a democratically elected government. The sixteen-month-old

regime has a very narrow political base, largely rooted in Islamic fundamentalism. I believe, as do a wide spectrum of other observers, the Bashir government took power to forestall a peace process to which the parties to Sudan's conflict had become committed in 1989. It viewed that process as recognizing Sudan's cultural, ethnic, and religious diversity and thus as incompatible with its narrow vision for Sudan.

The Bashir government quickly embarked upon a campaign of undermining Sudan's democratic institutions; human rights conditions plummeted. Those actions included banning political parties, newspapers, and trade associations, purging moderates from the military and universities, and eliminating most women from positions of authority. Our colleagues in international human rights organizations have well documented and publicized this deterioration, particularly Africa Watch in its thorough March 1990 report, "Denying the Honor of Living," Sudan: A Human Rights Disaster and Amnesty International in its August 1990 report, Sudan: A Permanent Human-Rights Crisis: The Military Government's First Year in Power.

The hard line taken by the Bashir government has also been evident in its unwillingness to seriously pursue any peace process to resolve the civil war. While engaging in substantial rhetoric about its peaceful aims, it has engaged in no peacemaking. It has grossly reinforced its military and aggressively used it--without success--in the field.

Early on in its tenure, the Bashir government made clear its dissatisfaction with Operation Lifeline Sudan (OLS). OLS was a unique international effort undertaken with the agreement of both the government of Sudan (the Sadiq government) and the SPLA in early 1989 after the starvation horrors of 1988. OLS was unprecedented in that it was initiated as a humanitarianly neutral relief effort.

It may well be that such an operation in a civil war context can only come

about under very limited circumstances, including that the government involved is locked--no matter how involuntarily--into a peace and reconciliation process (as was the case with the government of Sadiq al Mahdi, which opted into OLS). Without such a circumstance, the temptation of a government to use the tools it possesses by virtue of its being a government--control of access by United Nations and other relief organizations, media, etc.--is too great.

In the case of Sudan, government representatives made clear early on that there would be no OLS unless it comported with the government's military strategy. For example, Brigadier Dominic Cassiano said this plainly in his meeting with me and with John Prendergast of the Center of Concern in the fall of 1989.

As a result, a clear pattern of government action emerged in which relief trains didn't move, relief barges remained moored at the docks, flights by the International Committee of the Red Cross were increasingly curtailed. This pattern was evident throughout the last year, but culminated with the bombing of OLS relief sites in south Sudan last month. Some of these bombings occurred while UN and Red Cross planes and personnel were on site. For some months, a combination of manipulation by the Sudan government and poor choices/ performance by OLS itself has rendered it essentially moribund.

The only element of the relief operation that has consistently worked well is the land-based cross-border operation from Kenya.

The United States has been the major promoter and financier of Operation Lifeline Sudan. The Office of Foreign Disaster Assistance, Food for Peace, and other humanitarian elements of the U.S. government have done yeoman's work in Sudan, and have clearly been responsible for saving many lives there.

Yet, I must confess, I cannot fathom many of the political choices the U.S. Department of State has made in dealing with Sudan. I will return to this point later. But regarding OLS, those choices contributed to its

deterioration. Political parameters seem to have made the United States (and the UN) too tolerant of the Sudan government's obstructions to Lifeline.

We didn't call a spade a spade as Lifeline deteriorated. It took Sudan's alliance with Saddam Hussein to stiffen our position.

Saving Them All Must Be the Goal

There is no good way out of the current situation, barring a major change in the framework. The numbers at risk are staggering; the primary response tool, Operation Lifeline Sudan, is near collapse; the politics of responding, always maximally complex in Sudan, are grossly complicated by Sudan's support for Saddam Hussein in his confrontation with the world.

Having stated the obvious parameters, I believe the goal of U.S. humanitarian strategy is equally obvious. I think I speak on behalf of virtually all in the private voluntary agency and religious institution communities when I suggest that a comprehensive, humanitarianly neutral relief effort for all at-risk Sudanese is the target. There can be no decoupling of the needs of at-risk northerners from those of at-risk southerners. They are all victims worthy of our assistance. Responding to their needs must not be obstructed by understandable pique at the government of Sudan. Those who are at risk played no role in that government's coming to power. Many, in fact, are essentially viewed by that government as enemies at worst, and suspect at best.

Frankly, the short-run prospects for achieving the kind of relief operation I suggest is the goal are not good. The Sudan government appears committed to its aberrant course. Earlier this week, it announced plans to proceed with its previously declared union with Libya, and Colonel Qaddafi has announced his potential intervention in Sudan's civil war on behalf of the

government of Sudan.

In my view, one element of any approach to this situation must be a U.S.-led diplomatic effort to achieve the same sort of economic embargo against Sudan as is now in place against Iraq. The United States and others that have continued during the last year to back multilateral assistance to Sudan through the World Bank, International Monetary Fund, and others should just say No! Only humanitarian assistance should get through. Such an initiative should be undertaken not to punish Sudan for siding with Saddam Hussein. Rather, it should be clearly targeted at getting Sudan to cooperate in a reasonable relief effort for all at-risk Sudanese.

However, since the prospects are not good for early modification of the Sudan government's recalcitrance, other initiatives must be attempted in an expedited fashion. It should be clearly understood by all that no package of "other initiatives" can substitute for a comprehensive, humanitarianly neutral operation to which both the government and the SPLA are fully committed. Nevertheless, this is not the time to do nothing, to let the pursuit of the ideal inhibit what can practically be achieved now.

Sudan's situation is somewhat unique. It borders on eight other countries, plus the Red Sea. Also, a major portion of Sudan--perhaps the size of Uganda or Ghana--is not under the control of the government. Substantial cross-border relief operations into that area from contiguous countries already exist. The land-based cross-border operations are ongoing and cost-effective.

With or without Sudan government approval, the highest priority should be given to:

1. Expanding the carrying capacity of cross-border operations from Kenya and Uganda. Logistically, the resources exist in Kenya. The operation out of Uganda has been very spotty, but can be improved.

2. Extending the routes of the current cross-border operations deeper into Sudan. Land-based deliveries as far as Bor could begin as soon as

next week if the resources were made available. Forwarding by water from Bor to Ayod, Waat, and Kongor could also begin immediately. While there are limits as to how far this can be done, the intent must be to bring food closer to those in need.

3. Opening new cross-border channels. While some food undoubtedly enters Sudan through informal channels, additional routes--such as through Ethiopia--are needed. Formalized routes are necessary, given the volumes of supplies that are needed inside Sudan. Some may bridle at the thought of Ethiopia as a jumping-off point for relief transmission into Sudan. I believe such reactions are misguided. We must get our priorities straight.

Expanding cross-border relief operations as suggested above is not at all risk-free. Yet land-based efforts of this kind can and do work even in the most difficult of conditions.

It is true, however, that undertaking such an expansion without Sudan government approval would be a highly political act. But so would doing nothing; so would being so immobilized by political considerations that we stand by while the worst happens to innocent civilians inside Sudan. In my view, the United States and the international community are not entitled to stand by, pretending the fate of those at-risk is the internal affair of the "sovereign" government of Sudan. This is one of those very clear situations when human rights and the rights of human beings to survive confront the "sovereignty" rights of a government of questionable (at best) legitimacy.

I know which way the American people would go on this issue if you asked them.

U.S. Policy toward Sudan

For many years, Sudan has been an important geostrategic partner of the United States. For more than fifteen years, Ethiopia has been viewed by the United States as the major destabilizing force in the region--with good reason. Frankly, however, given the overwhelmingly negative changes that have occurred in Sudan at the hands of the Bashir government, I cannot think of any

reason other than being caught in the Cold War rut to explain the U.S. pattern of tolerating Khartoum's actions during the last year.

In some way, the pattern has been similar to our pre-August 1 pattern of cozying up to Iraq. When Bashir's coup overthrew Sadiq, U.S. aid began to shut down, but only because our law required it. The United States continued to support assistance to Sudan through multilateral institutions. Human rights conditions in Sudan deteriorated rapidly and massively, but U.S. criticism was muffled at best; the Bureau for Human Rights and Humanitarian Affairs was absent. Operation Lifeline Sudan was manipulated into impotence, but the United States (and the UN, for that matter) was not aggressive about preserving Lifeline's effectiveness and humanitarian neutrality.

Until Saddam.

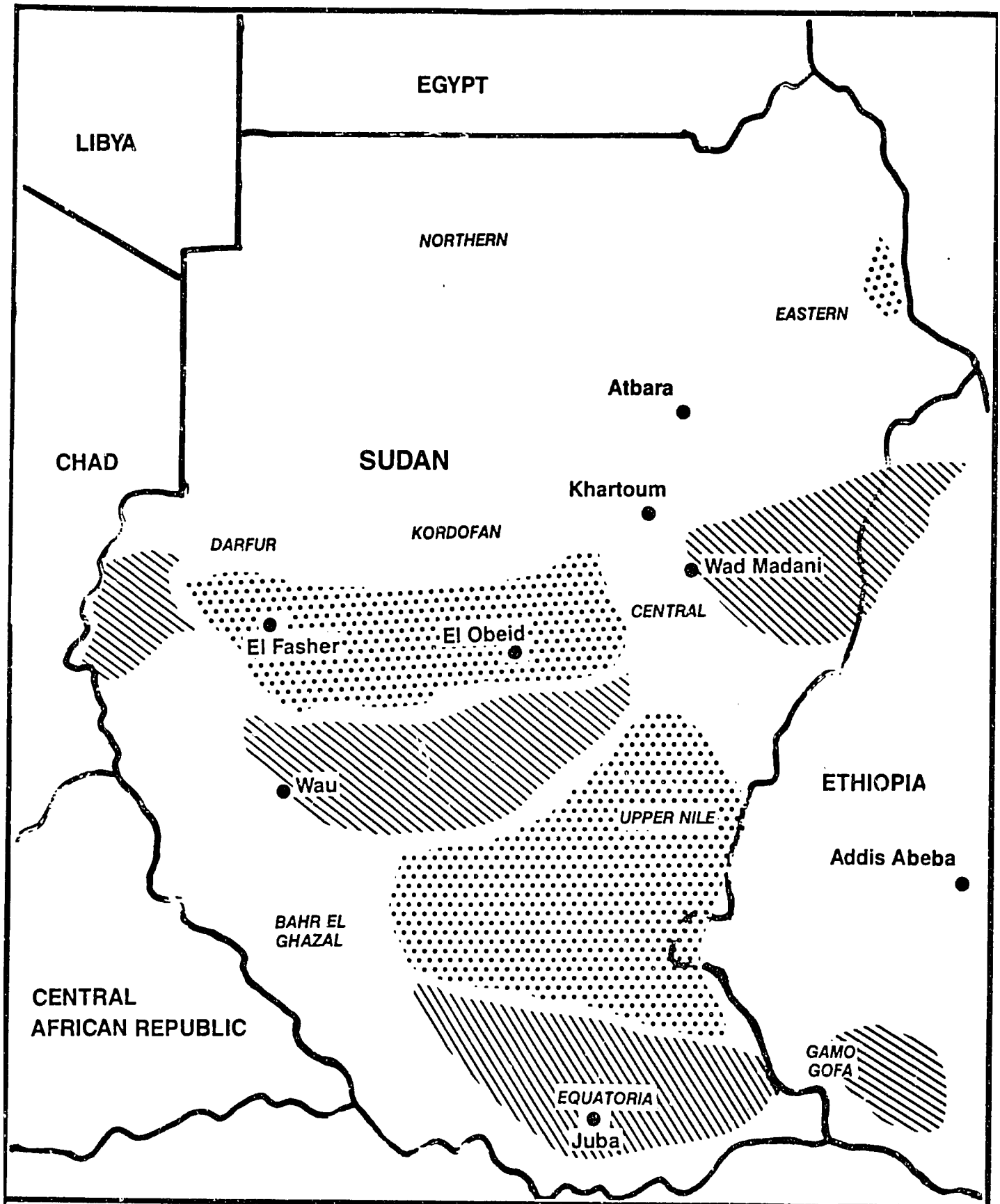
I believe the United States needs to fundamentally reconsider its posture regarding Sudan. We need to distinguish between our long-term interests in the welfare of the people of Sudan and the now minimalized need to view Sudan as an anti-Ethiopian ally. Our policy toward Sudan needs to be people-friendly, not government-friendly.

I wish it were otherwise, but I believe <u>a tough, U.S.-led international position toward the Khartoum regime now</u>, including a strong commitment to cross-border relief operations even without Khartoum's approval, <u>may be the only hope for the millions of people at risk who are in the government-held sectors of Sudan.</u> It may well be that the regime will ultimately fear massive backlash from the at-risk population in the north of Sudan when that population sees a functioning relief operation in the SPLA sector while they in the north face prospects of starvation.

* * *

In any event, we must view this situation in its starkest reality. The problem is massive, but when these people die, they die one individual human being at a time. A few weeks ago when I was in Western Ethiopia, many of the Sudanese children who had just arrived were no more than skin and bones. They looked like newborn robins spilled from a broken egg. I do not want to imagine what we will see when the worst of the famine strikes. Saving these innocent people, one by one, simply must become our highest priority.

CIVILIAN POPULATIONS AT RISK IN SUDAN



Immediate and substantial emergency food needs

Emergency food needs in 1991

Adopted from the FEWS Bulletin—October 1990.

THE NEW YORK TIMES WEDNESDAY, OCTOBER 31, 1990

West Distorts Food Need, Sudan Says

By JANE PERLEZ

Special to The New York Times

KHARTOUM, the Sudan, Oct. 30 — Two senior members of the Islamic fundamentalist Government accused Western donors today of exaggerating the food shortages in the Sudan and said there was no reason to make a public appeal for international help.

The United States, traditionally the biggest giver of food aid to the Sudan, has said that the country faces a famine next year unless plans are made to deliver large amounts of grain.

The director of the United States Agency for International Development here, Dr. Frederick Machmer, said the agency was working on the assumption that the Sudan, Africa's largest country, could have a shortage of as much as a million tons of grain, caused by drought and civil war. The fighting in the south has hampered farming and the distribution of fertilizer.

Eight to nine million people would be at risk of hunger if the shortage was one million tons, Dr. Machmer said.

U.S. experts fear hunger affects eight million.

The Sudan's total population is estimated at 25 million. But he said that the Sudanese Government's refusal to admit that the country faces a severe food shortage next year will make it difficult to get food here on time.

Col. Salah al-Din Karar, the chairman of the economic committee of the ruling Revolutionary Command Council, told a group of reporters invited here by the Government that "a gap might arise" after the November harvest, but that it would not exceed 500,000 tons. This, he said, would not be "a big problem" and would be made up next April by local grain harvested from irrigated areas.

Western and Sudanese agricultural experts said they did not know how the main irrigated area, south of Khartoum, would produce such quantities.

Another member of the junta, Brig. Pio Ukwan, said that if international organizations fed what he estimated to be the three million foreign refugees in the Sudan, the Government would be able to look after its own people.

The office here of the United Nations High Commissioner for Refugees estimates that there are 800,000 foreign refugees in the Sudan, most of them Ethiopian, of whom about 300,000 receive food aid from Western donors.

Denials of Need

For weeks now, the Khartoum Government has been publicly denying that the country faces acute food shortages, and has been lashing out at relief organizations based here.

The military Government, which came to power 16 months ago, has made its distaste for the country's traditional Western donors increasingly evident. The two Government newspapers recently carried a headline "Death to America Should Be the Motto for Every Muslim" over an article about the Persian Gulf crisis. The Sudan has not denounced the Iraqi invasion of Kuwait.

The food situation is a particularly sensitive matter for the Government, which declared self-sufficiency in food as one of its goals when it came to power. But even as the senior officials publicly say they do not want or need Western aid, they have quietly asked the United States for $150 million worth of grain for next year. Washington dismissed the request, made in September, saying the Khartoum Government was obstructing the effort to help the three million people displaced by the civil war.

Early this month, the United States diverted a ship with 45,000 tons of wheat that had been bound for the Sudan, citing the bombing of southern towns, the cancellation of relief flights and the confiscation of food shipments as the reasons. Ten days ago, the United States resumed delivery of the grain. Officials said the Sudanese Government had stopped the bombing, released the food and allowed partial resumption of flights.

Mobotu Views the Void

In a changing world, Zaire's dictator has lost his accustomed props

By Lucy Komisar

WHEN Romanian dictator Nikolai Ceausescu was executed, the shot reverberated like thunder in Zaire. Dictator Mobutu Sese Seko, who rose to power with America's blessing and was supported for 25 years as a bulwark against communism, had modeled his political system on Ceausescu's. "Take Romania as a model," Mobutu told Zairians, and then they saw the Romanian revolution.

Since America helped bring down Congolese nationalist Patrice Lumumba – mislabeled a communist in 1960 for seeking Soviet help against the Katanga secession – the US has anchored its Central African policy on Mobutu's rule. The Carter administration sent planes to transport Belgian, French, and Moroccan troops to counter invasions by Zairian exiles in 1977 and '78, and the Reagan White House kept opponents of Mobutu at arms length as the CIA used Zaire's Kamina airbase to ship arms to Jonas Savimbi's UNITA rebels in Angola.

Meanwhile, President Mobutu has run a "kleptocracy" where underpaid teachers demand bribes for grades, hospital guards extort money from patients seeking admission, and police in the street shake down passersby. Mobutu treats the national treasury as his bank account, chartering Concordes, buying European villas, and favoring his Ngbande tribe while most of the 35 million Zairians survive on a fraction of what they had under the Belgians.

Political opponents have spent years in prison, in exile in isolated villages, or abroad. Most Zairians were silenced by the fear of jail, torture, death and by the belief that the US would act to keep Mobutu in power.

Then the bottom fell out of the market for bulwarks against communism. The Namibia conflict was settled, improved US-Soviet relations augured an end to Angola's war, and peace seemed possible in South Africa.

Mobutu got frightened. At meetings around the country, he nervously asked citizens what they wanted. Emboldened by the changes in the East, people answered: democracy. Secretary of State Baker stopped in Zaire during a visit to Africa in March with the same message. Nguz a Karl-i-Bond, then Zaire's foreign minister, was present for part of the Baker-Mobutu meeting and told me: "The US used to tell him 'Reform, you are making our task difficult with Congress.' Now it is, 'Change or we can't help you.' He got a messsage that things have changed. He was upset."

Zairians believe that moved Mobutu on April 24 to promise a multi-party system. But the nationwide joy was tempered by a backsliding May 3, when Mobutu said political parties wouldn't be legal till next year, and June 30, when he said only the three top parties in a local vote could compete for national power.

Protests were immediate, and Mobutu answered with repression. At the University of Lubumbashi, the second city, electricity was shut off and bayonet-wielding security forces invaded the darkened campus the night of May 11 to terrorize and murder students hiding in rooms or running for their lives. Zairians were upset that, unlike the Belgians, Washington did not refute the government's claim of only one death – estimates range from 30 to 250 – nor did it call for an international inquiry.

Mobutu is trying desperately to reverse the glasnost that has sparked strikes of public workers in major cities, publication of dozens of new critical newspapers, the resignation of leading members of the government party, and a groundswell of new parties demanding a national conference to organize elections under international supervision. Reflecting a common fear, a technocrat who is an aide to the prime minister told me soberly, "The US has to give us a strategy to neutralize the presidential guard," a Ngbande tribal force he said was "trained to kill indiscriminately" on behalf of Mobutu. Zairians liken it to the Romanian Securitate.

Washington, which smoothed the way for Mobutu's accession to power, ought to help achieve a democratic transition. It needs to speak loudly for immediate legalization of all parties, for an international inquiry into the massacre, and for a national conference of representative groups to determine the country's future. It would send a strong message if the Senate followed the lead of the House of Representatives, which in the Foreign Operations Bill for FY 1991 ends US military financing to Zaire and requires all economic assistance to be channeled through private and voluntary organizations.

Perhaps Mobutu thinks America is too preoccupied with the Middle East to pay much attention to Zaire. But failure to act decisively could lead to instability, tribal conflict, and violence in a country Washington has long considered "strategic" because of its size, its mineral wealth, and its position at the hub of nine Central African nations.

■ *Lucy Komisar, a journalist and recipient of a John D. and Catherine T. MacArthur Foundation grant, recently spent a month in Zaire doing research for a book on US foreign policy.*

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Egyptian Military Debt Forgiveness: Costs, Implications, and the Role of Congress

By Larry Q. Nowels

SUMMARY

On Sept. 14, 1990, President Bush asked Congress to cancel Egypt's $6.7 billion military debt in recognition of the Egypt's strong support of U.S. policy in the Gulf crisis, for its contribution to the international military force in the Gulf, and as a means by which the United States can assist Egypt in countering some of the severe economic hardships stemming from Iraq's invasion of Kuwait. Following extensive questioning of the proposal, Congress granted the President authority in P.L. 101-513 to modify, and under certain conditions, to cancel Egypt's military debt. Section 592 of the Act directs the President to seek a multilateral conference on Egypt's debt and to report to Congress the value of Egypt's debt owed to the United States based on realistic payment expectations. The law further permits the President to reduce Egypt's military debt to the level reported to Congress and further, to forgive the debt if it is in U.S. national security interests. A multilateral conference convened in mid-November to discuss Egypt's official debt obligations and the Department of Treasury reported to Congress that the "real" value of Egyptian military debt is $997 million, or about 15% of the total principal. While the President reduced Egypt's military debt down to the $997 million level, he has not exercised his authority to cancel the debt.

At the time the President made his request, Egypt owed the U.S. Government about $12 billion. Of that amount, approximately 50% stemmed from U.S. military loans extended between 1979 and 1984 to help Egypt finance large weapons purchases under the Foreign Military Sales (FMS) program. Debt servicing for FMS credits represented between 50% and 75% of total Egyptian scheduled payments to the United States for the next 5 years.

In the early- to mid-1980s, Egypt increasingly found it difficult to service its military debt to the United States, began to fall behind in scheduled payments, and asked U.S. officials to consider some form of debt relief. Although the Administration did not originally support debt forgiveness for Egypt, the enormity of the military, political, and financial risks for Egypt brought on by the Persian Gulf crisis convinced President Bush that American policy on Egypt's FMS debt should change.

While Members of Congress registered a strong sense of appreciation for President Mubarak's bold actions, many questioned the proposed military debt forgiveness. Their reservations were based on four general concerns: what are the costs and budgetary impact; what other options exist that might be more appropriate; what precedent will this action set for considering debt forgiveness for others; and whether the Administration should first establish a comprehensive plan to deal with global official debt problems within which Egypt would be included?

World Policy Journal
Fall 1990

REVERSING AFRICA'S ECONOMIC DECLINE: NO EASY ANSWERS

John Ravenhill

"The outlook for Africa is potentially devastating." With these words, the World Bank concludes its most recent and most comprehensive examination of Africa's economic problems.[1]

Few would dispute this summation. Africa is teetering on the brink of mutually reinforcing economic, environmental, and human catastrophes. Even under the most optimistic of scenarios, per-capita incomes in Africa will stagnate until at least the turn of the century, failing to reverse recent declines that have taken them back to levels prevailing at independence 30 years ago.

In light of the experience of the past decade in Africa, the World Bank's thinking has evolved considerably on the question of what needs to be done to relieve Africa's economic malaise. In both substance and style, its 300-page *Sub-Saharan Africa: From Crisis to Sustainable Growth* represents a victory for moderates within the Bank over hard-liners.

The report does not retreat from some of the basic messages of the Bank's earlier work: price distortions have been a central factor in Africa's economic decline; poor public-sector management lies at the heart of unproductive investment projects; higher levels of domestic savings are required and may be obtained, in part, through more user charges; structural adjustment programs are necessary and have produced positive, albeit modest, results.

But in assessing Africa's decade of adjustment, the Bank, with this report, goes beyond its earlier work in a number of important respects. The Bank

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now admits that the adjustment process has been far slower and far more painful than it had anticipated in the early 1980s, and concedes that structural adjustment programs must be more flexible in the future. It also acknowledges that the adverse external environment has been in part responsible for Africa's economic decline. While maintaining its faith in market mechanisms, the Bank pays far more attention to nonprice constraints on supply than in the past. And for the first time, the Bank explicitly acknowledges that Africa's economic crisis has its roots in political malaise. With its emphasis on putting people first, on creating an enabling environment for growth, on building administrative capacity, and on addressing long-term supply constraints, the report brings the Bank much closer to the concerns expressed by the United Nations Economic Commission for Africa (ECA) in a report released last year.[2]

From Crisis to Sustainable Growth is an extremely important contribution to the debate on a viable development strategy for Africa. Even in African countries that accept the Bank's recommendations, however, an economic turnaround will not necessarily result unless the industrialized nations, donor agencies, and international financial institutions also significantly alter their approaches. Three interrelated sets of factors will be critical to the success of the Bank's recommendations: 1) whether higher export earnings and increases in the supply of agricultural and manufactured products can be achieved; 2) whether adequate external finance and debt relief will be furnished so that import capacity is sufficient for growth; and 3) whether the reforms proposed are politically feasible at the domestic, regional, and international levels.

Africa's Economic Condition

Generalizations about a continent as diverse as Africa are notoriously hazardous—even more so when it comes to prescribing solutions to economic problems. Aggregate data—especially those pertaining to agriculture—are particularly unreliable.[3] For instance, the inclusion or exclusion of Nigeria, by far the continent's largest economy, biases data in one direction or another. Moreover, the major international agencies have tended to present data selectively when arguing their case for optimism or pessimism about Africa's economic performance or when advocating particular policies.

These cautionary remarks notwithstanding, it was evident by the end of the 1970s that virtually all of Africa faced an unprecedented economic crisis. The most obvious manifestation was a growing imbalance of the

external account. The immediate cause was the poor performance of the export sector: African export volumes expanded at only 0.3 percent per year from 1972 to 1981 compared with an average for all developing countries of 2.1 percent and for Asia of 10.5 percent. Exports frequently failed to finance even half of countries' import bills—the balance being met by development assistance or borrowing from private and, more frequently, official creditors. Clearly, Africa's share of world markets for its principal commodity exports had substantially eroded.

The more fundamental causes of the crisis were multiple, complex, and interrelated. Both external and internal factors played a part. The immediate trigger was the second major oil price hike of 1979 and the ensuing recession in industrialized countries, which precipitated a decline in commodity prices. At the time, both the World Bank and the International Monetary Fund (IMF) considerably underestimated the problem, particularly the recessionary conditions that Africa's primary exporters would face. Most African countries were not equipped—either with human or financial resources—to cope with a shock of this magnitude, and the international community failed to provide as much assistance as had been made available during the 1973–74 oil shock.

The slow growth in exports signaled that Africa was also facing a production crisis. Estimates suggest that agricultural production was not keeping pace with the rate of population growth, a conclusion supported by evidence of growing malnutrition on the continent and a dramatic increase in its food imports. The production crisis was deep-rooted. Among the most important causes was a systematic anti-agricultural bias on the part of many governments. African governments tended to pay low prices to agricultural producers, thereby attempting to keep food costs low for urban workers and to generate revenue from export crops for other activities. Although taxing agriculture in order to promote industrial development in Third World countries makes a great deal of sense in theory, in practice African governments did not use the revenue productively. Much of it was devoured by state-owned corporations whose role as instruments of patronage (for instance, in providing employment for government supporters) undermined their economic efficiency.

The desire to control resources to sustain clientelistic links, coupled with a belief in the need for state-led development, or dirigisme, was at the root of a systematic overextension of a state apparatus that was weak in its analytical and administrative capabilities.[4] Corruption in many countries was endemic, with the state acting as a cancerous growth on society. Many investment projects (including those sponsored by Western donors

and the World Bank) showed low rates of return on technologies that were often inappropriate for local economies—but which, in any case, could not prosper in an economic climate that was conducive neither to long-term investment nor to market rationality.

An unprecedented rate of population growth further complicated the task confronting African countries and the international community. Even before the second oil price shock pushed African economies over the precipice, per-capita incomes were declining throughout the continent. They are estimated to have fallen by 0.7 percent each year between 1973 and 1980.[5]

Stabilization Without Growth?

Faced with growing payments imbalances, African governments had little choice but to approach the IMF and World Bank and negotiate structural adjustment programs. The Bank's structural adjustment programs in Africa have typically embraced the following conditions: devaluation (although this has sometimes been left to the IMF to engineer through its own conditionality); reductions in tariffs and quantitative restrictions on imports; reduction of the budget deficit by decreasing government expenditures and raising revenues through user charges; restructuring the public sector through institutional reforms; divestiture of public corporations; and agricultural reform.

Although it is axiomatic that any government would generally prefer not to have to submit to IMF or World Bank conditions such as these, the relationship between the international financial institutions (IFIs) and African countries is more complex than is often portrayed. It is not simply a case of unified, homogeneous external agencies imposing their programs on countries united in their opposition to such intervention; intricate coalitions, both within the various entities and among them, have been forged.

Neither the IMF nor the Bank is a monolithic institution. Even the Fund, which is less diverse than the Bank, has its "pragmatists" and its "theologians." Bank programs are sometimes portrayed as identical to those of the Fund, but there are significant differences between the approaches of the two institutions. While in the early years of structural adjustment the Bank's approach dovetailed neatly with that of the Fund, over time it increasingly diverged, which sometimes led to arguments over the correct course of action.

African governments have not been united in hostility toward the IFIs' programs. There are individuals and ministries in most governments that have considerable sympathy with the IFIs' approach. And, once a government has decided that a reform program is essential, it may welcome the involvement of the IFIs. Bank and IMF involvement provides the government with a scapegoat that it can blame for policies that it would in any case wish to pursue. Structural adjustment programs have also generally been supported—at least initially—by well-to-do farmers and some private businesses.

The design and implementation of structural adjustment programs in Africa have been very much a matter of learning by doing. Neither the Bank nor the IMF was well-equipped for the dominant role each was to play in Africa in the 1980s. The IMF had traditionally focused on short-term lending (usually no longer than three years) to correct payments imbalances, and it had very little experience with low-income countries. The short time period for which the Fund was authorized to lend money meant that it had very little concern with supply-side variables. The Fund's assumption was that the supply of commodities in real terms would remain constant during the period of its program, and thus, its primary focus was on easily quantifiable monetary aggregates like the money supply, interest rates, and exchange rates. Although the Bank had far more experience with low-income countries, its focus until the late 1970s had been almost exclusively on project lending.[6] Structural adjustment lending was initiated in 1980; by the end of the decade structural and sectoral adjustment loans comprised 25 percent of World Bank lending.

The initial expectation was that a country's structural adjustment program would last three to five years, by which time its economy would be restored to good health. A similar short time horizon was evident in the first of the Bank's major reports on Africa, *Accelerated Development in Sub-Saharan Africa*, which was released in 1981 and is often referred to, after its principal author, as the Berg Report.

Accelerated Development proposed a short, sharp, shock treatment for African economies centered around "getting prices right." The most important elements were exchange rates, prices for commodity producers, wages, and domestic interest rates. The intention of the structural adjustment programs was to assist countries in overcoming balance-of-payments problems by providing finance for policy reform programs that the Bank and the IMF approved.

Eight years later, the Bank released *Africa's Adjustment and Growth in the 1980s*, which proclaimed success for its structural adjustment programs. Countries with strong adjustment programs were claimed to have

experienced higher agricultural growth, faster export growth, stronger Gross Domestic Product (GDP) growth, and more investment than other African countries. These were quite extraordinary claims, particularly since another Bank study published a year earlier, *Adjustment Lending: An Evaluation of Ten Years of Experience*, had lamented the slow response of African countries to adjustment lending. It also noted that "inadequate commitment has limited the seriousness of reforms, especially in Sub-Saharan Africa," and that average GDP growth rates had fallen in these countries.[7]

The belligerent tone of *Africa's Adjustment and Growth* signaled the ferocity of the debate that was going on within the Bank between hardliners, who blamed the inefficiencies of African governments for the continent's continuing decline, and moderates, who conceded, as many Africans had long claimed, that a significant part of the problem lay in the hostile external environment. The report's denial of the importance of external factors; its argument that Africa had been unusually favored in receiving aid; and its forthright claim of success for adjustment programs which, for the most part, had only recently been implemented, were regarded as extremely provocative by the ECA, an African-dominated agency that is the continent's principal economic organization. The ECA wasted no time in issuing a rejoinder that claimed that the Bank had been able to reach its positive assessment of adjustment programs only by manipulating the data through such means as varying the choice of base year for time-series analyses in order to pick the one most favorable to its conclusions and failing to weight the data, so that the results for tiny Gambia were counted equally with those for Nigeria.

Estimating the impact of adjustment lending is particularly difficult in that it is impossible to isolate its effects from those of other factors such as changes in the external environment, unfavorable weather conditions, or the absence or presence of political stability. In addition, the time lag between policy implementation and the achievement of results, particularly in Africa, was expected to be substantial. At this stage the best that can be achieved by way of assessment is to examine the actual record of some of the countries that implemented adjustment programs in the 1980s. In doing so it is important to bear in mind that the performances of these countries might have been even worse in the absence of a program.

Many observers now acknowledge that the Fund and the Bank have enjoyed some (at least temporary) success in bringing about a degree of macroeconomic stabilization in a number of African countries. In particular, more realistic exchange rates now prevail throughout most of the continent, and budget deficits have been reduced in many countries.

Whether these changes have been achieved as efficiently as they should, and, more important, whether reforms implemented under structural adjustment programs have provided a basis for sustained future growth is much more open to question.

Overvalued exchange rates were a significant factor holding back Africa's economic growth in the 1970s. High rates of domestic inflation generated by large budget deficits were not compensated for by devaluation. The major focus the Fund and the Bank gave to exchange rate realignment was undoubtedly warranted. For instance, after Nigeria's currency was devalued in 1986, its manufacturing sector made substantial gains in providing local substitutes for goods previously imported. Unfortunately, however, the magnitude of devaluation and the way in which it has been achieved in some African countries have sometimes been disruptive and have directly undermined other objectives that were being pursued.

In some cases, massive devaluation has occurred. In Ghana the currency was depreciated 6,000 percent in nominal terms (90 percent in real terms) between 1982 and 1987.[8] As the Bank itself has acknowledged, changes of this magnitude can be severely destabilizing: "Sudden large changes in prices may themselves hinder adjustment, as in Ghana where industrial firms had great difficulty financing the working capital requirements of a ten-fold devaluation in 1983."[9] Large devaluations can dramatically increase the prices of essential inputs for agriculture and industry alike. Here the question of timing and sequencing is crucial: if producers are to invest for the future, higher prices for their products must be achieved before they are faced with significant increases in the costs of inputs like imported fertilizer.

The Bank's position has been that devaluation must be accompanied by complementary policies such as tight fiscal and monetary policies and/or an incomes policy if it is to be sustained. The danger is that massive devaluation will trigger hyperinflation and generate expectations of a continuing vicious circle of devaluation, inflation, and further devaluation. Prices and wages must be stabilized if devaluation is to be a successful policy instrument—and few African governments have yet demonstrated that they have the capacity to do this.

Just as a good argument could be made for devaluation, some reduction in tariffs and other restrictions on imports was also warranted so as to force African enterprises to become more competitive in international markets. Again, however, it is a matter of striking a healthy balance between admitting competition and running the risk of destroying Africa's fragile industries. The Bank's thinking on this point has evolved significantly over

the past decade. Where it once condemned tariffs and import restrictions, in *From Crisis to Sustainable Growth* it acknowledges that local manufacturing does indeed need some continued protection.

Although African governments have reduced their budget deficits, thus satisfying another Bank and IMF demand, this has been achieved largely at the expense of investment expenditure—hardly an outcome that will contribute to growth in the future. In Senegal the agricultural budget was cut by 24 percent in real terms, and gross fixed-capital formation as a share of GDP fell from around 30 percent in 1981 to less than 23 percent in 1984.[10] In Zambia, capital outlays were more than halved in real terms from 1982 to 1984; by 1984 they were more than 70 percent below the 1974 figure.[11] Governments have chosen soft targets for budget cuts, preferring to cut investment, maintenance, and social welfare funding rather than personnel expenditures, which sustain their patronage networks.[12] Consumption has been preserved at the cost of investment; expenditure on the military maintained at the expense of health and welfare. And there is no evidence that reductions in public investment expenditure have been compensated by increased private investment.

According to figures from the United Nations Educational, Scientific and Cultural Organization (UNESCO), spending on education fell from $32 per capita in 1980 to $15 per capita in 1987 on a continent where over one-quarter of the population is illiterate.[13] Not all of the decline in social expenditures can be blamed on adjustment programs, however, as the general economic crisis had already led to severe cuts in some states before adjustment programs were adopted. In Ghana, prior to the adoption of its structural adjustment program, real expenditures on health services in 1982 were only 23 percent of the 1976 figure. Nonetheless, stabilization programs have undermined an essential ingredient for longer-term growth—an educated, healthy population.

Although the Bank—under pressure from the United Nations Children's Fund (UNICEF)—has increasingly acknowledged this problem and has started to address it through such measures as the Programme to Mitigate the Social Costs of Adjustment in Ghana and similar measures introduced in Côte d'Ivoire, Gambia, Guinea, Mauritania, and Senegal, the sums raised to finance human development fall far short of those required even to maintain previous real levels of expenditure. On a continent where the Bank estimates that two-thirds of the population is living in absolute poverty, there is little scope for further downward pressures on living standards.

Subsidies are another area where there have been trade-offs between current stabilization and future growth. A strong case can be made that many of the subsidies dispensed by African governments have been wasteful, part of patronage networks that direct scarce resources toward political supporters. Subsidies on agricultural inputs, for instance, tended to benefit primarily the wealthier farmers. Universal food subsidies were wasteful, assisting the wealthy and the poor alike. But complete abolition of food subsidies can cause considerable harm to the poor—especially in highly urbanized countries like Zambia—and can directly threaten a government's political survival. Gradually the Bank has come to appreciate that a more nuanced approach—one that targets subsidies at the most needy rather than a theological insistence on their complete abolition—may not only help improve human productivity over the long term, but may also be the only politically feasible approach.

The Bank continues to insist, however, that countries attempt to recover costs of providing services through increased user charges. Again there is some justification for this: there is no good economic reason why scarce resources should be used to subsidize services to those who can afford to pay for them. And charges do provide an incentive to farmers to increase their output so that they can afford services. On the other hand, user charges may prevent the poor from gaining access to education, health services, and adequate water supplies—thus jeopardizing the long-term goal of providing a healthy and educated workforce. Moreover, it is doubtful that charging for some services is always the most cost-efficient means of raising revenue. A leading development economist, Reginald Green, cites internal Bank studies that suggest that at most only 10 to 20 percent of health and education services can realistically be self-financing.[14]

The Bank's attempts to privatize state organizations have also been resisted, in part because they threaten the government's patronage network. In many African countries where "crony capitalism" is the norm, the dividing line between the state and the private sector is far from distinct. The sale of state corporations could be turned into a source of patronage, thereby subverting the intentions of the Bank. In some countries where privatization has occurred, e.g. Senegal, the organizations have been sold cheaply to regime supporters.[15] Whether private monopolies will be any more efficient than the state monopolies that they succeed remains to be demonstrated.

To date, stabilization has come about predominantly through a reduction in demand rather than, as its architects had envisioned, through a

vigorous supply-side response as well. The volume of imports entering Africa fell on average by 8 percent *each year* between 1980 and 1986 and declined further in 1987 and 1988. The value of imports of machinery and transport equipment declined by 40 percent from 1981 to 1986.[16] Such figures again do not bode well for economic growth in the future as economies are starved of the capital goods they need for further development. Export volumes grew by only 1.5 percent each year between 1980 and 1986—an increase that was more than offset by declining terms of trade for Africa's commodities. As a consequence, the purchasing power of exports fell each year from 1980 to 1987.[17]

Bowing to pressure from the international community, African governments have given top priority to allocating more money to the agricultural sector in an effort to increase supply. In adopting the Organisation of African Unity's *Africa's Priority Programme for Economic Recovery* (1985) and the United Nations Programme of Action for African Economic Recovery and Development (1986), African states committed themselves to earmarking 25 percent of their total investment funds to the agricultural sector.

They have also attempted to raise the prices paid to agricultural producers. The Bank has long insisted that higher producer prices were necessary in order to increase agricultural output. Governments found that low producer prices were indeed counterproductive. Food crops were simply sold at higher prices in "parallel" (that is, unofficial) markets so that one objective behind governments' offering low returns to producers—to make cheap food available to urban workers—was frustrated. Low prices for export crops caused farmers to produce less or to smuggle their crops to neighboring countries that offered higher prices.[18]

Preliminary evidence suggests that higher producer prices have indeed stimulated production. In Ghana, the trebling between 1983 and 1987 of prices paid to producers of the main agricultural export, cocoa, generated an immediate and significant rise in exports. In Guinea, the Bank reported a "dramatic" rise in coffee exports once producers received higher prices after the government's coffee-marketing organization was supplanted by the private sector.

Such data, however, are open to a variety of interpretations. The ECA has asserted that the primary reason for Africa's improved agricultural performance in the late 1980s was good weather throughout the continent. Although this was a relevant factor, few would accept that it was the primary explanation for increases in export crop production. Some of the

reported increases in production undoubtedly represent the return to official marketing channels of produce that was previously being smuggled across the border or sold on "parallel" markets. Reginald Green, for instance, estimates that as much as one-third of the reported increase in Ghana's cocoa output between 1983 and 1987 was actually production that had previously been smuggled and sold in neighboring countries where producer prices were higher.[19] Similarly, up to 40 percent of the reported increase in groundnut production in Senegal is estimated to be crops previously sold on parallel markets.[20]

Moreover, higher producer prices may well be contributing to increased levels of inequality in Africa. Where the export crops are grown primarily on plantations or large farms, then the benefits of higher producer prices may accrue disproportionately to a favored minority. Growing reliance on fertilizers and other expensive inputs may similarly favor the more prosperous farmers. More specific targeting of poor rural producers will be required if the benefits of adjustment are to be widely disseminated.

While an initial increase in production can be achieved through raising producer prices, whether significant additional gains can be made through price manipulation is open to doubt. Econometric studies have estimated that the long-term price elasticity of supply for agricultural crops in Africa is 0.3; that is, for every 10 percent rise in price, aggregate supply will increase by approximately 3 percent. This suggests that higher prices will at best generate a modest increase in production. Higher prices thus are necessary, but in themselves insufficient, to achieve long-term agricultural growth.

There is now almost universal agreement that nonprice factors like inadequate infrastructure, shortages of key inputs such as fertilizers, and poor research and extension services are significant constraints on supply. Furthermore, farmers are unlikely to respond to higher producer prices in the longer term unless consumer goods are available so that they have something to spend their higher incomes on. Stabilization programs that depress government expenditures on infrastructure and support services for agriculture and that curtail the availability of consumer goods undermine the longer-term goal of increasing agricultural supply. For these reasons, the various structural adjustment programs have not addressed supply-side issues effectively to date.

The generally slow supply response discussed above, coupled with the financing requirements for new loans that donors have provided in support of countries that have adopted reform programs, has produced a worrying increase in indebtedness. Ghana's total debt rose from $1.1 billion in 1980 to $3.4 billion in 1987; similarly Zambia, which cancelled a struc-

tural adjustment agreement with the IMF in 1987, experienced an increase in its total debt from $2.2 billion to $6.6 billion over the same period.[21] Debt service ratios rose accordingly for both countries to more than 60 percent of total export earnings by 1987. By April 1989 Zambia's arrears to the IMF totalled $790 million.

These figures attest to the inadequate response from industrialized countries in support of African governments that are embarking on painful adjustment processes. The argument is not that African countries would have been better off without adjustment, but that the necessary finance to sustain the import requirements of a growth-oriented adjustment process has yet to be provided—and made available on such concessional terms that it does not add to the continent's debt-servicing problems. Despite the widespread adoption of adjustment programs, African countries paid back more—a total of $1.5 billion—to the IMF from 1986 to 1989 than they gained in new borrowing. Nigeria, which adopted a rigorous adjustment program of its own design in 1986, recorded a net outflow to the World Bank of $35 million in 1989. The total net transfer by the World Bank and its soft-loan affiliate, the International Development Association, to the region in 1989 was $877 million after taking into account repayments and interest charges amounting to $1.4 billion.[22]

The vast majority of new debt is owed to official lenders—the IFIs and the governments of industrialized countries. Because of the unpromising investment climate that has prevailed in Africa, inflows of private capital to the region have been negligible over the past decade. Indeed, some of the new capital inflows from official creditors have been used to pay back money owed to commercial banks. Only Kenya, Niger, Côte d'Ivoire, and Mauritius received net inflows of private external capital in 1987. From 1981 to 1987 foreign direct investment in all non-oil-exporting African states (including North Africa) averaged less than $300 million per year.[23]

The danger of relying on borrowing from the IFIs is that such debt cannot officially be rescheduled.[24] In addition, in accordance with the original mission of the Fund as a lender to help countries overcome "temporary disequilibria" in their balance of payments, IMF "purchases" have traditionally been of strictly limited duration and carry a market rate of interest of more than 8 percent. The need to repay short-term IMF credits often produces a "bunching" of debt obligations that severely strains debt-servicing capacity. The World Bank has advised some African countries against further borrowing from the IMF on conventional terms.[25] Five African countries—Liberia, Sierra Leone, Somalia, Sudan, and Zambia—

currently owe the Fund $2.7 billion, and Liberia faces the prospect of being the first country to be expelled from the Fund for noncooperation.

Substantially more finance on concessional terms is needed to relieve Africa's debt burden and to give adjustment programs a chance of achieving success. Under the current debt-servicing arrangements, much of the income from economic growth immediately flows back to the IFIs and Western donors—hardly a situation that is likely to engender popular support for structural adjustment. Debt relief is necessary for the structural adjustment programs to have the desired results. But again, debt relief has to be linked to a commitment to economic and political reform on the part of African governments.

Structural adjustment programs have also had significant redistributive effects. They have succeeded in their goal of engineering a major change in the urban-rural terms of trade in favor of rural producers—a trend that was already well under way given the rise in food prices and decline in manufacturing by the early 1980s. Urban wage earners have been the group most adversely affected by economic decline and subsequent stabilization. The index of real wages in Uganda fell from 100 in 1972 to 9 in late 1984; in Zaire the purchasing power of the minimum wage in 1982 was only 3 percent of the 1970 level. In many countries it appears that the flow of remittances from urban to rural areas has been reversed. Even though an increasing proportion of urban dwellers now grow part of their food requirements, malnutrition is rising in cities—in part because the Fund and Bank have insisted on the dismantling of food subsidy programs.

Toward Successful Adjustment

A decade's experience of adjustment programs in Africa permits a number of generalizations to be made about those factors that either facilitate or impede their success. First, the programs need a substantial amount of good luck. In Ghana, for instance, the introduction of the program coincided with the end of a drought. The subsequent good harvest provided a much-needed increase in foreign exchange and gave the program a morale-raising boost. In contrast, the introduction of Zambia's program occurred at a time when copper prices experienced a further fall; the resulting deterioration in the country's terms of trade immediately invalidated the calculations that had been made of the country's external financing needs.

Second, the timing and sequencing of the various elements of the program are critical. As already noted, massive devaluation prior to raising

producer incomes may prevent farmers from purchasing necessary imported inputs. Similarly, real devaluation is unlikely to be sustained unless donors make available sufficient foreign exchange to enable import capacity to be maintained. The Bank now acknowledges that Zambia's termination of its structural adjustment programs in 1987 was prompted in good part by the failure of donors to provide the promised foreign exchange. A senior Bank official has complained that Western governments have frequently failed to provide anticipated financing; as a consequence, programs have been seriously underfunded.[26]

The third, and perhaps most important, factor is the degree to which a government is committed to implementing a given structural adjustment program. There is no doubt that some African governments, like those in Liberia and Sierra Leone, have engaged in what Reginald Green has termed "grab the cash and run" exercises.[27] These governments made nominal commitments to programs to gain access to initial loan funding but had little intention of carrying through the conditions. Cancellation of the programs was fully expected, as was the subsequent impasse until governments and donors once again sat at the negotiating table. We may be witnessing a rerun of the "ritual dances" between African governments and the donor community that were observed in earlier negotiations on debt rescheduling.[28]

Regimes that have just acceded to power have proved to be more committed to reform—Rawlings in Ghana, Babangida in Nigeria, the Mwinyi government in Tanzania, and the military junta in Guinea. Governments that have just assumed power have no vested interest in defending the policies previously pursued, probably have fewer key decision-makers and clients who have materially benefited from past policies, and enjoy a honeymoon period during which the population may be willing to accept tough measures. In contrast, regimes that have been in office for a long period of time and that are least insulated from patronage networks have proved to be unwilling or unable to make a radical break with the past. Included in this category would be Kaunda's Zambia, Houphouet-Bolgny's Côte d'Ivoire, Moi's Kenya, Mobutu's Zaire, and two Francophone governments where new leaders inherited well-entrenched clientelistic systems in the 1980s—Diouf's Senegal, and Biya's Cameroon.

It may well be that the greater the deterioration of an economy, and the more ruptured the social fabric, then the greater tolerance that government and society will have for the initial hardships imposed by adjustment programs (and, of course, the lower the base on which growth rates

will be calculated).[29] Ultimately, if programs are to succeed, governments need to assemble a new coalition in favor of adjustment. But this is no easy task as the benefits from adjustment accrue slowly, while the losses are usually immediate and significant ones for politically influential groups.[30]

Programs are also more likely to succeed where governments have maintained the same teams of economic advisers and given them consistent backing. This has been the case in Ghana and Nigeria, but not so in Zambia, where President Kenneth Kaunda sacked the two leading figures involved in the implementation of the IMF program, and eventually cancelled it. Moves by the World Bank to insert its own officials into the administration of some African countries, most notably Liberia and Zaire, in an attempt to ensure compliance with program targets have been unsuccessful as these officials were simply bypassed by the local regimes.

Besides helping to arrange the prompt supply of necessary foreign exchange, the IFIs can enhance the likelihood that the programs will succeed by permitting more flexibility in their implementation. Here it is clear that the Fund and the Bank treat countries differently according to whether they are perceived as serious in their approach and whether they are regarded as "allies" by leading Western donors.

Although neither institution, particularly the Fund, had high expectations for what might be achieved in Ghana under Jerry Rawlings, the perseverance of his government with an adjustment program gradually convinced the IFIs of its serious intent. Accordingly, they became more willing to provide additional finance to Ghana, and allowed some flexibility in policy implementation as internal and external conditions changed. And Ghanaian officials were increasingly able to bargain with the IFIs for some concessions. By contrast, the IFIs consistently doubted the seriousness of Zambia's intentions to reform. Consequently, rigid and proliferating conditionality was applied to its program, and the IFIs were less willing to make finance available.

Some countries that have not seriously pursued structural adjustment—but are regarded as of strategic significance to the West—have continued to be favored recipients of external support, however. The IFIs have been far more tolerant of the governments of Sudan and Zaire than they deserve, in large part because Western countries have intervened at the top levels of the IFIs in an effort to prop up what they have traditionally regarded as "friendly" regimes in strategically important states. With the decline of the Cold War, a more rational distribution of development assistance can be hoped for.

The Bank Reconsiders: *From Crisis to Sustainable Growth*

Contrary to the arguments of some of its critics, the Bank's thinking on structural adjustment has evolved considerably as it has gained experience over the past decade. In a series of reports issued in the 1980s, the Bank moved beyond the confrontational "get the prices right" and "get the government out of the economy" approach of *Accelerated Development*, its 1981 report. *Toward Sustained Development*, issued in 1984, displayed a far greater awareness of the constraints—both internal and external—faced by African governments, and a greater sensitivity toward the Organisation of African Unity's call for continental economic self-reliance. It also placed new emphasis on the need for institution-building in Africa.

With *Financing Adjustment with Growth in Sub-Saharan Africa*, published in 1986, the Bank continued to emphasize the necessity of getting prices right and of reducing the role of the state in the economy. But it also made a powerful case that Africa's debt burden was "unmanageable," and that substantial rescheduling would be necessary to preclude widespread defaults. Moreover, the report asserted that domestic policy reforms would not succeed without a massive inflow of resources on concessional terms. In it the Bank admitted that aid policies toward the continent had been far from optimal, and that donors had to accept some of the responsibility for the white elephants that had been constructed with their assistance. For the first time, detailed attention was given to the necessity of reducing Africa's alarming rate of population growth.

Sub-Saharan Africa: From Crisis to Sustainable Growth is the most comprehensive Bank analysis to date on Africa's economic malaise and is a conscious attempt at bridge-building with African governments and their continental institutions. For the first time in the preparation of a major report, the Bank engaged in a lengthy process of consultation with African representatives. A council of African advisers was appointed, and 20 workshops were held in Washington and various parts of Africa to discuss the report.

While the report stands by many of the basic messages of the Bank's earlier work, in assessing Africa's decade of adjustment it does make some significant departures from previous thinking. The Bank admits here that the adjustment process has been far slower than it had anticipated, and that the external environment for African states has been significantly more adverse than it had predicted. It gives greater attention to the importance of declining terms of trade and unstable commodity prices as factors contributing to Africa's economic hardships. Albeit somewhat reluctantly, the Bank confesses that it participated in some poorly designed projects in Africa and concedes that more than half of the completed rural development projects it financed there have failed.

Although the Bank is not about to jettison the structural adjustment approach, it does now acknowledge that the IFIs need to be less dogmatic and more flexible in implementing adjustment programs and that greater account should be taken of the social impact of adjustment. Returning to the rhetoric of the McNamara Bank's basic human needs approach in asserting that "people must come first," this report places greater emphasis than previous ones on equitable growth; the special needs of women and the urban poor; and on increasing investment to improve health and education services, ensure food security, and create jobs.[31]

In another departure, the Bank also acknowledges that, given the deindustrialization we have witnessed in Africa over the past decade, some protection of industries may be necessary. It concludes that "the challenge is to balance protection, which nurtures domestic industries, with competition, which forces firms to innovate, raise productivity, and reduce costs.[32] Moreover, the Bank agrees that more attention needs to be paid to nonprice constraints on supply and puts import substitution—that is, efficient import substitution—back on the agenda. The Bank also adopts a less ideological approach to privatization, asserting that "the division of responsibilities between the state and the private sector should be a matter of pragmatism—not dogma," and acknowledging that "operating by competitive rules is more important than outright ownership."[33] The Bank endorses at length the OAU's and the ECA's calls for regional economic integration, perceiving production for an expanded regional market as a stepping stone toward international competitiveness for African industries. The report also comes out in favor of the ECA's call for a reduction in Africa's military expenditures, which currently run on average about 10 percent of government budgets (but constitute more than 25 percent of the budget in strife-torn Ethiopia and Uganda).

Moreover, for the first time the World Bank has explicitly acknowledged that Africa's economic crisis has its roots in political malaise. Early drafts of the report employed the terminology of a member of the council of African advisers who referred to Africa's "vampire" states, but this reference was not included in the final draft. Using a less inflammatory lexicon, the Bank calls for the establishment of the rule of law and independent institutions in order to ensure public accountability.

While many of the Bank's new objectives are commendable, its proposed means for realizing them are far more contentious. The first obstacle

is that *From Crisis to Sustainable Growth* has little new to offer on immediate supply-side issues. To be sure, there is a greater emphasis on human development as laying the foundation for a more prosperous future over the long term. And the report does concede the necessity for more import substitution, given countries' foreign exchange constraints and current levels of food imports. But the Bank pins its hopes for increased export revenues on countries doing more of the same.

Agriculture, it argues, should be the primary foundation for growth, for "this is where Africa has an immediate comparative advantage."[34] As the Bank itself notes, however, African countries have lost market shares over the past decade not only because of their own production failures, but also because higher-income developing countries such as Brazil and Malaysia have invested heavily in agricultural production and have aggressively exported into Africa's traditional markets, a problem compounded by burgeoning agricultural subsidies in industrialized countries.[35] Africa, the Bank asserts, "cannot afford to adopt a passive role and lose even larger market shares to more aggressive Asian and Latin American exporters."

But does Africa enjoy a comparative advantage over these other producers? Although the vast majority of African countries will inevitably remain dependent on agricultural commodities for the bulk of their export earnings for the foreseeable future, it is open to debate whether in fact most African countries currently enjoy a comparative advantage. In a world of unemployed or underutilized resources, the answer is probably negative.

Given the macroeconomic instabilities generated by stabilization programs, investors are unlikely to prefer African countries over places like Malaysia and Thailand, which are more stable economically and politically and which have much better infrastructure. And the debt problems of higher-income developing countries will almost certainly guarantee that they will not voluntarily give up their gains in market shares from the past decade but will continue to market aggressively; as Reginald Green points out, these countries are far better equipped to fight in the event of a trade war with African producers.[36] The Bank's plea that "in negotiating commodity agreements, Africa's loss of market share should be seen as an argument for more favorable treatment"[37] reads like wishful thinking.

Slow growth in demand from industrialized countries and intensified competition for market shares have caused commodity prices to tumble in real terms. These falls have occurred despite the industrialized world's having enjoyed its longest uninterrupted period of economic growth since World War II—a sign of the increasing delinking of the manufacturing

prices were at their lowest recorded levels in this century, excepting 1932, the trough of the Great Depression.[38] And for two crops of vital importance for Africa, cocoa and coffee, prices fell even further between 1986 and 1989—by 48 and 55 percent respectively. For nonfuel commodities, the terms of trade in the past three years were lower than any time since 1960.

The Bank itself concedes that commodity prices are unlikely to rise for the remainder of the decade. And the danger is that Africa's additional output of commodities will merely spark intensified competition in saturated markets, thus depressing prices further. Although African coffee exports for 1990 are expected to be 13 percent higher than 1988 levels, the Bank projects that this year's coffee receipts will be 25 percent lower than two years ago. Declining commodity prices inevitably make it more difficult for governments to sustain price increases for producers. For instance, Côte d'Ivoire was forced in September 1989 to halve the price it pays to its cocoa farmers; the Cameroon had earlier cut its production price by 40 percent.[39]

If Africa is to regain its share of commodity markets, then investors in countries like Brazil and Malaysia will have to perceive that exporting manufactured goods to industrialized countries is more lucrative than exporting commodities to them. To make manufacturing endeavors more attractive to higher-income developing countries, however, protectionism in industrialized countries has to be reduced. The Bank is disappointingly silent on this issue, however. It is similarly circumspect on the damage caused to African and other Third World producers by the agricultural subsidies of industrialized countries, and fails to note that African attempts at diversification into cut flowers and off-season fruits and vegetables have been hindered by agricultural protectionism in the European Community (EC).

"Market access," the Bank asserts, "is not a problem" for African manufactured exports because of the availability of Generalized System of Preference (GSP) schemes and the preferential access that African countries enjoy to the European market through the Lomé Convention. Yet this statement misses the point that neither GSP schemes nor Lomé offer the type of long-term security that potential investors seek. For example, both Mauritius and Zimbabwe have had to agree to "voluntary" restraints on their exports of clothing to the EC despite being only very minor suppliers—thereby undermining the security of assured access that the Lomé Convention was supposed to provide. For foreign capital to be lured to Africa's relatively unattractive economies, the investment climate must

itself if manufacturers are not guaranteed access to the markets of industrialized countries.

The recent report of the United Nations Expert Group on Africa's Commodity Problems is far more forthright on these issues and criticizes both the IMF and the Bank for their failure to take "sufficient steps to ensure that such countries embarking upon a diversified and expanded production base will gain adequate access to markets in industrial countries. Therefore, while attention is paid to the macro-economic elements, the broader trade policy situation is not brought into the equation."[40] The U.N. report also gives greater attention to the need to establish and reestablish price stabilizing internal commodity agreements, about which the Bank is skeptical at best. Nor does the Bank advocate increased support for the second window of the Common Fund, which might be utilized to promote greater local processing of African commodity exports and diversification.[41]

The second critical factor for the Bank's program will be the provision of sufficient funding. Although generalizations about the continent can again be misleading, Africa is now the world's most heavily indebted continent in terms of the ratio of debt to GDP. The total was estimated to be $143.2 billion at the end of 1989—up from only $6 billion in 1970. The ratio of debt service to export earnings for 1987 ranged from 3.4 percent for Botswana to 119.6 percent for Guinea Bissau. Only 11 African countries did not incur arrears or resort to debt rescheduling in the 1984–86 period. In the years 1986 and 1987 alone, Africa received more than $20 billion in debt relief. Yet despite the massive rescheduling that has already occurred, payments on debt remain a significant barrier to increased import capacity. A 1989 IMF study suggests that even if full rescheduling of forthcoming principal payments occurs over the next five years, and export earnings grow at about 3.5 percent each year, there will still be no growth in nominal import capacity.[42]

For much of the 1980s the problem was that new capital inflows into Africa were being used to service or repay existing debt obligations. The net outflow of resources from Africa to the IMF between 1985 and 1989 has already been noted: over 4 percent of Africa's exports were devoted to Fund charges and repurchases, the highest figure for any continent.[43] Inflows from official creditors were used to finance a net outflow of private capital. Recently the Bank has allowed its soft-loan affiliate, the International Development Association, to provide funds to countries no longer receiving World Bank loans to help them service their previous borrowing from the Bank. A complex paper chase has been under way in which credits and debts have been shuffled from one institution to another with little

positive impact to date in terms of net inflows to African countries. Indeed, an IMF study has calculated that net inflows to the continent were less than $1 billion per year in 1986 and 1987 if debt relief and arrears are not taken into account.[44]

The Bank assumes that debt relief measures will keep debt service payments in the 1990s at or below the level of the 1980s, or about $9 billion per year. This is probably a reasonable assumption, for even if official rescheduling is not forthcoming, countries will probably give themselves de facto "relief" by going further into arrears. But with debt payments still running at the high levels of the 1980s and export prospects poor, the Bank has been forced to rely on increased overseas development assistance (ODA) as a means of bridging the financing gap for the continent's development needs in the 1990s.

The Bank asserts that ODA must grow at 4 percent each year in order to finance its proposed program. If funding fails to reach this level, "Africa's decline is likely to continue in the 1990s," according to the Bank. Yet the Development Assistance Committee of the Organization for Economic Cooperation and Development projected in its 1989 annual report that assistance to Africa would only increase by 2 percent annually in real terms in the 1990s—an estimate predicated on the assumption that aid from Japan would continue to grow substantially. Africa's share of global ODA disbursements has already grown from 23 percent in 1980 to 30 percent in 1987,[45] and there are signs that "donor fatigue" has set in as industrialized countries become disillusioned with the slow progress in Africa. The December 1989 replenishment of the International Development Association only maintained its funding in real terms, whereas a significant increase had been hoped for; the EC's funding for the fourth Lomé Convention also fell far short of expectations. Together IDA and Lomé provide 20 percent of all aid to sub-Saharan Africa. Even if Western countries are willing to devote some of the anticipated "peace dividend" to fund additional ODA, the demands of the former East bloc for Western capital will inevitably compete with Africa's claims.[46]

Furthermore, for the Bank's scenario to be realized, the efficiency of investment must improve by about 50 percent over the levels of the 1970s; an increase of 50 percent must be achieved in domestic savings and net transfers as a percentage of GDP; and food production must increase at 4 percent a year—double what it has averaged over the past 30 years. Perhaps the most depressing aspect of the Bank's scenario for Africa in the 1990s is that even if all of these optimistic assumptions are fulfilled, per-capita income will rise by at most 1 percent per year. And, if the Bank's

targets are to be met, even this modest amount will not be available for consumption but rather must be used to raise the savings rate. The Bank assumes that improving the income levels of the bottom 95 percent will occur through squeezing the consumption levels of the top 5 percent of the population—which brings us to the question of political feasibility.

The Bank's proposals raise a fundamental question: why would African governments that have vested interests in existing structures of administration and production adopt reforms that threaten not merely their rent-seeking activities but also in all likelihood their very political survival? Perhaps the Bank is counting on the "wind from the East" to produce a wave of popular demands for democratization, the establishment of the rule of law, and governments run according to rational legal principles. Or perhaps it believes that economic pressures can succeed in forcing governments to come to terms with it and the Fund. The record to date, however, is that many governments have managed to survive by playing donors off each other, and by periodically gaining access to scarce resources by engaging in ritual rounds of negotiation with donors.

The Bank's proposals face political problems not only at the domestic level but also at the regional and international levels. [For a detailed discussion of the political implications, see Richard Sandbrook, "Taming the African Leviathan," in this issue of *World Policy Journal*.] While the Bank is to be commended for stressing the importance of regional integration for development, its specific proposals demonstrate that it has apparently learned little from the failure of regional integration schemes in Africa over the past 30 years. Although it acknowledges that progress toward market integration has been disappointing, and that one reason for this has been disputes over the distribution of benefits and costs, the Bank nevertheless is advocating trade liberalization and market-based integration. Recognizing that this type of approach generates "growth poles"—cities or regions where development becomes concentrated—and inequalities in the distribution of the benefits from regional cooperation, the Bank proposes only that budgetary compensation should be offered to those states that make relatively small gains from the integration process.

Yet the experience not only of African regional schemes but of those in other parts of the Third World is that budgetary compensation is seldom regarded as adequate by states when they see regional manufacturing activities concentrated across their borders in neighboring countries.[47] Not surprisingly, they see little benefit in facilitating their neighbors' industrialization if it comes at the expense of their own. Disputes over the distribution of gains from cooperation have been the principal factor causing the

breakup of regional schemes among developing countries. The only long-term solution to this problem lies in some form of regional allocation of industries. Curiously, the Bank dismisses this approach, arguing that any planning of industrial location inevitably means state-led development.

Another of the Bank's proposals is also likely to generate political tensions within regions—its advocacy of free mobility of labor within a framework of regional integration. While this may be desirable in periods of economic growth, guest workers become the first victims of economic downturns. Within the Economic Community of West African States (ECOWAS), for instance, Nigeria expelled large numbers of Ghanaian workers when its economy went into decline in the early 1980s. The resulting political tension between the two countries threatened the future of regional cooperation.

At the international level, the Bank's new slant on adjustment programs may have moved it closer to the OAU, but further away from the IMF and conservative Western governments. Some of the Bank's latest proposals—especially those calling for increased government expenditures—directly conflict with the Fund's stabilization objectives. Since prior agreement on a Fund program is a prerequisite for states wishing to obtain a structural adjustment loan from the Bank, the Fund's more conservative position may continue to have the upper hand.

In an attempt to sidestep this problem of cross-conditionality, the Bank has moved increasingly toward sectoral assistance loans, which do not require countries to first negotiate a program with the Fund. The tension between the two institutions appears certain to heighten despite a "truce" they negotiated in April 1989, which gave the Fund the lead role in determining macroeconomic conditions to be attached to adjustment programs. The Bank is also likely to encounter opposition to its new policies from the more conservative Western governments—particularly the United States, West Germany, and the United Kingdom—for whom the magic of the marketplace has yet to lose its luster. Since these governments are major financial contributors to the Bank and IMF, as well as significant bilateral donors, this problem relates to the one identified earlier—donors' reluctance to increase their financing of adjustment programs.

Toward an Improved "Enabling Environment"

It is far easier to identify the weaknesses in the Bank's program than to come up with alternative proposals. Devising policies that are not only

economically viable but also politically feasible in the African context is a formidable challenge.

African economies will not be transformed overnight. Right now agricultural exports offer the best prospect for earning the foreign exchange required to import the capital goods necessary to lay the foundations for economic transformation. In the short term, the Bank is right that there is no viable alternative for African countries but to maximize their exports of agricultural commodities, even though such an increase may well lead to declining prices for major crops. (This assumes, however, that commodity exports are not increased at the expense of the efficient production of food for the domestic market.) In the medium term, however, much more attention will have to be given, on a country-by-country basis, to promoting nontraditional exports and finding niches for them in the markets of industrialized countries.

There is much more that industrialized countries can and should do to assist those states that are making a genuine effort at adjustment. Whether such help will be forthcoming is much more doubtful.

First, greater efforts must be made to address Africa's debt problem. In the 1988 Group of Seven (G-7) summit in Toronto, the major industrialized countries agreed on a special debt initiative for nonconcessional official debts, i.e. export credits, owed by low-income African countries. Creditors would be allowed to choose between three options that offered a combination of rescheduling plus extended grace periods, write-offs, or lower rates of interest for countries that had reached an agreement on an adjustment program with the IMF. At best, these proposals offer some temporary relief and merely postpone the day of reckoning. They are significant in that they establish a precedent for writing off export credits, however. (In the past, donors had only been willing to forgive development loans.) But in practical terms, these proposals provide little in the way of actual relief. In fact, the United Nations Conference on Trade and Development (UNCTAD) estimates that the savings on interest will amount to no more than 2 percent of countries' annual debt-service payments.[48] Having established this principle, industrialized countries should now follow the recommendations of the Wass Report.[49] Written by an advisory group of bankers, officials, and academics under U.N. sponsorship, the report recommends converting these export credits into loans on terms similar to those available from the International Development Association—annual rates of interest of 0.5 percent over 40 years with a 10-year grace period.

The experience of Ghana, the only African country that has sustained a rigorous adjustment program throughout most of the 1980s, demonstrates that a massive inflow of resources is necessary to support structural adjustment. This is even more the case if poorer groups are to be protected from the adverse effects of adjustment and if the human foundations for sustained economic growth are to be built up. Debt relief will be insufficient if it comes at the expense of other forms of assistance. Additional inflows of aid—which will have to be in grant form or on IDA terms—are necessary.

Second, if industrialized countries are sincere in their support for diversification of African economies, and in their demands for a secure environment for foreign investment, then they should guarantee market access for the nontraditional exports of African countries. The ideal would be a commitment that no African manufactured exports would be subject to "voluntary export restraints" or other nontariff or tariff barriers for an extended period—say 15 years—provided such exports comply with reasonable "rules of origin." (Such rules specify how much value must be added locally for the export to be counted as a product of the country, thereby avoiding the problem of goods merely being transshipped through Africa from third countries so as to exploit the continent's privileged access to industrialized markets). Industrialized countries should also greatly liberalize access to their markets for African agricultural products that compete with domestic products. Moreover, the West needs to liberalize market access for manufactured goods from newly industrializing countries and to offer them greater debt relief so that they will concentrate their economic activities on manufactured goods, rather than commodities that compete directly with African products.

Third, industrialized countries should cooperate with Third World countries in attempting to revive international commodity agreements. The depression of nonfuel commodity prices over the past decade not only deprived the least developed countries (LDCs) of income, but also deprived industrialized countries of markets for their exports because of the decline in LDC purchasing power. Given the present overproduction of commodities and the cutthroat competition between commodity suppliers in the South, it is unlikely that a voluntary agreement on production quotas will be negotiated. For international commodity agreements to succeed, industrialized countries will almost certainly have to "enforce" production quotas by imposing quotas on the quantity of imports from individual suppliers.

A good case can also be made for the introduction of a global system

to stabilize the commodity export earnings of African countries through an improved and extended version of the commodity stabilization scheme that is part of the Lomé Convention between the European Community and 70 African, Caribbean, and Pacific countries.[30] The problem with such schemes as they are currently conceived, however, is that they merely offer compensation for earnings that have fallen below the average for the most recent years. In a period of declining commodity prices, they stabilize earnings around a declining trend. Thus, they should be supplemented by international commodity agreements that attempt to maintain price levels.

Fourth, industrialized countries should continue to promote regional cooperation among African countries. Donor agencies—including the World Bank and the EC's European Development Fund—have often appeared in the past to be more enthusiastic proponents of regional cooperation than African states themselves. Here the model should not be a common market—which inevitably exacerbates tensions over the distribution of benefits between participating countries—but flexible arrangements that promote joint ventures, joint provision of services, enhanced trade on the basis of local currencies or barter, etc. The Southern African Development Coordination Conference (SADCC) provides an appropriate model.

The measures listed above are feasible steps that industrialized countries could take to create an "enabling environment" for structural adjustment in Africa. And, since adjustment is necessary, it is reasonable for industrialized countries to make access to benefits conditional on African governments' agreeing to a reform program. But the reform program has to be flexible enough to take into account changes in the external environment and should avoid the proliferation of conditions that accompanied Fund and Bank programs in the late 1980s. Without additional assistance from industrialized countries, however, and without serious efforts at reform, the outlook for Africa is indeed "potentially devastating."

Notes

[1] World Bank, *Sub-Saharan Africa: From Crisis to Sustainable Growth* (Washington, DC: World Bank, 1989), p. 185. Like the Bank, I confine my analysis in this article to Africa south of the Sahara. "Africa" is used as shorthand for sub-Saharan Africa (excluding South Africa). I am grateful to the editors and to Thomas M. Callaghy for comments on an earlier draft.

[2] See United Nations Economic Commission For Africa, *African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation* (Addis Ababa: ECA, 1989). Although the two reports overlap significantly, the ECA rejects current programs of structural adjustment and prefers a prominent role for the state in managing exchange rates, undertaking import licensing, and providing selective subsidies and investment funds. By continuing to afford the state a significant role in the management of African economies, the ECA relies on the instrument that caused many of the problems that African economies currently face. The question that has to be asked of the ECA approach is whether African states have reformed themselves enough in the past decade to become efficient economic managers. There is little reason to believe that such a transformation has taken place.

As in its previous reports, the ECA analysis is very short on specifics and thus on how to move African economies from their present unhappy condition to the desired goal of independent, self-sustaining development. African governments have shown little enthusiasm for the ECA report. See, for example, *West Africa* (London), July 23–29, 1990, p. 2146, which reported that the Declaration of the 1990 OAU summit made no reference to the ECA report.

For a discussion of the convergence of Bank and ECA views over the past decade, see Stanley Please, "ECA and World Bank Strategy: Learning and Reassessment," in Thomas M. Callaghy and John Ravenhill, eds., *Hemmed In: Responses to Africa's Economic Decline* (New York: Columbia University Press, forthcoming).

[3] Data on agriculture are frequently little more than guestimates of actual yields. Once inscribed in official statistics, however, they are then used as the basis for further projections. These problems are examined in detail in Philip Raikes, *Modernising Hunger* (London: Catholic Institute for International Relations/James Currey, 1988).

[4] State enterprises are estimated to have provided as much as 75 percent of nonagricultural employment in Guinea; the wage bill for the country's 75,000 public servants accounted for 50 percent of government expenditures. Similarly, the state provided 58 percent of nonagricultural employment in Nigeria. Studies have shown that state enterprises throughout the continent accumulated significant losses. See John R. Nellis, *Public Enterprises in Sub-Saharan Africa* (Washington, DC: World Bank, 1986).

[5] An extensive literature examines the roots of Africa's economic decline. See, for example, John Ravenhill, ed., *Africa in Economic Crisis* (New York: Columbia University Press, 1986); Robert J. Berg and Jennifer Seymour Whitaker, eds., *Strategies for African Development* (Berkeley: University of California Press, 1986); and Tore Rose, ed., *Crisis and Recovery in Sub-Saharan Africa* (Paris: Organization for Economic Cooperation and Development, 1985).

[6] The Bank itself acknowledges that "Some early SALS [Structural Adjustment Loans] caught the Bank quite unprepared to give specific advice in a number of instances." See World Bank, *Adjustment Lending: An Evaluation of Ten Years of Experience* (Washington, DC: World Bank, 1988), p. 65.

[7] *Ibid.*, p. 36. Similarly, an earlier IMF report found that only one-fifth of the African countries with Fund programs had achieved the targeted levels of economic growth. Close to 20 percent of the programs had been cancelled for noncompliance. See Justin B. Zulu and Saleh M. Nsouli, "Adjustment Programs in Africa: The Recent Experience," IMF Occasional Paper No. 34 (Washington, DC: IMF, April 1985).

[8] Simon Commander, John Howell, and Wayo Seini, "Ghana 1983–7," in Simon Commander, ed., *Structural Adjustment and Agriculture* (London: Overseas Development Institute, 1989), p. 109.

[9] *Adjustment Lending* (fn. 6), p. 51.
[10] Simon Commander, Ousseynou Ndoye, and Ismael Ouedrago, "Senegal 1979–88," in Commander (fn. 8), p. 149.
[11] Jürgen Wulf, "Zambia Under the IMF Regime," *African Affairs*, Vol. 87 (October 1988), pp. 589–590.
[12] For examples from the Cameroon, see Nicolas van de Walle, "The Politics of Non Reform in Cameroon," in Callaghy and Ravenhill (fn. 2). Jonathan Kydd reported that the Zambian government's administrative controls over the economy enabled it to protect aggregate consumption levels while sacrificing investment. See "Coffee After Copper? Structural Adjustment, Liberalisation, and Agriculture in Zambia," *Journal of Modern African Studies*, Vol. 26, No. 2 (June 1988), p. 235. These findings reinforce those of the Bank itself. See *Adjustment Lending* (fn. 6), p. 24.
[13] Data from United Nations Secretary General's Expert Group on Africa's Commodity Problems, *Africa's Commodity Problems: Towards a Solution* (Geneva: United Nations Conference on Trade and Development, 1990); and Per Pinstrup-Anderson, "The Impact of Macroeconomic Adjustment," in Commander (fn. 8), pp. 90–104.
[14] Reginald Herbold Green, "The Long Road to Development," *Africa Recovery*, Vol. 4, No. 1 (April-June 1990), p. 28.
[15] Commander, *et al.* (fn. 10), p. 169.
[16] *Africa's Commodity Problems* (fn. 13), p. 23.
[17] World Bank, *Annual Report 1989* (Washington, DC: World Bank, 1989), p. 33.
[18] Michael F. Lofchie documents how different producer pricing policies produced a generally healthy agricultural sector in Kenya and disaster in Tanzania. By 1980 Tanzanian producer prices for coffee and tea were less than 20 percent of those paid in neighboring Kenya. See "Structural Adjustment in Kenya and Tanzania," in Callaghy and Ravenhill (fn. 2).
[19] Reginald Herbold Green, "Articulating Stabilisation Programmes and Structural Adjustment: Sub-Saharan Africa," in Commander (fn. 8), p. 38.
[20] Commander, *et al.* (fn. 10), p. 156.
[21] Data from Matthew Martin, "Neither Phoenix nor Icarus: Negotiating IMF Programmes in Ghana and Zambia, 1983–1989," in Callaghy and Ravenhill (fn. 2).
[22] *Annual Report* (fn. 17), p. 112.
[23] Data from *Sub-Saharan Africa* (fn. 1), p. 235, Table 20; and *Africa's Commodity Problems* (fn. 13), p. 129, Table 10.
[24] In effect, some rescheduling has taken place as the Bank has set aside 10 percent of IDA reflows and investment income to lend to countries with adjustment programs that have outstanding debts to its main loan account, the International Bank for Reconstruction and Development. The IMF has also proposed a complex system whereby countries in arrears to the Fund that are pursuing approved adjustment programs would be able to accumulate borrowing rights from the Enhanced Structural Adjustment Facility (ESAF), which could be activated once other donors pay off the arrears. The ESAF funds would then be used to immediately pay back the donors. The net result of this scheme—designed to maintain the fiction that the IFIs do not reschedule loans—will be that the IMF's own ESAF funds are used to pay off countries' overdue obligations to the Fund.
[25] In 1987, the Fund introduced a Structural Adjustment Facility (SAF) and an Enhanced Structural Adjustment Facility (ESAF). Loans from both have a five-and-a-half-year grace period, and must be repaid over the following five years at an interest rate of one half of one percent. In May 1990, 11 African countries—Benin, Chad, Equatorial Guinea, Guinea, Guinea Bissau, Lesotho, Mali, Mozambique, São Tomé and Principe, Somalia, and Tanzania had SAF arrangements with the Fund. Another 10 countries—Gambia, Ghana, Kenya, Madagascar, Malawi, Mauritania, Niger, Senegal, Togo, and Uganda—had ESAF arrangements. See *IMF Survey*, July 2, 1990, p. 205.

[26] Ravi Gulhati, "Response," in Kjell J. Havnevik, ed., *The IMF and the World Bank in Africa* (Uppsala, Sweden: Scandinavian Institute of African Studies, 1987), p. 91.
[27] Reginald Herbold Green, "The IMF and the World Bank in Africa: How Much Learning?" in Callaghy and Ravenhill (fn. 2).
[28] Thomas M. Callaghy, "The Political Economy of African Debt: The Case of Zaire," in Ravenhill (fn. 5), pp. 307–346.
[29] Thomas M. Callaghy, "Lost Between State and Market: The Politics of Economic Adjustment in Ghana, Zambia and Nigeria," in Joan M. Nelson, ed., *The Politics of Economic Adjustment in Developing Nations* (Princeton, NJ: Princeton University Press, 1990), pp. 257–319.
[30] Joan M. Nelson, *et al.*, *Fragile Coalitions: The Politics of Economic Adjustment* (New Brunswick, NJ: Transaction Books, 1989).
[31] The Bank argues that investment rates should rise from their current level of about 16 percent of GDP to 25 percent. Expenditure on human resource development is targeted to increase from the current 4 to 5 percent of GDP to 8 to 10 percent annually.
[32] *Sub-Saharan Africa* (fn. 1), p. 116.
[33] *Ibid.*, p. 121.
[34] *Ibid.*, p. 8.
[35] By 1988 Africa's market shares for cocoa, coffee, cotton, and copper had fallen by between 20 and 40 percent of their 1970 levels.
[36] Green (fn. 19), p. 39.
[37] *Sub-Saharan Africa* (fn. 1), p. 173.
[38] Overseas Development Institute, "Commodity Prices: Investing in Decline?" Briefing Paper, March, 1988, p. 1.
[39] *Africa Recovery*, Vol. 3, No. 3 (December 1989), p. 22.
[40] *Africa's Commodity Problems* (fn. 13), p. 32.
[41] The Common Fund was established by the United Nations primarily to finance international commodity agreements. Its "second window," however, provides finance to improve Third World production of commodities and to help promote Third World commodities in the industrialized world.
[42] Joshua Greene, "The External Debt Problem of Sub-Saharan Africa," International Monetary Fund Working Paper 89/23 (Washington, DC: IMF, 1989), p. 3.
[43] International Monetary Fund, *World Economic Outlook*, May 1990 (Washington, DC: IMF, 1990), p. 195.
[44] Greene (fn. 42), p. 9.
[45] *Annual Report* (fn. 17), p. 106.
[46] The relatively modest flows of assistance to Africa can be compared to the $12 billion that Western countries have pledged to the newly formed European Bank for Reconstruction and Development, and the estimated $11 billion in new credits, grants, food aid, and loan and investment guarantees the Western countries have pledged to Eastern Europe—mainly Poland and Hungary—in the past year. Data from *Financial Times*, May 29, 1990, p. 19.
[47] For the African experience, see John Ravenhill, "Regional Integration and Development in Africa: Lessons from the East African Community," *Journal of Commonwealth and Comparative Politics*, Vol. 17, No. 4 (November 1979), pp. 227–246.
[48] United Nations Conference on Trade and Development (UNCTAD), *Bulletin*, May-June 1990, p. 11.

EXECUTIVE SUMMARY

1. Women are responsible for at least 70 percent of food staple production in Africa (World Bank, 1989a). They are also important in other agricultural activities, including food processing and marketing, cash cropping and animal husbandry. Women's involvement is significant not only in terms of their labor input, but also in terms of their decision-making authority. In fact, as more men migrate to cities and other countries for work, increasing numbers of women are becoming heads of households, managing farms on a day-to-day basis. To support their extensive and multifaceted roles in agriculture and to enable them to respond to market incentives more efficiently, women need effective agricultural extension services.

2. The evidence shows, however, that despite a growing awareness of the need to reach women farmers, agricultural extension services are generally geared toward male farmers. This is sometimes by design, but more often by default. Bias toward male farmers is evident in the delivery of extension, which is generally provided by male extension agents to men, on the assumption that the extension message will "trickle across" to women. Unfortunately, the evidence clearly shows that it often doesn't. It is also evident in the message itself, which tends to focus on the activities of male farmers rather than the much wider range of agricultural activities of women. Such an approach ignores the unique workload, responsibilities and constraints of women farmers and results in a highly inefficient use of resources, not to mention sub-optimal levels of agricultural production.

3. This paper proposes a series of operational guidelines on how to provide agricultural extension services in a cost-effective way to women farmers. All small-scale farmers, regardless of gender, face constraints, but the focus here is on women farmers in order to foster a better understanding of the particular gender-related barriers confronting women and the strategies needed to overcome them. Attention is concentrated on Sub-Saharan Africa in view of the crucial role of women in agriculture throughout the sub-continent. Worldwide operational guidelines for agricultural extension for women farmers are planned for later this year.

4. The recommendations have been gleaned from the experiences of African governments, the World Bank and other donors, and researchers. Ongoing pilot programs have provided useful guidance about what can work to integrate women fully into the agricultural extension system and what problems are likely to emerge in different socioeconomic environments. This is, however, an ongoing process: it is a relatively new field and much remains to be learned. It will be especially important to test alternative approaches over the next few years. This paper will then be revised to incorporate new lessons of experience.

5. This paper is organized as follows: Chapter 1 addresses the question of <u>why women need help</u> -- the role women have in agriculture, especially in Africa, and the particular constraints they face in terms of access to

resources and information. Chapter 2 examines the information needed to modify extension systems to better reach women farmers, to modify the focus of research to address women's activities and constraints, and to monitor and evaluate programs. Ways to collect such data are also suggested. Chapter 3 deals with the transmission of the extension message to women farmers -- the role of the extension agents and the importance of gender, the use of home economists and subject matter specialists, and the use of contact farmers and groups. The final Chapter examines the formulation of the message to be delivered, and the linkage between extension and agricultural research and technology.

6. While the recommendations and analysis contained in this paper are relevant for different extension systems, particular attention is given to the Training and Visit (T&V) system. Much of the World Bank's investment in extension has been in the T&V system, originally in Asia and now in many African countries. T&V extension is a management system which has the flexibility to be adapted to local conditions. These guidelines are intended for use by Bank operational staff and government extension personnel. They supplement and can be used in conjunction with previous World Bank publications on T&V extension.

Why Women Farmers Need Help.

a) Women farmers operate under greater constraints than men, and hence need special help. They have less access to information, technology, land, inputs and credit. Because women have primary responsibility for the home and child care, they also have less available time and mobility. While there is much regional variation, women in rural Africa are frequently illiterate, engaged in subsistence agriculture and unfamiliar with current technology, and are often perceived by male extension agents as being "non-adopters".

b) There is a lack of awareness of these constraints. Most policy makers, managers, agents and participants in agricultural support services are males who are not directly affected by the problems and needs of women farmers, and hence are not sufficiently aware of them. A number of initiatives are needed to improve awareness. These include collecting necessary information, redesigning surveys and questionnaires, improving staff knowledge and understanding of the subject, and generating feedback on progress.

General Guidelines for Project Design.

(1) Situation specific

Given the wide variation in circumstances between and within countries, a single methodology or approach for improving extension services for women farmers is not appropriate. The approach chosen for any particular situation must be suited to that specific situation, and should be based on the socio-cultural and religious precepts of the farming community and on the institutional organization and resources of the country.

(2) Start small, focus on a few key issues, and follow with sustainable and incremental expansion from a successful base.

Large-scale, quick-acting remedies to the constraints of women farmers are not possible:

(a) financial and human resources are not normally available for comprehensive country-wide initiatives.

(b) many improvements will depend on changing attitudes -- a process which takes time, although it can be accelerated through deliberate efforts involving community leaders etc.

(c) certain changes in human capital take time. For example, increasing the number of female extension agents will require several years until training has been completed.

Consequently, it is advisable to start small and expand gradually from initiatives which have proved successful, and at a rate that the human and financial resources can absorb and sustain. This approach has been successfully adopted in Nigeria.

(3) Focus initially on testing approaches in areas with the highest potential for success

For the most efficient use of resources, begin with areas or approaches which have a high potential for success. These could, for instance, involve: (a) women's groups as the point of contact for extension; (b) pilot projects in villages with cooperative leaders or districts with supportive agricultural officers; or (c) new approaches centered round a popular radio program.

(4) Flexibility

Flexibility of design is essential when choosing situation-specific initiatives. Flexibility over time, with continual monitoring and evaluation, is also important. Successful initiatives should be expanded and tried elsewhere, and unsuccessful ones dropped or modified. To make a start, short-term measures may be chosen with the intention of modifying later to conform with long-term objectives.

(5) Participation of women in design and evaluation

The most important resource of all is the women farmers themselves. They are the people most directly involved both as those affected by the constraints and as recipients of the extension advice and support. They are best placed to define the problems, to suggest solutions and to evaluate technologies. Ways should be found to involve women in designing and evaluating the extension service, both in terms of developing an appropriate message and delivering the message effectively.

(6) Cooperation of husbands and male leaders

Men at all levels of society can have a profound effect upon the success of women's programs. At the village level, unless their support is enlisted before embarking on women's agricultural programs of any sort, men may resist programs for their wives until they see direct benefits, as happened in Malawi, for example (Evans 1989). At senior government levels, the support of departmental and regional managers is crucial to the effectiveness of programs for women farmers.

(7) An integrated extension system for all farmers

While women farmers do need special help, this must be provided through an integrated extension system. It makes no sense to have a parallel, separate system for women. This may take time, however, when there is a separate cadre of home economists or animatrices, with its own administration. A phased approach may then be needed. But all efforts should be directed to developing an integrated extension system which helps both men and women.

Suggestions for Project Components and Interventions

(1) Increase numbers of female extension agents.

Even in areas where there are no restrictions on male/female contact, communication with female farmers is generally enhanced when female extension agents (EAs) are used. To increase the number of female EAs, however, requires a long lead time and over the shorter term other means are needed. Suggested interventions are as follows:

- Increase enrollment of girls in agricultural colleges:

  - increase enrollment of girls in secondary schools. This is the factor most highly associated with female participation in intermediate agricultural training;

  - set target growth rates for women students at agricultural colleges;

  - make boarding facilities available at agricultural colleges;

  - remove irrelevant entry requirements;

  - provide common training curriculum for male and female students.

- Redeploy female agents already working with rural women. Female agents already teaching rural women subjects closely allied to agriculture can provide a quickly tapped recruitment source. Such

agents would be home economists in anglophone African countries and animatrices in francophone Africa. Once suitable agents are identified, to develop them into agricultural extension agents:

- identify gaps in their knowledge;

- provide in-service training in to fill these gaps, particularly in agricultural skills.

- Improve conditions of employment of female agents:

  - provide the same conditions of employment and same logistical support to male and female agents;

  - retain married and pregnant female agents;

  - help women meet their dual responsibilities of career and family, where possible select female agents from the area where they will serve.

(2) Improve contact and communication between male extension agents and female farmers.

Since most extension agents are and will be male, the effectiveness of their work with women farmers needs to be improved. This should be done through:

- Pre- and in-service training to enable male extension agents to work effectively with female farmers. Training should emphasize the following: diagnosis of women's agricultural activities and constraints, the organization of rural women for extension purposes, techniques for working with women farmers, and providing feedback to researchers on technology needs. After training, staff incentives to encourage male extension workers to work with women farmers should be integrated into the reward structure.

- Gender targeting, i.e., using agents of the same gender as the farmer to make the initial linkage. Using female agents initially to work with women -- particularly women's groups -- can help develop farmer confidence in the agent and familiarity with the extension system. Once this process is accomplished, the female agent introduces the group to the agent assigned to the area (who is usually male), and moves on to work with another group. This approach has had considerable success in North West Cameroon.

(3) Improve the transfer of messages

- Increase the number of female contact farmers:

  - remove selection criteria that bias against women;

- encourage leaders to advocate publicly the selection of women contact farmers;

- emphasize selection of women farmers in training sessions for extension agents.

- Increase the number of female contact groups. Women's groups, and to a lesser extent mixed groups, provide a cost-effective way of channelling and providing feedback on extension services, and offer women the means of overcoming social and educational disadvantages. Groups can be multi-functional, or can focus on a single activity: extension, credit, communal crop or livestock production, labor exchange.

- Monitor extension/farmer contacts by gender and set targets. Regular reporting with data disaggregated by gender will increase the awareness of extension agents and encourage them to address the issues of women farmers.

- Identify ways to deliver extension services to women to overcome their constraints of time, mobility and lower educational levels. Suggested approaches are:

  - mobile training courses to overcome difficulties of leaving the village or family to attend residential training;

  - use of mass media -- radio and video cassettes are promising adjuncts to face-to-face extension. They are an effective, low cost way of transmitting agricultural information to farmers, and are particularly useful with illiterates. Local dialects should be used, and radio messages should precede visits from extension agents. Videocassettes can also be useful training tools, especially for low resource farmers. Viewing by farmers' groups is particularly cost-effective.

(4) Appoint Subject Matter Specialists (SMS's) with special responsibility for rural women. SMS's can serve particularly useful functions. They can diagnose women's activities and constraints, stimulate appropriate research and technology, develop recommendations, organize women's contact groups and broaden the technical training of extension agents to cover women's activities.

(5) Improve the appropriateness of the messages and technology for women farmers. An extension system is only as good as the technology offered. To develop messages and technology to better meet the needs of women farmers in Africa, the following are recommended:

- Identify the information and technology needs of women farmers by collecting information on women's farming activities to identify the needs, constraints and objectives of women farmers. Gather such information from three main sources: baseline socioeconomic

and agricultural data, disaggregated by gender; farming systems research or similar approaches; and feedback from extension.

- Develop the linkage with the research institutions to ensure that the research agenda covers farming activities of women, and that technologies are developed to meet the needs of women farmers. The scope of the research should include crops and livestock produced by women, technologies and farming systems suitable to the circumstances of women farmers (such as alley cropping), technologies for water and fuelwood collection and use, and food processing, preservation and storage.

- Design tools and machines suitable for women. These should be portable, inexpensive, multi-functional, suited to women's size and strength, and have use patterns compatible with other activities. To the maximum extent possible, they should be produced locally.

- Improve the availability of new tools and machines, using women's groups as the channel for distribution wherever possible.

EXECUTIVE SUMMARY

An analysis of the determinants and consequences of rapid population growth in Kenya represents an encounter in contrast and paradox.

On the one hand, no country in Africa has had a longer tradition of concern about rapid population growth. Yet, the apparent record of achievement in population programming has been disappointing--at least as measured by the high annual rate of population growth approaching 4 percent. On the other hand, in spite of concerns by Kenyan and world leaders about population growth that have sometimes reached alarmist proportions, this nation has been able to accommodate a high rate of population increase, although not without considerable effort and cost.

This report examines these paradoxes not by providing yet another rendering of the impacts or potential challenges of accommodating rapid population change--such reports are readily available and would thus serve little useful purpose--but by analyzing the manner in which Kenya has confronted its unusual demographic situation. This analysis will speculate why, now a quarter of a century after Independence, Kenya's demography may be entering a new phase of declining growth rates.

Interestingly, this new phase may well be substantially caused by those very adverse impacts of rapid population growth highlighted by analysts and political leaders in the past. Indeed, "population pressures" may be naturally, and without fanfare, giving rise to a moderated pace of demographic change by reducing the benefits and raising the costs of children to the household.

It is plausible that the results of population programming in Kenya, while somewhat disappointing to date, may in fact represent a key to success in the future. For example, improved systems of health delivery and family planning, now in place, will predictably influence the pace at which population growth recedes in the coming decades. One might therefore characterize the record of population programming in the past as one of laying the groundwork with infrastructure that will reap increasing returns in the future. These programs will facilitate the powerful interactions between demographic and economic change to adjust to a new, sustainable balance between population numbers and the economy and environment.

It is uncertain how fast this adjustment will take place. That depends fundamentally on the strength of those factors motivating parents to seek smaller families. And this, in turn, depends on the interactions of population growth and the society and economy, as well as population policy and programming. This

report, which raises more questions than it answers, attempts to provide a preliminary assessment of some of these interactions in a way that lays the basis for developing both a research agenda, and some insights useful for formulating a population strategy for Kenya over the next decade.

To provide background for such an assessment, the record of population change in Kenya is examined in section 2.0. As an overlay to the demography, aspects of the way in which the Kenyan economy has performed, has accommodated, and has been influenced by rapid population growth is next presented in section 3.0. The interactions of population with the economy have been conditioned by population policies and programming. Both are summarized in section 4.0.

The development of population policies and programs requires identifying those factors giving rise to the "turning point" in fertility. Will the decline in fertility be rapid or slow? Will it be sustained, or will there be pauses of relatively constant rates of change? Unfortunately, population research on Kenya precludes the providing of even provisional answers to these questions. However, some empirical results are beginning to emerge from the recently released Demographic and Health Survey 1989 (DHS), and from an analysis of economic and social trends and events. Some of these results are presented in section 5.0. Given the limited number of observations across geographic areas (districts/provinces) in the published DHS, any conclusions based on geographic associations must be guarded, and indeed be considered as informed working hypotheses until the micro data can be examined in detail. The analysis does, however, permit the identification of some issues that require further research to arrive at a longer-run population strategy for Kenya--one that not only facilitates the pace of fertility decline in the short run, but more importantly, sustains that pace over time. (Components of a research agenda are provided in section 6.0.)

Section 7.0 provides a set of recommendations.

Population Trends

Kenyan population growth has risen steadily from an annual rate of 2.5 percent in 1948 to around 3.8 percent in the 1980s. These trends derive from an increase in the total fertility rate (TFR) from 6 to almost 8 children over this period (the crude birth rate has been high and constant at around 50 per thousand), and a steady decline in the crude death rate from 25 to around 13 per thousand. Reductions in child and general mortality, and especially in infant mortality (from 184 per thousand in 1948 to 60-80 per thousand in the late 1980s) have increased life expectancy at birth from 35 to over 56 years.

A "turning point" in population growth may be in the making. Evidence from the recent DHS shows a substantial reduction in the TFR from 7.7 in 1984 to a current figure of 6.7. Government projections (based on the higher TFR) place the Kenyan population at 35 million by the turn of the century.

A striking feature of Kenyan demography is the substantial variation in fertility and mortality by geographic area. Total fertility rates vary from a low of 4.6 in Nairobi to a high of 8.1 in Western Province; infant mortality is lowest in Rift Valley and Central (34.6 and 37.4, respectively), and highest in Coast (107.3). These figures justify caution in generalizing national experience to individual areas, as well as implementing a common format of population programming to all regions of the country. They, in addition, offer clues on the determinants of the decline in total fertility.

Economic Trends

Kenya's overall economic and social development has been quite respectable since Independence, at least as compared with the experience of other developing countries.

The record can be divided into early (1965-1980) and late (1980-1987) periods, corresponding to relatively normal growth, and a decade when most countries sustained poor performance. During the first period Kenyan per capita output grew by 2.8 percent per year, exceeding the average of Sub-Saharan Africa (2.4 percent) and South Asia (1.4 percent), although short of the impressive performance of Latin America and the Caribbean (3.5 percent). Agricultural expansion exceeded population growth by 1.3 percent; and industrial growth, while beginning from a small base, proceeded at a substantial pace (6.2 percent).

Most countries performed badly in the 1980s and Kenya was no exception. While there was a slight reduction in output per capita, this retrenchment was less than that experienced in Sub-Saharan Africa and Latin America/Caribbean. The severe drought of 1984 exacerbated the adverse impacts of the second oil crisis and the world recession on Kenya. Presently the expansion of output per capita is moderate in major producing sectors.

A driving force in Kenyan development has been high rates of accumulation, both in physical and human capital. Gross domestic investment as a share of GDP has risen from around 14 to 25 percent, and is presently one of the highest in the Third World. Most of this investment is financed from domestic saving which is around 20 percent of GDP--also high by world standards.

Kenyans have invested heavily in human (capital) development as well. The increase in the primary school enrollment ratio from 54 to 94 percent is exceptional by world standards. While

Kenya's central government expenditures on education are substantial (5.8 percent of GNP), given the manner in which education is financed through increased and now considerable "cost sharing" at the local (household) level, the total share of national output devoted to education could well exceed 10 percent.

The ability to accommodate high rates of population growth in the future will be increasingly difficult given the mounting pressures on the land and the fragile ecology in what is still a dominantly agrarian-based economy. Moreover, demographic pressures, requiring heavy investments in education and health services, as well as in job creation as the baby boom enters working ages, will necessitate structural adjustments toward an economy less dependent on agriculture. In a sense demographic pressures are not only stimulating structural changes, but importantly these pressures (e.g., the financing of education) are beginning to provide a primary mechanism causing population growth itself to decline.

Population Policies and Programs

To what extent can the recent reduction in the TFR be attributed to population policies and programs in Kenya? An answer to this question requires an assessment of the political and financial commitments, mainly to family planning.

The evolution of political statements and programs directed toward population in Kenya has been path breaking as assessed by African historical experience. However, until recently Government's programs in population have been modest in scope and intensity--the record can be characterized as a deliberate, but not a particularly dynamic progression of Government commitment and activity.

In 1984 there was a modest break in the previous, slow-paced evolution, toward a somewhat expanded involvement in population matters, as signaled in a pair of speeches by Hon. Mwai Kibaki at the Second World Population Conference in Mexico City, and President Daniel Arap Moi in his address at the first National Population Conference held in Nairobi.

Whether the recent increasingly strong political statements are now in fact translated into efficient and effective population programs remains to be seen. An examination of the financial and related resource commitments (e.g., family planning training and service delivery points) by Kenya and international donors to population programming, as well as measures of outcomes (e.g., family planning acceptors), reveals that serious government commitment to fertility reduction through active population programming began around 1987, and that the momentum is likely to be maintained for at least the next few years.

A "Turning Point" (?) in Kenyan Demographic History: Documentation, Speculations and Issues

Three questions arise in assessing the "turning point" in Kenya. First, what is the nature and plausibility of the recent turning point in fertility; are its timing and magnitude of change believable? Second, what factors appear to account for the break in fertility? While answers to this question must be speculative, they not only provide elements of a research agenda, but also provide yet another basis for assessing the turning point. If quantitatively important factors causing a reduction in fertility cannot be identified and documented, confidence in the (magnitude of the) observed downturn in fertility must be qualified. Third, what have been the roles of family planning (FP) in accounting for the fertility decline?

Several empirical findings relating to the turning point are notable.

- The reductions in the TFR between 1984 and 1989 are pervasive geographically, occurring in most provinces.
- The reductions are large by international standards.
- While increases in the contraceptive prevalence rate (CPR) *per se* account for a significant portion of the decline in the TFR, much of the decline is due to other factors (e.g., an unexplained increase in the effectiveness of contraception).
- The reductions do not appear to be as strongly correlated with changes in the "usual" socioeconomic determinants as might be expected. This suggests another major (given the size of the TFR change), common (given the pervasive spread of the TFR changes) factor or factors as possibly triggering the fertility decline. (As a group, the usual socio-economic factors are certainly antinatal in impact, serving to reinforce the emerging downward trend in fertility. A threshold model, or one positing substantial lags, may also be offered as alternative perspectives in accounting for the turning point.)

Six "unusual" factors occurring during the mid-1980s were assessed as possible candidates explaining the TFR decline. Five, while supportive, probably did not act as the primary underlying cause. They are:

- *Changes in the political environment* toward FP, the results of which did not translate into increasingly effective programming and manpower/financial commitment until very late in the period.

- *Changes in the provision of FP services*, which did not expand notably until the late 1980s. However, returns on earlier FP infrastructure did indeed partially account for observed increases in the CPR, a trend motivated in large part by shifts in demand for children.

- *The drought of 1984*, which is probably viewed as an "unusual" short-run phenomenon, and thus unlikely to have affected long-run fertility decisions.

- *AIDS*, whose potential impact on increasing the use of condoms for disease protection is not yet notable, at least in the period that could have influenced the TFR.

- *Changes in infant/child mortality* (in part resulting from the expanded immunization program), which may well have been influential in accounting for the timing of the turning point, although the evidence is shaky. (Mortality changes are more likely to exert impacts on longer-run fertility trends.)

An important factor accounting for the turning point in fertility was probably the substantial *increased costs of education* resulting from the (8-4-4) curriculum reform of 1985 and the financing of a major portion of those costs by parents in direct proportion to the number of their children in school. This format/distribution of financing is unusual by international standards, and may represent an emerging "African Model" (applicable to other public services as well) that could be important to influencing the pace and pattern of future fertility trends.

Will the downward trend in fertility continue? Yes, since several of the antinatal fertility impacts will continue to intensify over time. However, the trend could be attenuated if FP services do not continue to improve in accessibility and effectiveness, unemployment of youth results in diminished parental investments in education, and infant/child mortality rates do not continue to decline.

Several empirical findings relating to FP in Kenya are notable.

- The change in the overall rate from 17.0 in 1985 to 26.9 in 1989, while seemingly large, is not unusual at the turning point, as assessed by international experience.

- There has been some shift toward modern methods.

- The association of the TFR and the overall CPR appears to be weak, although it is fairly strong for modern methods, suggesting the relative efficiency of the latter.

- The CPR appears to be strongly associated with ideal family size and reductions in child mortality; and somewhat less with knowledge of methods, which is already quite high.

  The reduction in the "demand" for children has been large, with "ideal family size" declining from 6.3 to 4.8 children over the five-year period. This is corroborated by the percent of mothers who state "they don't want more children," which increased from 31.5% in 1984 to almost 50% in 1989.

  The reduction in demand has been widespread, even in areas that appear to be lagging in the fertility transition.

- Lagged infant/child mortality impacts on the CPR are empirically strong, as indirectly measured by the impact of immunization on the CPR. Integration of immunization and MCH with FP appears particularly promising in high-mortality areas.

Research

Providing answers to the types of questions asked in this report--in particular, explaining the turning point in fertility, ascertaining whether recent fertility trends will be sustained, and identifying how specific population policies and programs will impact on these trends--requires a reasonably detailed empirical research base. Unfortunately, the volume of high-quality policy-oriented empirical research on fertility, mortality, and family planning is insufficient to meet current programmatic requirements for project formulation and evaluation. Kenya must move to close this "research gap."

Population Strategies and Policies

Based on the results of this report and the experience of other countries, eleven areas of population programming are singled out for attention. These can be grouped into five strategies in which it is argued that Kenya should:

- Develop an IEC strategy and program that focuses not on lowering the "value" of children, but on lowering the social/psychological costs of family planning; and consider options for redirecting IEC efforts toward a major public-, or possibly private-sector program that eliminates unproductive duplication, and is sensitive to local conditions and needs.

- Improve the effectiveness and efficiency of the existing service delivery facilities and system, even if this is at the expense of some replication and expansion.

- Intensify the research program to provide timely and useful inputs to population policy and programs.

- Formulate differentiated population programs and targets specific to relatively small geographic areas (i.e., districts).

- Position NGOs to undertake a relatively larger role in service delivery and a relatively smaller role in IEC, and the public sector to shift its responsibilities primarily to coordination, financing, and possibly IEC.

Lionel Rosenblatt

Horror in Liberia

African Hospitality, American Indifference

As a veteran observer of refugees in Southeast Asia, I was prepared to see more suffering when I went to West Africa to assess conditions for Liberian refugees. Like almost all refugees, the Liberians brought little with them except tales of horror—the kind of atrocities I had not encountered since listening to accounts of Cambodian refugees who fled the murderous Khmer Rouge regime more than a decade ago.

Sometimes the terror in Liberia is random: villages burned, inhabitants massacred. Sometimes the terror is dreadfully focused, as in the instance of a young woman who told us how her brother had pleaded for her life, saying to take his instead; his captors obliged, killed him before her eyes and then let her go on to a lifetime of nightmares.

I found two things astonishing about the Liberian situation and its refugees—the hospitality of neighboring countries and the apparent willingness of the United States and the international community to tolerate continued violence in Liberia, which indiscriminately generates more dead, more wounded and more displaced.

The problem is large and growing—more than half a million Liberians have fled to the neighboring countries of Sierra Leone, Guinea and the Ivory Coast. Counting those displaced inside Liberia, half of the country is homeless, which may be the current world record for displacement.

Yet there are no refugee camps. Hospitality for those who manage to flee across the border is given by villagers in neighboring countries. To see this personal generosity is deeply moving—an extraordinary willingness of those who have little to share with those who bring nothing. In effect, the villagers were the sole international donors to Liberian refugees until the slow-moving relief machinery began to respond months after the first refugees fled.

The advantages of living in a village environment instead of confinement in a refugee camp are great. Village life permits dignity and freedom of movement, not possible in the confinement of a camp and at a much lower cost. The refugees may be poorer than those in Southeast Asia, but their daily existence is immeasurably better. It is now past time for the international community to reimburse the front-line village hosts. Yet the rice and other food now finally being distributed in these villages goes to refugees only.

An international appeal for aid to some

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200,000 villagers in Guinea to replenish their food supplies has received only scant international support. One hopes that the United States will lead the way in generating the overdue response to this appeal.

If it is time to recompense the villagers of the neighboring countries. It is also time to encourage an end to the fighting in Liberia. Even before the Gulf crisis the United

Where are the voices for a more responsive approach to Liberia?

States apparently decided to sit on the sidelines rather than seek a settlement in the Liberian civil war.

There is bitterness among the Liberian refugees toward all factions, but there especially is grief that the United States—long a special patron of Liberia's since freed slaves returned there from America—has failed to play a strong role to end hostilities. Officials in Guinea and the Ivory Coast, as well as U.S. diplomats in the two countries, believe that active U.S. intervention months ago could have saved hundreds, perhaps thousands of lives.

It is now time to put other solutions in place. Though the cease-fire engineered by Assistant Secretary of State Herman Cohen in late September lasted only days, this peacemaking attempt does show the potential for constructive U.S. involvement.

What is needed from the United States is a presidential push for a settlement in Liberia, starting with a new cease-fire. Perhaps a U.N. peacekeeping component could be added. U.N. Secretary General Javier Perez de Cuellar should appoint a high level representative immediately. But with the African group at the United Nations split, the secretary general can only move ahead with support from major powers like the United States.

Where are the voices in and out of government for a more responsive approach to Liberia? Those in Congress who follow Africa—including the Black Caucus—have been generally passive. Meanwhile, the media continue to allow the Gulf to dominate their radar screens.

While pressing for a more effective U.S. approach to the Liberian civil war, we should encourage recent, belated U.S. actions to get food to Liberia. Starvation is looming. As helpless as the Liberian refugees are, they never forget to remind a visitor of the need to get food to their brethren back home and the imperative to stop the fighting. Obstacles to increased food delivery need to be addressed: maritime carriers must be insured, the interdiction of food must be ended and the facilitation of distribution on the ground improved. These problems are soluble and the world should be doing more than watching Liberia starve.

One last problem: Why is it so difficult for those Liberians with relatives and other close ties to the United States to get non-immigrant visas? Thousands of Liberians have been granted the right to remain indefinitely in the United States until conditions improve at home. This should be extended to those close family members who arrived after July, and the State Department should instruct our embassies to interpret the visa law flexibly and humanely.

It is unconscionable that the United States and the international community are not acting more effectively on Liberia across-the-board—inside the country, along its borders and at ours.

The writer, executive director of Refugees International, recently visited Liberian refugees in Guinea and the Ivory Coast.

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THE NEW YORK TIMES, WEDNESDAY, OCTOBER 24, 1990

Mr. Bush, Liberia Needs Your Help

By Michael Massing

"It's hell here," writes a Liberian journalist from the ravaged capital of Monrovia. "The war continues to be bloodier without end despite the death of President Doe. As I am writing this note, I can see thick smoke rising from parts of the city.... Dead bodies and the skeletons of bodies that have decayed in the streets are a common sight.

"Besides the killings being committed by forces, people are dying from starvation and epidemics. People are boiling leaves and eating them just to survive. One palm kernel is sold for 25 cents or more in some places. Rice is now called 'gold dust,' and many people cannot afford to buy even a cup...."

Liberia's civil war has raged for 10 months now, but never before has the situation been so desperate. In Monrovia, where an estimated 80,000 people are stranded, many are eating leaves and nuts in an effort to survive. Children roam the streets with jars of mayonnaise, selling spoonfuls for 5 cents apiece. Of the 20,000 or more deaths that have occurred during the war, at least half are due to starvation and disease. And things are getting worse fast.

Liberia is in anarchy. Two rebel armies, plus a West African peacekeeping force and the remnants of Samuel K. Doe's army, have turned the country into one vast battlefield. Boys not yet in their teens prowl the streets with Kalashnikov automatic rifles; those too small to carry guns carry grenades. The killing, Africa Watch states in an upcoming report, has reached "near-genocidal proportions." Unfortunately, no one outside Liberia seems to care.

The indifference is particularly distressing in the case of the United States. During Mr. Doe's decade-long rule, the United States provided Liberia with about half a billion dollars, making it our largest aid recipient south of the Sahara. In 1985, when Mr. Doe blatantly stole an election, the U.S. Government gave its stamp of approval, then kept quiet as his abuses mounted. Today with Liberians murdering one another, we remain silent still.

In September, Assistant Secretary of State Herman Cohen traveled to Liberia to try and arrange a cease-fire. After meeting separately with the two rebel leaders, Prince Johnson and Charles Taylor, Mr. Cohen declared that "Both men would like to see Liberia with a truly democratic system." In fact, both men have proved themselves to be perfect tyrants. Mr. Cohen's statement shows how far out of touch the State Department is with the realities in Liberia.

Surely it's time for the White House itself to become involved. A statement from President Bush demanding an end to the conflict could help push the warring armies toward a settlement. And the U.S. should introduce a resolution before the U.N. Security Council urging a negotiated settlement in Liberia.

It should also ask Security General Javier Perez de Cuellar to send a special envoy to Liberia to meet with the contending parties and arrange a cease-fire, with free elections to follow. Having mobilized the world community so effectively in the Persian Gulf crisis, the U.S. should do no less in the case of Liberia.

Today, the rainy season is still in progress, and people are able to collect and drink rain water. Soon, however, the rains will ebb, and by November they will stop altogether, leaving Monrovia dry. At that point the number of deaths will likely soar.

"It seems like the world has forsaken Liberia, and lots of people are dying from hunger daily," a Liberian woman wrote to her husband in the United States. "I am out of money now. I am afraid, especially for our daughter. She is getting very thin. Please try to get us out of here. Please don't leave us to die...." □

Michael Massing, a journalist, visited Liberia on behalf of the Fund for Free Expression in 1985 and 1986.

LOS ANGELES TIMES

COLUMN RIGHT/
WILLIAM F. BUCKLEY JR.

The World Should Fear Bitter-Enders

■ Even as Mandela questions sanctions, there are those who seek only vengeance.

On Nov. 27, Michael Johns, the policy analyst for Third World and African affairs for the Heritage Foundation, testified before the U.N. Committee on Apartheid. He did not meet with a critical reception because Johns has for many years been a voluble critic of apartheid, so that it was not thought necessary to pass much time on the disavowalist rituals. What Johns pleaded for, and flatly predicted, was that the West would remove its sanctions against South Africa "as early as in February or March."

This would have sounded very rash, except that from inside South Africa we hear now from Nelson Mandela, widely accepted as the patron saint of economic sanctions. What Mandela is saying is that perhaps the time has come to "reconsider" their appropriateness. For him to say even that much dilutes the moral absolutism of the call to sanctions, the kind of thing that Bishop Trevor Huddleston of Britain has made his militant cause for many years.

Johns recited statistics that were not effectively challenged by the U.N. committee. He said that "combined unemployment and underemployment figures for South Africa's black majority now stand at 47%, largely because South Africa—an export-driven economy—has been denied access to many foreign markets." He then went on to cite the latest Gallup poll addressed to South Africa's black majority: Do you oppose sanctions as a means for ending apartheid? Opposed: 82%.

In South Africa today, most political forces are harnessed to move toward a general election. The exact shape of the new constitution is not yet established, but President Frederik W. de Klerk has said that it will include "a universal franchise. No domination [of one race by another], equality before an *independent judiciary*, [and] the protection of minorities as well as of individual rights."

It remains to be seen whether the Boer voters of South Africa, who are the backbone of what is left of apartheid, will feel that the new constitution will secure their lives, liberty and property. There will be heavy debate within the white community when the time comes.

This much we know, but we have not reflected on the debate that is bound to engage the black community. And that community's two principal leaders are Nelson Mandela of the African National Congress and Zulu Chief Mangosuthu Gatsha Buthelezi of the Inkatha movement. And obviously Mandela is asking himself whether he wishes to engage in a voting contest against a black leader who opposes sanctions at a time when almost one-half of the black population is unemployed or underemployed.

The events of the past year or two in South Africa have been almost as dramatic as those in Eastern Europe, and they are by no means unrelated to those events. As long as the ANC was thought by the white population and the white government to be the arm of a Soviet state systematically engaged in oppression, violence and subversion, the congress was rightly suppressed. The decision to free Mandela coincided with the conviction that the steam had run out of the communist revolution and that the ANC's continuing link to international communism was something on the order of sentimental historical formality, unrelated to any potential to do revolutionary damage. It could be said that when the wall went down in Berlin, so it did in South Africa, between the government and the primary black party of dissent.

What we have to fear is the bitter-enders who would really prefer a non-peaceful end to the South African story. Three years ago in London, Bishop Huddleston, the honorary chairman of the anti-apartheid movement, said, "I would never suggest civil war is welcome; I say it is inevitable." The hatred of apartheid and of its sponsors has not been entirely appeased by the collapse of apartheid. There is sentiment among such as Bishop Huddleston for vengeance. One way in which that vengeance could be satisfied is by a constitution that has the effect of jeopardizing the security of white-owned property. Another would seek that civil war of which the bishop spoke.

In the next months, the debate will open on sanctions. It will be interesting to see how the fundamentalists react. Will Harvard reinvest in South Africa? Will the Third World powers in the United Nations heed the revised judgment of Mandela? Or will he be branded an opportunistic Uncle Tom? Worth watching, particularly by those who do not believe that a civil war in South Africa would please anybody this side of the good bishop.

William F. Buckley Jr. is a syndicated columnist in New York.

'One way in which that vengeance could be satisfied is by a constitution that has the effect of jeopardizing the security of white-owned property.'

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THE CHRISTIAN SCIENCE MONITOR Monday, October 15, 1990

Time to Lift South Africa Sanctions

By Jerry B. Eckert

THE visit of Frederik de Klerk to the US last month places the issue of sanctions against South Africa back on the nation's policy agenda. President de Klerk has said that he doesn't expect an immediate lifting of sanctions. Yet, it is time to examine just what this continuing policy is doing to his country. With sanctions in place, South Africa faces continued constraints to its reform process. And the US is missing important opportunities to influence and assist South Africa's transition.

Four reasons suggest modifying sanctions now. The most immediate is their role in recent factional fighting that continues to interrupt progress toward negotiations. Chaos in the townships threatens to harden white attitudes toward a shared future.

One important, largely unrecognized, cause of this unrest is not political but economic. Part of the vehemence of this internecine struggle stems from stiff competition for employment. Sanctions have cost tens of thousands of blacks their jobs, pushing unemployment above 30 percent. South Africans refer to this as "the policy of making the blacks suffer until the whites give in."

Second, sanctions as a policy tool should be flexible. Sanctions are a means of forceful communication first, and iron-fisted coercion second. Flexible sanctions can convey positive signals as well as disapproval.

It is time to signal South Africa that the fundamental steps taken by both sides in the last year are welcome. De Klerk's direction is clear, even though the end result is not yet defined. Further, the process he has launched is essentially irreversible. Nelson Mandela, Chief Mangosuthu Buthelezi, and other black leaders have also taken some hard decisions that lead toward negotiations.

Both sides are entrusting their futures to a constitutional process, founded soon on a popular vote and governed by law and established institutions. For the moment, revolution has given way to politics and diplomacy. These trends are rare in Africa. Enlightened foreign policy would commend the architects.

Third, by crimping the economy, sanctions close off needed options that could let the discussions proceed with less heat. Unemployment, reduced revenues, the possibility of a recession, all constrain government's ability to meet immediate survival and welfare needs. An unnecessary urgency is created that threatens to force reforms to a premature, and thus unsustainable, conclusion.

Fourth, adjusting sanctions selectively offers a chance to assist South Africa to its ultimate destination. Different sectors of the economy have vastly different impacts on the different races. Selective repeal stressing commodities most closely linked to black employment and incomes could contribute directly to their welfare.

Laws prohibiting black ownership of capital assets and property have been repealed. Yet, their relative poverty prevents many blacks from taking advantage of this new opportunity. Relaxing prohibitions against capital inflows and investment in ways that capitalize black entrepreneurs would provide a major stimulus to the emergence of a strong black middle class.

Other opportunities exist for creative assistance through amended sanctions. The point is that South Africa's blacks need help to enter the economic and thus social mainstreams. Sanctions in their present form no longer contribute to political change. They do, however, delay the social and economic transition.

It's true that some conditions in our sanctions law yet been met. Political prisoners, they say, are still in jail. Many prisoners have been released, though, and most remaining were convicted of clearly criminal acts.

Although the Group Areas Act remains in place, it has been amended and weakened. And it is unenforced in most areas, now that the pass laws are gone. Some 2 million blacks have flooded into cities in search of jobs since the pass laws were scrapped - proof that the repressive act exists mainly on paper.

Finally, a partial state of emergency remains in Natal. Events of the last several weeks should have made the reasons for it clear. If 5,000 people had died in our cities as they have in Natal, you can bet that our government would exercise special powers to maintain order. Why should we hold South Africa to a different standard?

From a humanitarian view, removing sanctions is overdue. At last, political dynamics have evolved to the point that this law can be reconsidered.

■ *Jerry B. Eckert is professor of development economics at Colorado State University. From 1982 to 1987 he led South Africa's policy research program on income distribution and inequality.*

NEW YORK TIMES, October 15, 1990

ABROAD AT HOME
Anthony Lewis

'We Know What's At Stake'

"I believe the rights to property should be retained," Joe Slovo said. "It would be absurd for us to move into a post-apartheid society trying to eliminate the private sector, foreign investment and so on. We know that they aren't charities and they need security, they need the feeling that what they've got they're going to keep."

Joe Slovo is general secretary of the South African Communist Party and a member of the executive committee of the African National Congress. He is on a visit to New York and spoke with me about the current talks with the Government and about South Africa's future.

"Private property is not an issue," he said. "The question is whether we'll have the capacity in a new constitution to take steps to redress the inherited economic imbalances due to racism. There must be a certain degree of state intervention, which doesn't necessarily mean state ownership.

"For example, in the last 20 years four million people have been dispossessed — removed from their homes and land. There's no way we can move into the new period ignoring that racial injustice."

How can you meet the white community's desire for security, I asked, if the state takes land or other property without compensation?

"I don't believe it should take anything without compensation," Mr. Slovo said, "I really don't. The form of compensation will have to be worked out very carefully, so that there isn't an enormous flight of capital — the compensation remains within the country and is in a form which encourages reinvestment. But those things can be worked out."

Mr. Slovo said he believed in the market system and in economic incentives. But he said the black workers of South Africa have to feel they have a stake in increasing productivity, "which isn't the case today. They have a feeling of complete alienation."

Joe Slovo's vision for a new South Africa.

When it came to land, he said, there would have to be some redistribution to the black majority — who have been barred by law from owning land in 87 percent of South Africa. But that has to be done while maintaining agricultural production, and some efficient large farms would remain undivided.

In a pamphlet published last winter, "Has Socialism Failed?" Mr. Slovo said the one-party state was not a Marxist idea but a Soviet idea that failed. Was he against a one-party system in South Africa? I asked. "Absolutely," he said. "It's a recipe for tyranny."

He said there should be no issue between the A.N.C. and the Government over "political pluralism, language, culture, religion. We've said over and over again that we're quite prepared to have those freedoms irreversibly entrenched in a constitution subject to a justiciable Bill of Rights."

For years in exile Mr. Slovo was chief of staff of the armed wing of the A.N.C., Umkhonto We Sizwe. For that reason, and perhaps also because he is white, he was a particular hate figure for the Government and its supporters. (Liberals also criticized him severely as an unyielding Communist.) Now he is playing a leading role in the talks. I asked how he got along with the men on the Government side.

Government ministers, he said, occasionally try to depict him as a leader of a faction that disagrees with Nelson Mandela and does not really want peace. Just last Monday, he said, at a meeting with President de Klerk, "we reminded him" that the A.N.C.'s decision to suspend the armed struggle "came as the result of a proposal I made."

There is a "rather soured atmosphere" between the Government and the A.N.C. right now, he said, "a strain on the peace process. But I would not like to think, and I don't think, that it's reached a point of no return. Both sides know what's at stake if these talks break down."

President de Klerk feels in his mind that "there's no way back" to apartheid, Mr. Slovo said, but his belief alone does not make the process irreversible. The number of whites opposed to change is growing, "and they've got presence at every level that counts in the state apparatus: the army, the police force, the civil service. And they could still help to reverse the process."

Mr. Slovo returned to South Africa last May after 27 years in exile. What differences did he find? I asked.

"You walk down the streets in Johannesburg," he said, "the place I wouldn't say is owned by the blacks, but they walk around as if they're about to own it. Which wasn't the case when I left in 1963. There was a hangdog, submissive, slightly fearful visage in those days — but no more." □

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Key Challenges Facing South Asia

John H. Kelly, Assistant Secretary for Near Eastern and South Asian Affairs

Statement before the Subcommittee on Asian and Pacific Affairs, House Foreign Affairs Committee, Washington, DC, November 2, 1990

Thank you for this opportunity to discuss developments in South Asia at a time of change and turmoil.

Before discussing each of the South Asian countries in turn, I would like to reflect on the key challenges facing us in South Asia.

First and most important is the search for regional peace and stability. You are familiar with our efforts to reduce the risk of conflict over [the province of] Kashmir last spring. I am pleased to note that tensions between Pakistan and India have eased since that time. Both countries continue to maintain diplomatic and military contacts. We continue to urge both countries to adopt confidence-building measures, and we remain ready to work with them if they should find that helpful.

Bitterness and violence continue to plague the Kashmir Valley, however. A cycle of violence and repression has set in, retarding the ability of Indians, Kashmiris, and Pakistanis to address the underlying issues. The human rights picture is a disturbing one. The Kashmiri militants have exacerbated this situation through tactics we find repugnant. But the Indian authorities have a special responsibility not to depart from due process of law and to maintain law and order in a humane manner.

Closely related is our interest in reducing the proliferation of weapons of mass destruction. The crisis in the gulf and the high tensions last spring over Kashmir have made us and our friends in South Asia acutely aware that these weapons present a real danger, not just an abstract one. US-Soviet progress in nuclear arms control and the groundbreaking US-Soviet agreement to destroy the vast majority of chemical weapons stockpiles is another positive step toward ridding the world of potentially devastating weapons. It would be ironic if our success in reducing the arms race were accompanied by an acceleration of this wasteful competition elsewhere. We will continue to work on these issues with the countries of the region and others whose interests are strongly engaged.

As you are aware, our continuing review of the issues relating to the Pressler amendment certification for Pakistan is part of this effort. In keeping with our longstanding friendship, we expect to engage the new Pakistani government early on in discussions of these issues. Meanwhile, we have complied with the law and suspended all military assistance and new economic aid to Pakistan because of the absence of certification at the beginning of the new fiscal year.

Maintaining and advancing democracy in the region is a challenge for the countries of the region themselves but we have a strong interest in their efforts. Pakistan's recent elections arose in circumstances that strained the fragile democratic system in that country. In its preliminary assessment, the 40-member international observer team announced that it found the elections to have been generally open, orderly, and well administered. A new government should be formed shortly. Peaceful transfer between the roles of government and opposition is part of the democratic process, and we hope that the roots of democracy will continue to deepen in Pakistan.

India's government is dealing with stubborn social and political controversies that have led to tragic loss of life and to the breakup of the government coalition. India's strong democratic traditions augur well for constitutional resolutionof this crisis, but uncertain times lie ahead. Sri Lanka continues to try to maintain its democratic tradition in the face of a challenge to its national integrity by the Liberation Tigers of Tamil Eelam (LTTE). The stress has taken its toll in the form of human rights violations by both sides. Debate continues in Nepal over aspects of the new democratic constitution, which we believe will be promulgated soon.

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Opposition political activity appears to be picking up in Bangladesh. Bangladesh and Nepal continue to move toward more representative institutions, with our encouragement.

All the countries in the region face the challenge of economic development. For most, their economic difficulties are magnified by the impact of the gulf crisis and their decisions to maintain sanctions. Development assistance is an important element in our relationship with most of the countries of the region. But they will have to rely on their own efforts to evolve sound economic policies and unleash the productive power of the private sector.

Finally, and most generally, the United States faces the challenge of maintaining friendly relations throughout the region. We have sought over the years to free our ties in South Asia, and especially with India and Pakistan, from the "zero sum" mentality which suggests that strong relations with one must come at another's expense. This will continue to be our goal as we move into the post-Cold War period.

Pakistan

In recent months, Pakistan has been preoccupied with elections for the National Assembly. These were held as scheduled on October 24 with the IJI [Islami Jamhuri Ittihad] winning 105 seats and the PPP [Pakistan People's Party] winning 45 seats.

The National Democratic Institute-sponsored 40-member international observer delegation said the elections were generally open, orderly, and well-administered. They observed some flaws in the voting, which in their judgment were not of sufficient magnitude to alter the overall results. Other observer groups, including the Canadians, provided similar assessments.

Based on the information available now, the national election seems to us to have given the Pakistani people a generally fair opportunity to choose their government. It was not without flaws or controversy, but the process of dealing with irregularities and controversies is critical to a functioning democracy. We will review all available information to implement the recently enacted requirement to certify the election as condition for certain US aid.

As you are aware, charges were filed against former Prime Minister [Benazir] Bhutto and members of her government. Court proceedings have begun. We hope that the process will be marked by fairness and judicial independence.

History's final judgment of the process will take into account how complaints are dealt with and the process of accountability. We hope the government formation process will move forward peacefully and that the Pakistanis can put this difficult political period behind them and begin addressing the very serious challenges facing the country. We expect the National Assembly to be convened shortly, elect a speaker and deputy speaker, and then select a prime minister.

The United States places great value on its longstanding relationship with Pakistan. Pakistan and the United States continue to share important interests in regional peace and stability and in an honorable political settlement in Afghanistan. We also are partners in a common enterprise in trying to reverse the effects of Iraq's aggression in the gulf. Pakistan has contributed to that effort, sending over 2,000 troops and upholding the UN sanctions. We have faced challenges in our relationship before and will do so again; our aim is to build on this solid base of shared interests.

India

A year ago, India held elections which peacefully replaced the long-dominant Congress (I) Party with a minority government led by Prime Minister V. P. Singh. The new government weathered a series of domestic and foreign challenges. Since early August, violent demonstrations have swept through northern and eastern India over the government's decision to pursue a broad "affirmative action" plan, reserving about half of all government jobs for the lower castes. The drastic reduction in job opportunities for other groups has led to bitter political protest, with 63 deaths and more than 150 attempted suicides.

More recently, the Bharatiya Janata Party [BJP] withdrew its support from the governing National Front coalition. This decision resulted from a longstanding religious conflict centered on the BJP campaign to build a Hindu temple dedicated to the Hindu god Ram on a site which houses a 16th-century mosque. The government has insisted that temple construction await a decision by the Uttar Pradesh high court. The BJP insisted on beginning work on October 30. BJP leader L.K. Advani has led a month-long, 6,000-mile chariot procession through northern India to gain support for this endeavor. Singh attempted to reach a compromise but failed. Advani's arrest on October 23, intended to prevent potentially violent communal confrontation, led to the BJP withdrawal of support from Singh's coalition.

At this point, the government has neither resigned nor been asked to resign by President Venkataraman. The president has, however, called parliament into session on November 7 to test the government's strength. The next step could be formation of a new government, if one can command a parliamentary majority, or new elections.

In addition to the government crisis, unrest and violence persist in Punjab and Kashmir. We have expressed our concern about human rights abuses in both states.

In Punjab, continuing violence has taken nearly 3,500 lives so far this year and has dashed hopes for new state assembly elections. In early October, parliament extended the president's rule, which has been in effect since 1987, for an additional 6 months. No date has been set for new elections.

India's support for UN Security Council sanctions against Iraq is one example of an opportunity for convergence between Indian and US policies. We seek to continue in this direction as the world adjusts to the end of the Cold War. We place particular importance on the evolution of India's economic and trade policies, and we hope that economic liberalization policies will continue in spite of the present uncertain political environment.

Indo-Pakistani Relations

One of our key goals in South Asia is to reduce tensions and promote regional stability. The 40-year Indo-Pakistani rivalry has been a primary threat to peace in the area. Tensions over Kashmir have led to two wars, and since last December that troubled area has again been the focus of concerns.

Within Kashmir, the Indian government has had little success in establishing a political dialogue with Kashmiris. Attacks by militants against security forces often provoke retaliatory action that harms civilians.

In early October, fires destroyed hundreds of dwellings in Srinagar and surrounding areas. Jammu and Kashmir Governor Saxena has acknowledged the possibility of the security forces' responsibility for some of these blazes and promised to investigate. We expressed to the government our concern over security force excesses and the use of "collective punishment" against unarmed civilians.

Last spring, the conflict in Kashmir escalated Indo-Pakistani tensions to an alarming level. American diplomacy was actively engaged on this issue. Following the May mission to both countries by Deputy National Security Adviser Robert Gates, the two sides initiated a series of talks at the foreign secretary level designed to improve government-to-government communications and explore ways of reducing tensions.

The immediate risk of conflict between India and Pakistan has subsided, but tensions remain high. We hope that the two governments will continue their contacts through diplomatic and military channels and will institute other confidence-building measures to reduce the risk of conflict. We will continue to urge implementation of the 1988 India-Pakistan agreement prohibiting attacks on each other's nuclear facilities. Finally, we encourage both sides to discuss other ways to limit the risk of proliferation and the possibility of conflict on the subcontinent.

We intend to work with other interested parties, such as the Soviet Union and China on this issue.

Bangladesh

Bangladesh faces presidential and parliamentary elections in the next 2½ years. The opposition has not yet agreed to contest the elections, but we hope that they and the government will be able to agree on a set of arrangements which will encourage full participation. Meanwhile, at least eight people have been killed in scattered violence related to an anti-government protest movement that began October 10. We hope Bangladesh will follow the lead of the new democracies in Eastern Europe, Nicaragua, and elsewhere by leaving the past and searching in good faith for a peaceful way to make its elections free, fair, and representative.

In August, Bangladesh agreed to an IMF [International Monetary Fund] enhanced structural adjustment agreement designed to address its deteriorating macroeconomic situation. The country has made progress in privatization and liberalization of trade, but additional steps must be taken to make it competitive in the world market.

Bangladesh has been fully supportive of international efforts in the gulf. The government has sent 2,300 troops to Saudi Arabia, adhered to sanctions, and condemned Iraq despite the presence of over 100,000 of its citizens in Iraq and Kuwait. Their remittances totaled more than 40% of the country's import capital. The gulf crisis has further aggravated Bangladesh's poverty. The administration estimates the cost of the crisis to Bangladesh for the rest of 1990 at about $350-375 million.

Nepal

Nepal continues its transition to democratic government. The constitutional reforms commission presented a draft constitution to King Birendra September 10. An extensive cabinet review, which resulted in some changes, was completed on October 11. Since then, the interim government has been considering additional changes proposed by the king. Tensions in Kathmandu deepened during this third phase in the constitutional reforms process. On October 25, however, the palace announced that the constitution would be promulgated on November 9. This step will pave the way for elections, which are tentatively scheduled for spring 1991.

From the drafts we have seen, the new constitution appears to represent fundamental political change. It charters a multi-party parliamentary democracy and constitutional monarchy in place of the previous "partyless" [*panchayat*] system, which recognized the king as the sole source of political power. The constitution also guarantees many fundamental rights. We believe it is a major step forward in the process to develop democratic institutions, which are essential to a workable, thriving democratic system.

The United States has encouraged and supported Nepal's democratic transition from its beginnings last spring in Kathmandu. Through the Democratic Pluralism Initiatives program, we provided more than $800,000 in FY 1990 to support constitutional reform and the development of pluralistic democratic institutions. We will continue to offer our experience of democratic systems in whatever way the Nepalese find useful as the political transition continues.

Sri Lanka

Sri Lanka embodies one of South Asia's starkest paradoxes. On the one hand, Sri Lanka takes pride in a strong, democratic tradition and dynamic economic policies that brought a 6% annual growth rate for the first half of 1990.

But Sri Lanka's continuing separatist strife has placed strains on the political system and the economy. It also has raised troubling human rights issues. Since the revival of fighting with the LTTE last June, we estimate that over 4,700 people have been killed. The military picture is still ambiguous.

We are deeply concerned by alleged abuses by all parties to Sri Lanka's conflict—Tamil separatists, the JVP (a Maoist revolutionary group apparently subdued in 1989), and government security forces. The United States continues to insist, clearly and unequivocally, that human rights and humanitarian law must be respected by all. We have underscored this point on many occasions, including at the donor consultative group meeting in Paris on

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October 25. Other delegations, including the European Community, expressed similar concerns in their statements. Sri Lankans themselves—Sinhalese, Muslims, and Tamils—hold the key to peace and thus to a brighter future.

Afghanistan

Our efforts to lay the groundwork for a political settlement have made some progress. We are continuing our discussions with the Soviets on a transition process, which would allow the Afghan people to determine their own future. The United States and the Soviet Union believe that there should be a transition period, culminating in self-determination, to select a government for a non-aligned Afghanistan. Our principal difference with the Soviets concerns the Najibullah regime's transition role and the powers of a transition mechanism. The fundamental decisions and responsibilities for restoring peace ultimately rest with the Afghans themselves.

Within the Afghan resistance, *mujahidin* commanders have recently demonstrated increasing willingness to cooperate across party, ethnic, and religious lines. The most notable example of this trend was the October 9-13 meeting of several major commanders near the Pakistan-Afghanistan border.

Over the past month, resistance groups have increased military pressure on the government, taking the provincial capital of Tarin Kot (Oruzgan Province) in early October through a combination of military attack and induced defections. Another provincial capital, Qalat (Zabul Province), is under siege, with a small garrison holding only the town's central fort.

We welcome increased resistance unity and military effectiveness. So do the Pakistanis, as evidenced by the high-level reception given to Masood by Pakistani leaders when he visited Islamabad October 16. However, we have no favorites in the resistance, and we continue to consult closely with resistance and Pakistani leaders. ■

REMARKS BY RICHARD SOLOMON
December 5, 1990
Conference -- "Vietnam Today, Vietnam Tomorrow: Prospects for U.S. Business"
Ramada Renaissance - Techworld
Washington, D.C.

MODERATOR: I'm particularly pleased to introduce Dick Solomon, because I've known him since he was Dr. Kissinger's head senior staff member for Asian affairs on the National Security Council in the early 1970s, when relations with China were in their infancy.

He's one of the most experienced Asian analysts in this administration. He's been at the forefront of negotiations on the Cambodia issue. He's also the author of many books, including, "A Revolution is Not a Dinner Party."

It's a great pleasure for me to introduce Dr. Richard Solomon.

(Applause)

DR. SOLOMON: Good morning. I must say I'm impressed with the turnout here. We know that there is growing interest in prospects for normalization of relations with Vietnam, and in terms of our quickening diplomacy on Cambodia, this is a welcome opportunity to lay out for you the Administration's policy. That hopefully will not require the kind of historical perspective that Nick laid out for you of thousands of years of Vietnamese efforts to establish an independent position in the world, but, rather, one where, within a few years, we could see ourselves move to a new pattern of relations with Vietnam.

As my colleague Bob Manning, over here on the side, likes to point out, we live at a time when geopolitics is being shaped by geoeconomics. Economics is the name of the game now in international affairs. Particularly with the end of the virulent phase of cold war confrontation, we are all keenly aware of the fact that America's competitive economic position in the world is essential to our national vitality.

For that reason, believing in free market economics, believing in the vitality of the private sector, we believe that the American business community has a critical role to play in developing and expanding America's relations with every part of the world, in Asia probably more than most other areas, just given the economic dynamism of this region.

We also understand full well that the American business community doesn't want to be left behind in an increasingly competitive situation where, whether it be Vietnam or many other countries, we know that the French, the Australians, the British, the Dutch, and many other Asian countries, Korea, Japan, are very active in developing new markets.

One of the commitments of the Department of State is to try to facilitate American businesses' effective involvement in business dealings with every part of the world.

My friend Nick Ludlow alluded to the fact that we've been working on issues relating to the opening up of American dealings with a number of parts of Asia now for almost 20 years, and I'm going to be talking to another group before long. I'm intrigued that a number of good friends -- not only Nick, but several lawyers who are very active, have been for two decades in the China trade -- are now picking up on prospects for trade with Vietnam. And as Nick indicated, my own early experience in government involved the efforts to move beyond the period of confrontation with the People's Republic of China and establish a mutually productive relationship.

I think there are some important lessons from the experience of normalization of U.S.-China relations which are worth thinking about as we try to pursue the same process in terms of our dealings with Vietnam. And I would stress as part of that experience the need to overcome the burdensome past by building trust and confidence, to act meticulously -- a word that my former boss, Henry Kissinger, liked to use -- act meticulously to implement understandings that have been reached between the governmental authorities as they seek to advance the normalization process and in that way build a level of confidence and political support that will enable the economic relations to go forward.

In thinking about these remarks last night, it occurred to me that it took about eight years from the time of Henry Kissinger's secret trip to Beijing in the summer of 1971 to accomplish full normalization (with China) at the beginning of 1979.

As we assess prospects for normalization with Vietnam, we think the process could be carried out much more rapidly, in two years or less, if the processes that are now underway are in fact actively supported.

And so, as we look to the next several years, it is our hope that the kind of interest that you all are showing in the normalization process will be implemented in short order.

The fact is -- and I think Mr. Donovan's initial remarks pick up a theme that we also bring to this task -- we see the normalization of U.S.-Vietnamese relations as serving the interests of both sides. From the point of view of the U.S., we have important strategic, economic and humanitarian interests in Southeast Asia in general, and in Vietnam in particular. And as we pursue the normalization process, in an effort to realize these national objectives, we want to try to keep our relationship on track, even as we want to avoid false starts and the kinds of unfulfilled expectations that, unfortunately, are a part of our past efforts to normalize relations with Vietnam.

Let me lay out for you from a policy perspective how we see the normalization process developing. There are two issues at the top of our normalization agenda. The first is a just and stable settlement of the conflict in Cambodia. And second, but by no means second in terms of order of precedence, is a resolution of the fate of the nearly 2300 missing Americans from the Vietnam war period.

Without a stable settlement of the Cambodia conflict, we are likely to see continuing conflict and uncertainty in Indochina that will only perpetuate what has been an unstable and unpromising environment in this important region, a situation that would not be a good environment for investment or economic growth.

As you know, Vietnam occupied Cambodia for a decade and more beginning in 1979, a burden that clearly contributed to the economic difficulties that the country continues to face. Unless we get a stable resolution of the conflict in Cambodia, it seems to us that Vietnam, concerned about security on its western frontier, could very well be pulled back into an unstable situation in Cambodia.

And if I were a business investor, I would say, "Do I want to get heavily involved in investments in Vietnam if the overall strategic environment had not finally been stabilized?"

As far as the POW-MIA effort, from the point of view of the Administration, we have a fundamental commitment to do justice to the American families who continue to bear the emotional scars of the war period. And if there is to be the kind of domestic support that would bring about the reconciliation, both in our relations with Vietnam and within our own country, it is essential -- as General Vessey told Foreign Minister Thach when he visited Washington in the middle of October -- it is essential that we deal effectively with the POW-MIA issue to be able to lay ongoing doubts and concerns to rest.

I think you're all aware that the United States made an effort to try to normalize relations with Vietnam shortly after the ending of the war, particularly in the years 1977-78, and at that time prospects for normalization seemed high. But, unfortunately, Vietnam's demands undercut that process.

The State Department had set aside money for an embassy, and we were doing the kind of planning that we assumed within a two-year period would enable us to move ahead. But Hanoi's demands for a multi-billion-dollar reparations payment as a pre-condition for normalization, in a situation where political support in this country for such reparations just did not exist, contributed to a slowdown and eventually a stalling of that effort to normalize.

And then, at the end of 1978 and the first months of 1979, Hanoi invaded Cambodia, leading to a final freezing of that normalization process.

Now, since that time the U.S. has pursued a consistent policy in our approach to normalization through both Democratic and Republican administrations. Our basic position has been to urge Vietnam to withdraw its occupation army from Cambodia and to cooperate with the world community in achieving a just and durable political settlement of that war as the basis for moving again to establish normal economic and political relations.

We imposed an economic embargo on Vietnam, which Nick alluded to, which remains in place until we see the kind of progress, the kind of cooperation in our work with Vietnam that will lead to a resolution of this issue.

Now, we believe that our policy has been remarkably successful. Our patience has begun to pay off, in part because of the burden of Vietnam's occupation of Cambodia, and in part because of the imminent withdrawal of Soviet economic support for both Cambodia and Vietnam.

By September of last year Vietnam concluded it had to withdraw the bulk of its combat forces, although as Foreign Minister Thach conceded in New York when he met with Secretary Baker a few weeks ago, several thousand military advisors do remain in Cambodia.

But despite this legacy of the past, we are committed to try to pursue a policy of reconciliation with Vietnam, and I think there's no clearer symbol of that commitment than Secretary Baker's meeting with Foreign Minister Thach on September 29th in New York. The Secretary made very clear to Foreign Minister Thach that we are prepared to move ahead with Vietnam on normalization, but Hanoi's cooperation in achieving a Cambodian settlement and in resolving the fate of the missing Americans is essential if we are to proceed in a sustainable and politically supportable manner.

Now, the effort to bring about a solution of the Cambodia conflict is something that has just in the last year and a half developed a very rich history of its own. I don't think I need to get off into all the gory details, other than to say that it's taken probably a third of my time, but it's a commitment that we feel is very important to do justice to the people of Cambodia as well as to bring about our broader objectives in the region.

I think you're aware that the French and the Indonesians co-hosted a conference in Paris in the summer of 1989 which attempted to bring about a political settlement, an effort that unfortunately stalled because of the deep hostility among the various Cambodian factions and Vietnam.

And then last fall Secretary Baker, in the wake of the extension of the Paris conference, called for the five permanent members of the U.N. Security Council to pick up the effort to achieve a political settlement. And since the turn of this year, I've had almost a dozen meetings with my counterparts among the Permanent Five -- the Soviet Union, China, France, Great Britain and the United States -- to put together the basis for a U.N.- centered peace process that would culminate in free and fair elections in Cambodia.

Now, why have we put so much emphasis since the stalling of the Paris conference in the summer of '89 on a U.N. role? For two reasons: One, we believe that this is about the only way you're going to somehow get the fractious Cambodian parties to cooperate, and, hopefully, Vietnam as well; and, secondly, because we believe that the primary supporters of the factions in the Cambodia conflict, China and the Soviet Union, have concluded that their own national interests are served by ending their own involvement in the Cambodian conflict and distancing themselves from this ongoing sore point.

For the United States a resolution of the Cambodian conflict, while really not a matter of strategic interest, does pursue our long-term objective of seeing Southeast Asia stabilized, and it hits very close to basic human rights considerations in this country in view of the genocidal violence that tore apart Cambodian society in the late 1970s.

Just over a week ago in Paris, the U.N. Permanent Five finally brought to a conclusion the crafting of a detailed peace settlement process that now only awaits the support of Vietnam and the Cambodian parties if this settlement process is to go forward.

I must tell you, frankly, that we're concerned that Vietnam has adopted a rather ambiguous stance in regard to this U.N. settlement process. But we have made clear, and Secretary Baker did in his talk with Vietnamese Foreign Minister Thach, that we look to Vietnam to support this process if we are to lay the Cambodia issue aside and get on with the normalization process.

But despite our concerns about this ambiguity in Vietnam's position, we are nonetheless encouraged by what we believe are understandings reached last September in a summit-level meeting between Chinese and Vietnamese leaders -- dealing with their own efforts to normalize relations -- in which China, it seems, is adopting a very similar policy to our own, namely, that Sino-Vietnamese normalization can proceed as there is a settlement in Cambodia.

So we look for a serious follow-through in not only our own understandings with Vietnam, but those understandings that Vietnam and China have reached on their part as well.

I think for those of you who follow the situation at all closely, we're now at a critical point where the French and Indonesians in Paris are trying to bring together the Cambodian factions and form a leadership group that we call the Supreme National Council, which would be the embodiment of Cambodian state sovereignty during the transition period in which the United Nations would try to create a neutral political environment, a secure environment in which elections could be held to create a new and legitimate government.

And so we're at a point where, with the support of the parties concerned, we would be able to reconvene the Paris conference -- if not by the end of this month, hopefully in January -- to formalize a Cambodian settlement process and move that country, which has suffered so much over the past two decades, on the road to national reconciliation and economic reconstruction.

Now, Secretary Baker stated very clearly to Foreign Minister Thach that with the successful completion of the Paris conference -- which would mean both the U.S. and Vietnam as well as the 17 other countries who would be participating in the conference -- once we have signed the documents that were just put together in Paris, the United States is prepared to formally begin the process of U.S.-Vietnam normalization.

This is a process that we see moving in stages, with the full normalization of diplomatic relations coming when the agreement on a Cambodian settlement process had been fully implemented -- that is, with the elections held in something like a year and a half or thereabouts and the installation of a democratically-elected government in Phnom Penh.

And we also indicated that with the signing of an agreement in Paris -- which, as I say, could happen within the next two months or so -- we would begin discussions with the Government of Vietnam on the technical issues that would remain in the way of normalization: for example, the financial claims that Americans have against Vietnam, and vice versa; the mechanics of setting up an embassy; and the other aspects of a normal relationship.

Moreover, as we gain Vietnam's cooperation in that process following a settlement in Paris, the U.S. is prepared to take certain confidence-building steps as a measure of our willingness to work with Vietnam to turn the page on the sorry period of history that we hope to leave behind us and move on to a new era in Indochina.

But I should also emphasize that for us the pace and the scope of the normalization process will be influenced by Vietnam's cooperation in resolving the other essential issue between us -- that is, the fate of the POW's and the MIA's and the other humanitarian issues of importance to us.

I think I should frankly point out that in the past, those who managed the POW-MIA issue, the League of Families, those in th Pentagon who are involved in the search for remains of our servicemen, have felt that this issue has been dealt with not in a humanitarian way, but, rather, with Vietnam seeking ways of establishing political influence here.

We hope that in this new climate that lies before us, and give the new conditions facing Vietnam, that we will see the POW-MI issue dealt with expeditiously and in a humanitarian and not a manipulatively political manner.

When Foreign Minister Thach visited Washington at the beginnin of October, he fully accepted a host of proposals put forth by General Vessey, the President's Special Representative on POW-MIA issues, understandings which, if effectively implemented, would provide for rapid results in a sustainable program that would achieve the fullest possible accounting of the Americans missing from the war period.

Now, let me be explicit about what we view as progress in setting this issue aside. Vietnam could immediately turn over the remains of servicemen that are accessible to them. They could share their own historical records from the war period with us, and they could help resolve the so-called discrepancy cases of captured U.S. servicemen who did not return -- that is, where our records show a live American being sighted after let's say, his plane went down, indicating a discrepancy with the records of the Vietnamese.

And let me just say to you here today that the business community can be very helpful in this process by delivering clearly to Hanoi the message that rapid resolution of the POW-MIA issue on a humanitarian basis, as well as cooperation in achieving a Cambodian settlement, will pre-position both countries for speedy advancement of the normalization process.

And, as I say, as one looks at what has now been laid in place in terms of the Cambodia settlement process, the work that we have done with the Vietnamese for almost a decade now on the POW-MIA issue, the Orderly Departure Program, the Amerasian program, we have the basis where, within a year or two, we could see the impediments to normalization drop away and move to a new era in our relations.

But for this new era to arrive, for it to survive and to flourish, we need a durable peace in Cambodia, and we need, through resolution of POW-MIA issues, the development of strong domestic support in the U.S. We don't want to see this process go forward only to stir up all of the pain, the bad feelings left over from the war era that are embodied in the issue of our missing servicemen.

I'm convinced that the Bush Administration's policy, which is consistent with the policies of its predecessors on these issues, is consistent both with U.S. principles and with our national interests and is in the best long-range interests of the business community.

We look forward to a new era in Indochina, and for U.S. relations with Vietnam, with Cambodia and with Laos. Such a new era is only months away, we hope. And I should just conclude by saying, in the late 1970s we believe that Hanoi missed the boat on normalization. We hope that will not happen again this time.

We note that all three Indochina countries have begun economic reforms that could transform their respective societies. We want to see these three countries integrated into the dynamic region of Southeast Asia as a whole and begin to interact with the entire Pacific Basin community. The U.S. private sector is essential to achieving that goal, and we look forward to helping lay the basis for getting you all there.

So thank you very much, and I'll be glad to answer some questions.

Economics 101 for Vietnam

By SESTO E. VECCHI

Vietnam, a country newly emerging from nearly two decades of economic isolation and stagnation, is getting one crash course in economics after another.

The government first tried an experiment in agriculture — it lengthened land tenures and lowered the rice tax that farmers must pay. What was supposed to happen, did happen. Last year Vietnam became the world's third largest rice exporter, selling over 1 million tons of rice abroad, despite severe rice shortages only a few months before.

But the economics lesson isn't over yet. The Vietnamese expect rice exports in 1990 to surpass those of 1989. Even so, Vietnam's rice trade is in chaos. There are now over 100 rice exporters, mostly state-owned enterprises. Without a system of export controls, each exporter is free to set prices and they compete ferociously with each other for both suppliers and buyers.

As a result, Vietnam's rice prices are below world prices. In addition, money generated from rice sales is being channeled into high return, fast turnover consumer goods. That's one reason Ho Chi Minh City and Hanoi have become flooded with foreign alcoholic beverages, electronics equipment and other consumables. Meanwhile, there is insufficient foreign exchange to purchase adequate supplies of pesticides and fertilizers to keep the rice-fueled boom alive.

However, the Vietnamese, who appear to learn quickly from their mistakes, haven't let the situation unravel entirely. Steps are under way to limit the number of rice exporters and to license rice exports.

Agriculture is not the only sector teaching the government hard lessons about the pitfalls of economic reforms. With all the eagerness to move away from micro planning by the state, some sectors have become completely unregulated. Many bank depositors have suffered huge losses due to mismanagement or outright fraud by unregulated financial institutions.

So the government enacted a new banking law effective this month, imposing greater controls on banking activities. Because of the accelerating number of business failures, the development of a new bankruptcy law is high on Vietnam's list of priorities.

The impact of the American trade embargo on the pace of reforms also has been instructive. With the embargo in place, Vietnam remains unable to attract financing from institutional lenders. Without institutional loans, commercial banks are unwilling to breast other formidable risks.

But a rein on the pace of reform might not be all bad. As one Vietnamese businessman ventured, chaos would reign if the embargo were suddenly lifted. There is no commercial-legal structure in place. Lifting the ban without the enactment of many more laws and regulations would result in ad hoc solutions to issues with long-term policy implications, he predicted. And errant practices, once begun, would be difficult to change.

In the meantime, Vietnam's march toward a legal structure continues. Within the past year, tax, labor, banking and accounting laws and rules have been adopted. The already liberal foreign investment law has been amended. Other liberalizing amendments to the law apparently are on the way, reflecting feedback from critical foreign investors.

Reforms have posed new challenges for Vietnamese economic planners. But global political changes have presented new fiscal problems as well. Vietnam's traditional trading partners from the Soviet bloc, strapped for cash, are now demanding hard currency rather than barter trade.

As workers return to Vietnam from Eastern Europe, remittances to families in the North are drying up. Unemployment and underemployment have jumped. One estimate puts unemployment at 8 million in a population of 65 million. Under the circumstances, tax revenues remain small.

With these fiscal problems plaguing the economy, previously subsidized, state-owned enterprises are left to struggle as best they can. Many, perhaps most, will fail. Government ministries and departments now are being encouraged to set up businesses in order to subsidize their own budgets. Some also have entered into business to maintain certain political controls. This trend will probably continue.

Many Vietnamese desire to be part of the anticipated foreign investment boom. Learning Russian and German is no longer fashionable. Bookstores carry dozens of English grammar books. And the value of ideas imported over the past 20 years from countries with planned economies has diminished. Paul Samuelson's best-selling freshman text, "Economics," has been translated into Vietnamese, photocopied and widely distributed.

The U.S. economic embargo remains the most significant outside impediment to economic growth. Meanwhile, Vietnam is addressing its economic problems through a gradual conversion of its centrally planned economy to a market economy, learning lessons along the way and adjusting its plans as it gains experience.

"Not without a pre-hibernation agreement!"

Sesto E. Vecchi is a partner in Kaplan Russin Vecchi & Kirkwood, a New York law firm.

Asian Security in the 1990s: Integration in Economics; Diversity in Defense
Richard Solomon, Assistant Secretary of State for East Asian and Pacific Affairs
Address to University of California
October 30, 1990

INTRODUCTION

IT IS RARE IN HISTORY, SHORT OF A MAJOR WAR, THAT THE TECTONIC PLATES OF GLOBAL POLITICS SUDDENLY SHIFT POSITION, ENDING ONE ERA AND OPENING UP NEW POSSIBILITIES FOR A DRAMATIC REALIGNMENT OF INTERNATIONAL RELATIONSHIPS. THE LAST FEW YEARS HAVE SEEN SUCH A BREAKDOWN IN THE ALIGNMENTS OF THE COLD WAR ERA, CREATING NEW INTERNATIONAL PATTERNS AND NEW PROSPECTS FOR THE WORLD ORDER OF THE TWENTY-FIRST CENTURY.

THE PAST YEAR'S STUNNING RUSH OF EVENTS IN EUROPE -- THE EVAPORATION OF COMMUNIST REGIMES IN EASTERN EUROPE, THE COLLAPSE OF THE WARSAW PACT, THE REUNIFICATION OF GERMANY, AND NEW FORMS OF US-SOVIET COOPERATION -- REFLECTS DEVELOPMENTS DRIVEN BY TRENDS OF GLOBAL SCOPE: THE BANKRUPTCY OF COMMUNISM AS AN ECONOMIC AND POLITICAL SYSTEM; WORLD-WIDE ECONOMIC INTEGRATION SPARKED BY SPECTACULAR TECHNOLOGICAL CHANGE; AND THE WIDESPREAD MOVEMENT TOWARDS MARKET-ORIENTED ECONOMICS AND POLITICAL PLURALISM.

THESE WORLD-RESHAPING DEVELOPMENTS HAVE LED SOME TO SURMISE THAT THE END OF HISTORY, THE EMERGENCE OF A NEW INTERNATIONAL HARMONY, IS NOW UPON US. UNFORTUNATELY, THE ELATION BROUGHT ON BY THE ENDING OF THE COLD WAR HAS BEEN TEMPERED BY DARKER COUNTER-TRENDS: A RENASCENT ETHNO-NATIONALISM; AND THE RE-EMERGENCE OF REGIONAL ANTAGONISMS AND AMBITIONS LONG FROZEN IN THE TIME OF COLD WAR CONFRONTATION. THE CURRENT CRISIS IN THE PERSIAN GULF IS TEACHING US THAT THE NEW CYCLE OF HISTORY MAY BE MORE THREATENING TO INTERNATIONAL SECURITY AND ECONOMIC

PROGRESS THAN THE RELATIVE STABILITY OF THE COLD WAR STAND-OFF, EVEN IF THE RESPONSE OF THE MAJOR POWERS -- INDEED THE INTERNATIONAL COMMUNITY -- IS AN UNPRECEDENTED LEVEL OF COOPERATION.

WE ARE ENTERING AN ERA OF SOME INTRIGUING CONTRADICTIONS: POWER AMONG NATIONS IS INCREASINGLY DIFFUSE, YET NATIONS ARE MORE INTERDEPENDENT THAN EVER; ANCIENT FEUDS AND RIVALRIES ARE AGAIN BEING PLAYED OUT BY SMALLER POWERS, YET WITH THE DESTRUCTIVE POTENTIAL OF STATE-OF-THE-ART WEAPONRY. WE ARE ENTERING A WORLD IN WHICH THE INFORMATION REVOLUTION -- WITH ITS INSTANTANEOUS FLOWS OF COMMUNICATIONS AND CAPITAL ON A GLOBAL SCALE -- IS ERODING THE BOUNDARIES OF THE NATION-STATE AND COMPRESSING INTERNATIONAL INTERACTIONS IN BOTH TIME AND SPACE.

WE NOW FACE A FUTURE IN WHICH TECHNOLOGICAL AND COMMERCIAL CAPABILITIES MORE THAN MILITARY STRENGTH ARE THE SIGNIFICANT DETERMINANTS OF STATE POWER AND INFLUENCE. NATIONAL SECURITY IS EVER MORE RECKONED IN TERMS OF ECONOMIC AND ENVIRONMENTAL CONCERNS. INCREASINGLY, GEOECONOMICS IS SHAPING GEOPOLITICS.

Asian-Pacific Regional Security

Edited by June Teufel Dreyer

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Foreword

Senator Richard G. Lugar

The openness of United States markets and the forward presence of American military forces have contributed significantly to the peace and prosperity enjoyed by the countries of the Pacific Rim for many years. No vacuum of military authority has been countenanced, and thus no major threat to the territorial integrity of nation-states in the region has emerged. Over sealanes kept open without visible threats to shipping, Asian countries have increased exports to a relatively open United States market in a dynamic fashion that has contributed to their sustained economic growth. Any review of the security equation in Asia and the Pacific must begin with and underline the importance of American openness and forward presence to the fulfillment of many of the aspirations of the Pacific Rim nations over the last two decades.

The decade of the 1990s, however, will commence with both American openness and its forward military presence in the Asian-Pacific region increasingly subject to vociferous debate at home and abroad. Even as the Uruguay round of GATT lurches toward a climax in the 1990s—hopefully with progress recorded in the area of general reductions in tariff barriers or at least an explicit recognition of non-tariff barriers as a prerequisite to systematic reduction—the United States trade deficit with the rest of the world will likely remain well above $100 billion. Our cumulative external debt may well be in excess of a half-trillion dollars. These tendencies, along with the more specific but highly publicized annual trade deficit with Japan, in excess of $50 billion, and the smaller but still notable deficits with Taiwan and South Korea, have stimulated a significant alteration in the United States domestic political climate.

Occasional public opinion polls declare that Japan is perceived by a majority of Americans as more threatening than the Soviet Union. Various authors attempt to exploit a demand for comprehensive knowledge of the Japanese with tomes that describe a

trade deficits dramatically and produce severe economic crises in the economies of our trading partners.

These deficits are dangerous because they will increase pressure for American military withdrawal from the Pacific to save money.

They are dangerous because they contribute to endless disputes in Asian countries about the United States military presence and alleged United States bullying as we assert our trade interests. Many Asian politicians, business persons, students, and self-proclaimed nationalists conclude that Asia would be happier with fewer and less forward Americans.

Many South Korean students seriously contend that the United States military presence prevents peaceful reunification of North and South Korea and props up the current democratically elected government. Many Filipino politicians and intellectuals contend that "manhood" for the Philippines is impossible until the United States military withdraws from Clark and Subic Bay. Japanese businessmen speak and write about the whining excuses of an uncompetitive American business sector populated by management and workers who lack self-discipline, ambition, and adequate education.

An increasing number of Americans are fully prepared to respond in kind with enthusiastic calls for the removal of all military presence in the Asian sphere and a thoroughly emotional call for large-scale shutouts of Asian exports. To the extent that American and Asian leaders are swept along by these sentiments of withdrawal, protectionism, and mutual recrimination, security in Asia and the Pacific will decline dramatically. How ironic and tragic this would be! By all historic measurements we have erected a remarkable edifice of security and prosperity that should be envied, celebrated, and used as the foundation for improvements in the future.

For the moment, the co-development phase of the FSX aircraft agreement with Japan moves forward. It is critical that it should result in production of an aircraft that will meet the Japanese security needs in patrolling strategic straits and naval passages.

For the foreseeable future, the Soviet Pacific fleet is a threat to Japan. One need not disparage Soviet efforts to mend relations with Japan at a time of tensions in the United States–Japanese bilateral relationship in order to justify the continuing need for United States–Japanese cooperation in the naval field. A Soviet peace treaty with Japan that resolved the issue of the disputed Northern Islands would likely have little impact on Japan's security equation or its position in the Pacific. While *glasnost* and *perestroika* have had some far-reaching foreign policy implications in Eastern and Western Europe, the impacts of these reforms in the Pacific are not as clear. The Japanese are under no security illusions.

Less well understood is the delicate relationship among American military protection, the rebirth in Japan of desires to build aircraft and other military instruments independently, and the conduct of an aggressive Japanese export policy that threatens to destabilize not only Japan's relationship with its best market but also with many other trading partners vital to its economic security. For the moment, the FSX debate has served both to define some limits to the Japanese go-it-alone movement and to simultaneously rekindle discussion of the advisability of proceeding with such a policy in the future. A strategy for containing the trade imbalance is apparent neither in the United States nor in Japan, but it must be a primary goal of top leaders of both countries. In my judgment, the security relationship is in some jeopardy without resolution of the trade imbalance.

The result of the United States–Philippines base negotiations is difficult to predict, but I am hopeful that the outcome will include a continued United States military presence, a strong new surge of cooperation between the United States and the Philippines in behalf of mutual security objectives, and strong new ties with the ASEAN nations for mutual security in the area. The agreement should be for the long term and not a formula for incremental withdrawal. Already, creative United States and Filipino private-sector leaders have sketched out ways in which military and economic security needs for the Philippines might be met simultaneously in a long-term base agreement. The external debt of the Philippines and the need for substantial new capital investment could be addressed. Filipino democracy and nationalism must be carefully considered and respected.

The United States played an important role in the birth of Filipino democracy. The potential for a long and productive new friendship based upon mutual respect, admiration, and appreciation is possible, although clearly not inevitable. If Clark and Subic Bay are closed to the United States, we may have to work out substitute arrangements with other nations. The change will mark

predatory mercantilist power with a culture and ideas about democracy very different from those entertained by Americans. The debate in the United States Senate on the FSX co-production agreement with Japan lifted political passions and economic techno-nationalism to new heights and cut to the heart of the basic Japanese–United States bilateral relationship.

In other Senate debates during the 101st Congress, the United States troop commitment to South Korea has been questioned. The U.S. Congress has warmly applauded the administration of President Corazon Aquino of the Philippines while worrying aloud about some of the demands heard in the Philippine Congress regarding negotiations on the future of Clark Air Field and Subic Bay Naval Base.

Although the Soviet increase in naval and other military forces in the Pacific over the past decade has shown no signs of abatement, President Mikhail Gorbachev's suggestion in 1988 of mutual reductions in bases and forces by the United States and the Soviet Union has served to further complicate matters. Moreover, current negotiations in Vienna between members of NATO and the Warsaw Pact over reducing military personnel in the heart of Europe and the destruction of thousands of tanks, aircraft, and other "conventional" weapons have encouraged some along the Pacific Rim to call for an Asian negotiating equivalent. When coupled with an appreciation of European efforts toward greater unity and harmony in 1992, it is somewhat understandable that some political leaders in various Asian and Pacific countries are increasingly questioning the postwar economic and security order in the region.

Before such tendencies become too pronounced or are translated into policy prematurely, some of us who recognize the gains in the areas of peace and prosperity achieved by the countries of the region and, of equal importance, the foundations behind those gains, should speak out strongly and unambiguously.

And our message, delivered in unison as much as possible, must be that security in Asia and the Pacific will continue to depend for the foreseeable future on the forward presence of the American military and the openness of the American markets to exports from the region. While the validity of this observation may appear self-evident to some, it is, unfortunately, too often taken for granted.

As the Republican floor leader during the two Senate debates on the FSX aircraft co-production agreement with Japan, I mentioned a conversation that I enjoyed with Prime Minister Lee Kuan Yew of Singapore in Jaunary 1989. Lee stated that under no circumstances should the United States military presence leave Asia. His comments coincided with those of Japanese parliamentarians who reiterated the Japanese constitutional limits on the rebuilding of Japanese military power.

Lee argued that without United States military protection, Japan would be compelled to protect itself. In due course, Japan would find a manifest destiny to fill the vacuum left by American withdrawal and insist on protecting the ASEAN nations. From time to time, the nations involved may comfort themselves that the Soviet Union is withdrawing or has lost interest or that the Chinese are preoccupied with internal matters, but such diminished interest or preoccupation may not continue following United States withdrawal from a geographical region that includes China and the Soviet Union.

So strongly did Lee wish to make his point that he offered to discuss potential support for the United States Navy in Singapore and potential support for the United States Air Force in other regional circumstances. In talks with other Asian leaders in 1989, I noted a constant refrain of doubt about the physical staying power of the United States military in Asia and open speculation about the consequences of a power vacuum and about potential successors to fill that vacuum.

United States domestic political consideration of our role in Asian regional security is made increasingly difficult by a seemingly endless series of arguments on trade issues. Governments usually try to separate security issues from trade issues and to conduct negotiations in separate compartments. But average American citizens make no such separation, nor do most of their elected representatives.

I am not the only American who has explained tactfully and often to leaders in Japan, South Korea, Taiwan, Thailand, and Singapore that the trade surpluses that each of those countries continues to maintain with the United States are dangerously unsustainable, both economically and politically. They are dangerous because they may contribute toward a severe recession in the United States that will likely cut United States imports and

and expanding market-oriented global economy; of working diplomatically to help resolve dangerous regional conflicts; and of striving to reduce and perhaps eventually eliminate the danger of nuclear war. We have sought with increasing urgency over the past two decades to meet our responsibilities and achieve those goals in the Asian-Pacific region. There and elsewhere, we have acted in the belief that America's prosperous and peaceful future can only be assured in a world in which other people, too, can determine their own destiny, free of coercion or tyranny.

The prospects for such a future in the Asian-Pacific region seem brighter than at any previous time in history. Yet Americans should not blind themselves to the obstacles that may obstruct such a future.

The United States cannot meet its responsibilities or protect its interest in the Asian-Pacific region without an active yet prudent diplomacy buttressed by American economic and military power. The United States cannot be expected to devise solutions to insoluble problems in the Asian Pacific. But neither should it proceed in a half-hearted manner when there are prospects of success in the area. Wishful thinking reflective of peculiar ethnocentric tendencies and vacillating commitments born of economic pique will not protect or promote the interests of the United States in the Asian-Pacific region.

Only those leaders at home and abroad who are able to rise above such sentiments stand a reasonable chance of confronting in a constructive fashion both the challenges and opportunities—be they in the areas of balance-of-payments problems, currency realignments, base negotiations, burden-sharing, cultural diversity, or human rights—that will manifest themselves in the Asian-Pacific region during the next decade and the coming century.

Congressional Research Service

JAPAN'S EXPANDING ROLE AND INFLUENCE IN THE ASIA-PACIFIC REGION: IMPLICATIONS FOR U.S. INTERESTS AND POLICY

by Richard Cronin September 7, 1990

SUMMARY

During the 1980s Japan decisively supplanted the United States as the principal supplier of business investment, technology and economic aid in the region stretching from Pakistan to the Pacific Islands. Although the U.S. market remains the single largest source of Asia-Pacific economic dynamism, countries in the region tend to perceive the United States as increasingly protectionist and otherwise inclined towards reducing its economic, political and security role. Japan, meanwhile, is fast becoming the "core economy" of an expanding Asia-Pacific economic zone and an increasingly influential political actor.

Especially in the context of a declining sense of a Soviet military threat and rising trade friction between the United States and the Asia-Pacific countries, Japan's expanding role and influence potentially has far reaching implications. To date, the effect of Japan's economic impact has been profound, and generally has been viewed in positive terms, but some countries worry about the possibility of Japanese economic domination. Japan's cautious but deliberate efforts to expand its political role and assume regional leadership have been hampered by conflicting bureaucratic objectives, uncertainty about what role it should play and reluctance to become entangled in contentious disputes. While Asia-Pacific countries generally have welcomed and even encouraged Japanese diplomatic activism, most remain strongly opposed to a Japanese military role and some worry about the consequences of an anticipated U.S. military withdrawal.

Given these mixed trends, the future structure of economic, political and security relationships in the Asia-Pacific region remains uncertain. The most favorable scenario would have Japan shore up the current U.S.-fostered system by further opening up its economy to manufactured imports while assuming a greater share of global partnership with the United States. A second scenario would feature a closing U.S. market coupled with the pursuit of neo-mercantilist policies by Japan, heightened trade rivalry between Japan and the Asian NIEs (South Korea, Taiwan, Hong Kong and Singapore) and possibly an unstable multipower military balance. A third scenario would see the consolidation of a Japan-dominated Asia-Pacific region, with the potential for either a positive-sum successor to the postwar era of American preeminence, or an unstable negative-sum order based on an unequal economic "division of labor" between Japan and its neighbors.

Broader Japanese import liberalization, a reasonably open U.S. market and a continuing U.S. regional security role appear to provide the conditions most favorable to continued growth and stability and most likely to forestall adverse scenarios. The challenge for U.S. policymakers will be to find the right combination of economic, political and security policy initiatives to promote a smooth adjustment to Japan's growing influence, while at the same time fostering domestic economic renewal, so that the United States remains a vital and credible Asia-Pacific power.

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TRADE

Committee Links China Status To Progress on Rights

The House is expected to vote the week of Oct. 1 to put stiff human rights constraints on a future extension of normalized trade relations with China.

A bill (HR 4939) sponsored by Rep. Don J. Pease, D-Ohio, would require President Bush to certify before June 4, 1991, that China has made "significant progress" toward achieving specific human rights goals. Otherwise, he could not extend so-called most-favored-nation (MFN) trade status to China for an additional year, beginning July 1991.

The House Ways and Means Committee approved the bill by voice vote July 18. *(Weekly Report, p. 2288)*

The Pease bill is expected to pass the House easily, but its future remains in doubt. It is not certain to come to a vote in the Senate, where the Finance Committee has no plans to consider it. Even if the bill should pass the Senate, sponsors fear a presidential veto. A second bill (H J Res 647) that would cancel China's current MFN eligibility outright is highly unlikely to become law.

Ways and Means sent that bill to the House floor Sept. 25 without recommendation. The measure is expected to be voted on in tandem with the Pease bill. If it passes the House, which is uncertain, its odds in the Senate are seen as even lower than those for the Pease bill. And it faces a certain veto.

Annual Waivers

MFN status for China is crucial both for China's economy and for U.S. businesses that have found markets or opened plants in that country in recent years. China is the United States' 10th largest trading partner. Among other things, MFN grants China the same low tariffs on exports to the United States that are enjoyed by most other countries.

Without MFN, the domestic price for imported Chinese-made goods — including large quantities of toys, clothing and electronics goods — could nearly double under higher duties. A loss of MFN presumably would also lead China to stop buying from U.S. manufacturers. China shipped $12 billion worth of goods to the United States in 1989 and purchased goods worth about half that. *(Background, Weekly Report, p. 1773)*

The United States first granted MFN status to China in 1980 and has renewed it annually since then.

Because of their emigration policies, many communist and former communist countries are not eligible for MFN. Although there have long been complaints about China's emigration policy, it routinely has been granted annual waivers of MFN restrictions contained in the so-called Jackson-Vanik provisions of the 1974 Trade Act.

The current controversy over China's trade status dates to that government's crackdown on a fledgling pro-democracy movement in 1989, symbolized by tanks that rolled through Beijing's Tiananmen Square on June 3 and 4.

"China's emigration policy has never been free and open, and it has been even more restrictive since last year's Tiananmen Square massacre," objected Ways and Means member Richard T. Schulze, R-Pa.

Schulze and others support the joint resolution that would cancel MFN immediately in order to bring stiff pressure on China to change its human rights policies. They say they want a vote even if the resolution is ultimately vetoed and that veto is sustained.

"At least the Chinese government will understand that the ground it stands on with the American people is extremely shaky," Schulze said.

Pease and his allies say that ending MFN precipitously would be counterproductive and that demanding specific improvements before MFN could be renewed in 1991 would be sufficient pressure on the Chinese government.

Beyond economic considerations, the administration is also concerned because China is a member of the U.N. Security Council and has been supportive of the U.S. position on sanctions against Iraq in the current Persian Gulf crisis.

By John R. Cranford

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RURAL ENTERPRISES IN CHINA TO ADOPT NEW TECHNOLOGIES

WASHINGTON, December 6, 1990 -- Rural enterprises in China will get a boost from a program to help these firms adopt new technologies and management systems. The program is being supported by a $50 million loan from the World Bank and a credit of SDR 45.1 million ($64.3 million) from the International Development Association (IDA), the Bank's affiliate that lends on concessional terms to the poorest countries.

"Township and village enterprises (TVEs)"--many of which are owned by community organizations--account for about one-fourth of China's industrial production, and over the past decade their output and employment have grown much faster than those of the state firms. However, they frequently lack access to the skills and technologies they need to raise their efficiency and improve the quality of their products.

The program will make credit available to selected TVEs in Jiangsu and Jilin provinces and Shanghai Municipality to help them acquire technologies that will boost their productivity.

The program includes support for training of managers and technicians in the rural industries to help them streamline their operations and make them more profitable. Expert advisory services will also be provided to several government agencies in charge of technology diffusion to help them carry out the program and strengthen the system for lending to rural enterprises.

The World Bank loan is for 20 years, including five years of grace, with a variable interest rate, currently 7.72 percent, linked to the cost of the Bank's borrowings. It also carries an annual commitment charge of 0.25 percent on the undisbursed balance.

The IDA credit is for 35 years, including 10 years of grace; it carries no interest, but has an annual charge of 0.75 percent on the disbursed balance and a variable charge of up to 0.5 percent (currently zero percent) on the undisbursed balance.

Note: Money figures are in U.S. dollar equivalents. IDA credits are denominated in SDRs (Special Drawing Rights), which are valued on the basis of a "basket" of currencies. The U.S. dollar equivalent of the SDR amount of the IDA credit reflects the exchange rates existing at the time of the negotiation of the credit.

Executive Summary

Introduction

i. The purpose of this report is to review recent economic developments, including the progress of the medium-term (1989-91) stabilization program being implemented by the authorities since late 1988, and to discuss options for China's future development strategy. The report also analyzes the economic reforms initiated in late 1978.

Background

ii. Over the last decade, China's GDP growth rate has averaged 9.5 percent per annum. Investment was high throughout (averaging 31 percent of GDP during the early 1980s and 38 percent of GDP since 1985) and was matched by a strong savings performance, which contained the need for external borrowing. Industrial modernization increased the competitiveness of China's manufactures in the international market and merchandise exports grew from $18.3 billion in 1980 to $52.5 billion in 1989. China's share of international trade rose from 0.97 percent to 1.7 percent during the same period. The average incomes of the 800 million rural population more than doubled and absolute poverty receded nationwide. In 1988, some 13 percent of rural households fell below the poverty line, compared with 17 percent in 1981. Infant and child mortality declined, the rate of population growth was slowed and universal education of five years was achieved.

iii. Economic system and management reforms introduced incrementally after a period of regional experimentation have played a major role in these achievements. They have served to magnify the growth impulse derived from China's high rate of capital accumulation based on domestic savings. The major areas of reform can be summarized as follows:

- farmers and nonagricultural (industrial, commercial, transport) enterprises now have greater freedom to determine the composition and pricing of output, to retain profits and decide on the disposition of retained earnings;

- administrative decentralization has transferred more of the authority to plan and manage economic activity from the central government to provincial and local bodies, better informed about the local situation and strongly motivated to promote development;

- central control over the economy has been scaled back by reducing the number of commodities and the volume of production subject to mandatory plan targets, and the share of key products distributed through state controlled channels;

- although China remains an economy where public ownership is dominant, the government has permitted other forms of ownership (e.g., private, cooperative, foreign joint venture, etc.) and supported these with the necessary regulations and constitutional amendments.

- resources previously annexed by the state have been transferred to enterprises and rural producers and this, together with a degree of fiscal decentralization, has given provincial authorities more discretion in taxation and expenditures;

- product markets have been created, first in the rural areas and then extended to the urban sector, which allow producers to trade their above plan output at freely determined prices;

- financial reforms have dismantled the old monobanking system and increased the variety of financial institutions, as well as the volume and scope of financial transactions and instruments. The pronounced shift away from budgetary support of investment has reinforced the importance of the financial sector in mobilizing and allocating resources;

- external trade, now equivalent to over a quarter of GDP, has opened up the economy significantly, and, in parallel, there has been greater readiness to seek direct foreign investment in a range of manufacturing and service industries. The creation of several Special Economic Zones, with adequate infrastructure, legislation governing foreign investment and the steady elaboration of laws defining the rights of overseas businesses operating in China, have helped attract a large volume of foreign capital.

iv. The attempts at transforming such a complex economy in fairly short span of time have inevitably resulted in macroeconomic as well as institutional imbalances. During the course of the 1980s, China experienced three cycles in economic activity of increasing severity. This instability, which appears to be associated with the transition from a centrally planned system to one where plan and market are more evenly balanced, has at least three sources. First, the lag between administrative decentralization and the creation of an institutionalized capacity for macromanagement, gave rise to excessive monetary expansion that stoked inflation. Second, multiple pricing, that has evolved with the emergence of free markets alongside the planned system, leads, at times, to additional distortions; it reinforces the propensity towards negotiating prices, taxes, and input allocations; the possibilities for corruption multiply; and enterprises are sheltered from the full force of competition by bureaucratic connections, that provide intermediate goods on terms guaranteeing high returns. Third, because of slow progress towards nationally integrated and competitive markets that would supplement the now attenuated planning mechanism as a source of discipline, decentralized industrial management has permitted provincial bureaucracies to push ahead with unsustainable rates of expansion. Only a fraction of enterprises, almost exclusively in the township and village enterprise (TVE) sector, are financially autonomous. As yet China has been unable to enforce financial accountability on the state and collective enterprises. Closely related to this is the problems posed by the exit of firms through bankruptcy. Closure of state or collectively owned enterprises has been resisted because it leads to unemployment and a loss of productive assets. As a consequence, the effects of market forces to rationalize capacity or achieve efficient resource allocation has so far been blunted. A social security system and some separation of ownership from management, that could dissuade local authorities from becoming

too involved in the operations of the enterprise sector would ameliorate th difficulties. However, the development of national welfare system and of a institution such as joint stock ownership is a slow process. Trials have b conducted but full scale operation is still some years away.

Economic Developments in 1988/89

It was against this background of partial reforms that demand pres sures became pronounced in the first half of 1988, pushing the economy to t limits of its productive capacity. When, under these overheated conditions the authorities announced in June 1988, plans for a major price reform to b implemented in 1989, inflation worsened as consumers switched in some panic from financial into real assets. Prices that had been rising at annualized rates of 10-15 percent in early 1988 soared to rates approaching 80 percent on an annualized basis, by August. Faced with this crisis, the government postponed further price liberalization and, in late 1988, adopted a series stabilization measures.

vi. First, the authorities introduced administrative guidelines to red state investment in 1989 by 20 percent and to cancel or defer a large numbe of projects in low priority sectors such as service, office construction a processing industries. By the end of 1988, 14,000 construction projects wi a planned investment of almost Y 50 billion had been cancelled. While thi amounted to only 4 percent of the total volume of construction then in prog ress, the impact of the controls on investment became more apparent in earl 1989. The value of new projects begun in 1989 declined by 80 percent compa to the previous year.

vii. Second, a contractionary monetary policy, relying principally on t administrative allocation of credit, was imposed. The Central Bank set a target of 15 percent for the growth of credit in 1989 and began stringently monitoring changes in credit supply on a weekly basis. Conventional moneta instruments reinforced credit controls. Reserve ratios were raised from 12 percent to 13 percent for banks, up to 30 percent for nonbank institutions; rediscount policies were tightened; the redeposit obligations of specialized banks increased; and both deposit as well as lending rates were pushed up by percent and 3 percent respectively, with savings deposits of three years and more being indexed.

viii. Third, direct controls on prices and marketing were stiffened begin ning in late 1988. Numerous regulations, generally ignored during recent years, were applied, albeit with varying degrees of effectiveness in differe cities and regions of the country; and local governments were required to notify the central authorities whenever they raised prices for a range of daily necessities and certain raw materials. Finally, the credit squeeze wa used to leverage incomes policies with the result that the wage bill of the urban formal sector remained unchanged until the last quarter of 1989, when some wage increases were permitted.

ix. These measures have reduced the rate of inflation significantly, fr an annualized rate of 26 percent in December 1988 to less than 1 percent (on monthly annualized basis) in the first quarter of 1990. They have checked t growth of labor earnings and, for the time being at least, alleviated cost

push pressures. In addition, the steps taken plus curbs on imports of consumer goods have reversed the trade imbalance. After rising in the first two quarters, the trade deficit stabilized at about $6.7 billion in the third quarter of 1989 and a quickening of exports lowered the deficit to $6.6 billion by the year's end. Exports rose 15.4 percent in the first half of 1990, while imports were 17.7 percent lower. As a result, China registered a trade surplus of $4.54 billion. There was a marked slackening in the rate of industrial growth throughout 1989, which became negative in the last quarter. By the first quarter of 1990, industrial output had regained lost ground and was at about the same level as a year earlier. It rose more rapidly in the second quarter and, for the first six months of 1990, registered a growth of 2.2 percent. Urban unemployment worsened somewhat, rising to 2.7 percent by the end of 1989. Initially, much of the shock was absorbed by the large transient population of rural migrants, many of whom have returned to the countryside. But the persistence of slow growth in the first half of 1990 pushed the unemployment rate to over 3.5 percent.

x. The imbalances that developed in 1987/88 and the stabilization measures that have been applied during 1988-90 have brought into sharper focus both the strengths and weaknesses of China's economy. At this juncture, it appears that the latent dynamism of its productive sectors will enable the economy to continue growing during the 1990s at rates (once the contractionary policy is eased) that would be considered very respectable in most other countries. Neither the resource needs for investment nor the prerequisites for external borrowing, are likely to become major constraints.

Economic Consequences of the Events of June 1989

xi. The apparent short-term implications of the events of June 1989 are somewhat slower growth rate; smaller trade and current deficits; greater unemployment; the possibility that certain reforms will be postponed for a longer period of time than was apparent in May 1989; partial withdrawal of investors from OECD countries; a fall in tourist traffic from Western countries which has also forced a rescheduling of various hotel loans; and greatly reduced access to the international capital market, which is now compelling China to seek trade and current account surpluses to manage its external transactions. However, there are signs that some of the adverse developments in the period immediately following the events of June 1989 are being reversed: tourist arrivals are on the rise; there is renewed interest on the part of foreign investors; and industrial activity is starting to pick up.

The Fifth Plenum of the Thirteenth Party Congress and Medium-Term Plans

xii. In November 1989, the Fifth Plenum of the Thirteenth Party Congress declared the government's intention to concentrate during the next two years on stabilization; on restoring growth; and on correcting deficiencies that have become apparent in reform of macromanagement and pricing.

xiii. The Fifth Plenum's call for some augmentation of the center's authority, particularly in selected areas of macroeconomic management, is a prudent one and could enlarge the role of indirect instruments, that can be employed more flexibly than administrative measures. The decision to abolish dual pricing for major items such as transport and petroleum and move towards a

unified price system, will also be a positive step, provided that it leads to a more basic liberalization of prices rather than a return to administered prices and central allocation. However, although the Fifth Plenum identified the two major areas of reform, it was not explicit about their content, phasing or direction as considerable uncertainty persisted at that time regarding the degree to which macrostability had been regained. Now that inflation has been reduced, the most urgent task facing the government is to prepare an agenda of actions that will establish a sound basis: for strengthening macroeconomic policies and institutions to prevent a recurrence of demand and price pressures; and for advancing towards the next stage of price and market liberalization.

xiv. The modernization of China's institutions for macromanagement will require initiatives in the areas of fiscal, monetary and exchange rate policies. For example, budgetary discipline could be enhanced if all current and capital expenditures are matched by clearly defined sources of funds. The focus of monetary control could be shifted more towards controlling base money using reserve ratios, rediscount rates, and open market operations. Interest rates might be used more extensively to regulate aggregate demand within the context of meaningful budget constraints on enterprises. As financial markets are broadened, there may also be greater opportunity for open market operations. Finally, there still is considerable room for introducing market forces into the allocation of foreign exchange.

xv. As long as the authorities are able to sustain a macropolicy that will keep inflation at bay, it would be important, during 1990, to resume the selective decontrol of prices. In mid-1989, procurement prices for grain were adjusted, followed by railway and airline fares in the fourth quarter, and freight tariffs in March 1990. As the severity of deflation has brought market prices of several commodities, such as rubber and cement, very close to state fixed prices, decontrol of some of these could be relatively painless. During the course of 1990, the government intends raising the procurement prices of sugar, cotton and oilseeds. Parallel to price reform, it is equally necessary to proceed with a gradual dismantling of quantitative allocation. In 1989, the list of commodities distributed by the state was augmented slightly and the share of coal output passing though state channels is to be raised. While the chaotic market conditions of 1988 might have made the enhancement of quantitative controls unavoidable, with the return of normalcy, the justification for such measures is less obvious.

Economic Prospects and Creditworthiness

xvi. To avoid a worsening of open unemployment (disguised unemployment is of course far greater), the government has begun injecting more credit into the economy while remaining within its tight annual credit ceiling of Y 180 billion. Instead of releasing most of the credit in the second half of the year, in conformity with past pattern, more has been provided at an earlier stage so as to pull the economy out of the doldrums. As production accelerates by the third quarter (once inventories begin to be run down), it might be possible to achieve 3-4 percent growth for the year as a whole. This assumes that the austere macroeconomic policy is kept in place. The delayed effects of devaluation and proposed price adjustments could result in inflation of as

much as 10 percent but much will depend on the degree to which monetary expansion is used to revive the economy in the second half of 1990. China had accumulated a trade surplus of $4.54 billion by mid-1990 and current trends point towards modest trade and current account surpluses for the year as a whole.

xvii. The government's intention is to achieve a growth rate of 6 percent per annum growth in the next 2-3 years. At that rate of expansion China should be able to enjoy single digit inflation (depending on the extent of annual price adjustment) and assuming that savings performance is not allowed to flag, modest current account deficits. Of course the management of external accounts is likely to be guided by conditions prevailing in international capital markets.

xviii. The official estimate for the debt outstanding at the end of 1989 is $41.3 billion and the debt service ratio is about 9 percent. Currency and gold reserves were equal to $18.5 billion or about 3.5 months of imports (using customs data). These had risen to nearly $25 billion by end-April 1990 (equal to six months of imports according to trends in 1990). Past trends and the current assessment suggest that the country's growth as well as export potential are substantial and savings behavior is likely to remain stable. Projections based on reasonable assumptions regarding macropolicies and the continuation of reform show creditworthiness remaining secure over the forecasting period 1990-95. Even the low case scenario, which assumes diminished growth and export prospects but a firm management of imports, does not materially alter the creditworthiness picture.

Growth and Reform in the Medium Term and Long Term

xix. To raise efficiency and maintain the moderate growth rates that are being sought over the course of the Eighth Five-Year Plan (1991-96) and beyond, policy actions will be needed in several areas, including the following.

Macropolicy Management

- The ability to conduct effective monetary and fiscal policies will be crucial to the success of future reform efforts, because they will exert a major influence on price stability, domestic savings, the volume of investment and the external balance. Further institutional changes might be needed to enhance the capacity of central agencies to implement policies. The authorities will also need to refine indirect macro instruments, as well as develop financial markets so as to maximize the effects of monetary measures.

Government Finances

- In recent years, the government's capacity to raise revenues from industry (the principal source) has been substantially reduced by enterprise contracting arrangements that have permitted firms to retain more of their profits. As a result, the revenue/GNP ratio has

fallen below 20 percent; this has been accompanied by an almost parallel decline in expenditures and the budget deficit (a little over 2 percent of GNP) has been approximately constant for the past few years. Given the high rate of savings in the economy, financing the budget deficit through the issue of bonds should not pose serious difficulty, but eliminating it altogether is a superior remedy. Nevertheless, if the government's share of revenues continues sliding, flexibility in financing its development activities, such as education and transport, might be reduced. Stabilizing revenues over the medium run, through a broadening of indirect taxes and the separation of taxation from enterprise contracting, may be the appropriate step. However, major new taxes, as distinct from a refinement and strengthening of existing taxes, are probably unnecessary. While the government must tailor its tax efforts to its long term expenditure needs, and financing of most investment might best be left to the financial markets and enterprises themselves, there remains a major role for the budget, especially for the key infrastructure sectors.

Price and Market Reform

- Price reform and the creation of competitive markets continues to be fundamental to the improvement of resource allocation in China. As some phasing may be warranted to spare the economy the shock from sudden decontrol, a plan of action, including priorities and a timetable, for price liberalization remains critical for future reforms. Chapter 4 of the report offers suggestions regarding the decontrol of agricultural procurement prices, retail food prices, and prices of industrial materials. While the government is right to be concerned about the effects of inflation, and the distributional consequences for particular population groups, there are reasons to believe that, in an environment, where there is considerable slack, inflation need not gather momentum and there is scope for temporarily ameliorating distributional effects.

Trade Reform

- The opening of China's economy to the international market is a reform that rivals the transformation of agriculture. In 1989, trade amounted to nearly 28 percent of GNP as against 14 percent in 1981. While industrial modernization and direct foreign investment have certainly contributed, the effective use of Foreign Trade Corporations (FTCs) to market products, arrangements that allow enterprises to retain a portion of the foreign exchange earned, and Foreign Exchange Adjustment Centers (FEACs) have been as important. External trade remains a vital element in China's development and the reforms already introduced need refinement. For instance, better access to credit for exporters would be a potent stimulus and trading rights should be extended to more producing enterprises, providing the latter are guided by strictly supervised rules so as to avoid the delivery, quality control, pricing and other problems that emerged after the creation of decentralized FTCs in 1988. In addition, there are gains to be had from substituting tariffs for quotas and licensing;

from introducing simplified procedures for providing exporters' drawbacks on indirect taxes; and, last but not least, from an exchange rate policy that maintains China's competitiveness.

Private Direct Foreign Investment

- The pledged value of foreign direct investment amounted to $34 billion at the end of 1989, of which $15.4 billion had actually been disbursed. Although disbursements rose by 4 percent in 1989 to $3.3 billion, the number of applications fell after the events in June and, unless the earlier momentum is regained, could affect flows a few years into the future. Foreign investors have made a major contribution to the development of services, oil exploration and export-oriented manufacturing industries. It is important for China's economic modernization that such capital flows be maintained. To revive interest among overseas investors, the authorities have begun leasing land for development purposes in the "open cities" and Special Economic Zones. These leases run to 70 years. The government has also modified the law on Sino-foreign equity joint ventures so as to enhance incentives. However, there remain certain areas that still require attention: for instance, the time-consuming negotiations that precede any agreement; the high charges for land use, energy and infrastructure; and difficulties with the enforcement of contracts linked to the state of China's legal system.

Industry and Enterprise Reform

- The next stage of enterprise reform is to make firms autonomous so that market competition, dynamic entrepreneurship and price-guided allocation can flourish. Much progress has been made, but neither enterprise managers nor their employees closely follow profit and efficiency maximizing rules that firms operating in a market environment would observe. A wider spectrum of ownership could be a solution to the existing difficulties. It would give enterprises the autonomy needed if market discipline, which requires exit as well as entry, is to have its therapeutic effect and it would insulate firms from the demands of local authorities. If enterprise accountability and the prospect of state enterprise being permitted to go bankrupt are to be realized, a dependable social security system will have to be put in place. In the publicly owned sector, joint-stock systems that spread ownership over a number of publicly owned and collective entities, could assist in the separation of management and ownership of these enterprises and promote further efficiency gains. In the foreseeable future, the change in ownership structure and the emergence of market competition might be pursued through policies that stimulate the nonpublicly owned sector, specifically township and village enterprises (TVEs), which have provided important momentum to growth over the past six years. Furthermore, efficiency would be enhanced if this sector were permitted to compete freely with the publicly owned sector.

- Through a combination of a more neutral policy regime and guidance by market signals, China might shift the emphasis away from expansion

(as distinct from the technological upgrading) of heavy machinery metallurgical and traditional engineering industries towards manufacturing sectors richer in linkages as well as in technological possibilities, for example, transport and electronics. Service industries might also receive more attention because they contribute importantly to overall growth, employment and industrial productivity.

- Technological improvement is as critical as investment in determining growth. Attention to coordinated and commercially oriented R&D activities should have considerable priority. While China's own research endeavors may be decisive over the longer term, foreign direct investment, patent licensing and other arrangements might be of greater significance in the medium run.

Agriculture

- A modern and productive agriculture is both capital and energy intensive. China's resources of cultivable land being fully utilized, a steadily rising output will require ever greater farming intensity and significant additional investment in irrigation, as well as the manufacture of fertilizers and farm machinery. This will only be possible if, over time, there is some additional transfer of resources to agriculture; the use of agricultural land and other assets is rendered more efficient through the trading of land leases; there are improvements in the area of distribution; and increased efficiency in the functioning of factor markets. The scale of intersectoral resource transfers will depend upon the composition of the agricultural output that is sought and the desired degree of self-sufficiency. China needs a food policy for the long term which sets realistic targets for grain, meat and cash crop production and then backs these with pricing policies to engineer the necessary movement in resources. As the amounts involved will be large and the implications for other sectors far reaching, the food strategy merits close attention.

Infrastructure

- Water management, energy and transport facilities have long lead times and planning for capacity must occur well in advance of needs. Complaints about inadequate infrastructure facilities have periodically forced the government to attempt to redirect resources to the development of public overhead capital. This is disruptive for other sectors and steps need to be taken to rationalize infrastructure investment planning, to ensure its financing, and to develop more appropriate pricing policies for the public services provided. For intermediate raw materials, by contrast, moderate but stable growth rates in the 6-7 percent range, together with price reforms that generate the needed supply response, would facilitate better resource allocation at all levels; industry will have less reason to complain about input bottlenecks; and government programs to redeploy capital to key industries by administrative fiat can be avoided.

xx. Priorities for the nineties include strategies for sectoral development, price liberalization and further progress with ownership reform. The first will have a major influence on growth of the real economy, whereas the latter two will determine the gains in efficiency and stability to be derived from the market system. If the balance between planning and reliance on market could be shifted towards the latter--this could be done even with assets remaining largely in public hands--the problems arising from decentralized administration could be lessened, and the government would be able to pursue firm macroeconomic policies.

American Enterprise Institute for Public Policy Research

Slaughter of the Innocents: Coercive Birth Control in China

By John S. Aird

This volume presents detailed evidence that the Chinese family planning program relies on coercive measures to secure compliance by a largely reluctant population and that the coerciveness of the program has been escalating since 1986. Following is a summary of the book's major findings.

The Coercion Controversy

Foreign apologists for the Chinese family planning program insist that the program is a voluntary one or that it is becoming progressively less coercive. There is ample evidence, however, that coercion has been an important aspect of the program at least since the early 1970s and that the central demands that result in coercion at the local level have been escalating since 1986. These conclusions have implications not only for U.S. funding for the United Nations Population Fund (UNPF) for human rights in China, but also for the credibility of family planning organizations that maintain ties with the Chinese program despite their claim to support only voluntary family planning.

From the founding of the People's Republic of China, its leaders have seldom allowed considerations of human rights to stand in the way of their policies. Faced with popular opposition, they have often resorted to mass arrests, imprisonment, torture, and execution. The Tienanmen slaughter has forced the outside world finally to recognize the kind of brutality of which the Chinese leaders are capable.

Until June 1989 foreign criticisms of human rights violations in China were remarkably few. The physicist Fang Lizhi, a leading Chinese dissident, has pointed out that U.S. foreign policy does not hold China to the same human rights standards as it does other countries. The same charge applies to many other governments that have accorded China special indulgence. In the mid-1980s Deng Xiaoping allegedly said that foreigners cared only about China's stability, not about its human rights record. The reaction of many foreign governments and international organizations to China's coercive family planning program fully justifies his cynicism.

Many family planning advocates have a conflict of interest regarding China. Those who have identified themselves with the Chinese program, like the UNPF and the International Planned Parenthood Federation, risk a loss of public support if they now acknowledge that the program is coercive. Therefore many ignore or deny the coerciveness of the program; some even disseminate misleading Chinese propaganda about it. In May

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1989 Nafis Sadik, the current executive director of the UNPF, said in a speech in Washington that the Chinese program was "totally voluntary."

Some demographers who write about China hesitate to mention the coerciveness of the Chinese program in public for fear of losing access to demographic data, contacts with colleagues, and opportunities to carry out research in China. Others, accepting the notion that population growth constitutes a worldwide crisis, tend to take a tolerant view of the program.

The dramatic idea of a crisis has a superficial plausibility. It ascribes many of the world's ills—including poverty, hunger, and health problems—to a single factor, prescribes a single remedy, and invests the combination with a sense of great certitude. It is the sort of cause that inspires zeal. But there is no sound basis for assuming that a coercive birth control program does less damage than continuing population growth to human welfare, and there is no justification for the extreme measures used in China.

Despite Chinese and foreign denials, the evidence on coercion is overwhelming. It is not simply a matter of interpretation. The evidence comes mainly from Chinese documentary sources, official directives, statements by political leaders, and hortatory articles in the Chinese media. The published record is often vague or deliberately distorted, especially in communications addressed to foreign audiences, but there is not much room for doubt about what the evidence shows.

When Chinese authorities deny that their program is coercive, they seem to be using an extremely narrow definition of coercion: physical force without propaganda accompaniment to give it the superficial appearance of "persuasion." But specific practices condemned as coercive in one year have often been approved and encouraged the following year. When a measure the central authorities have approved arouses strong antagonism among the people, they usually disclaim responsibility for it and ascribe it to a lack of "understanding" by grass-roots cadres, but they also acclaim the gains in family planning work that resulted from the measure.

Since the early 1970s the Chinese media have given evidence that popular resistance to birth control is widespread and persistent. Without strong government pressure, birth control does not advance, and any relaxation results in an upsurge in births as married couples hasten to have another child before the next crackdown. In the 1980s the enforcement of birth control was weakened several times by new central policies adopted for other purposes that incidentally made family planning work more difficult to carry out. The virtual dissolution of the communes in 1981 made it harder for the cadres to monitor pregnancies and to impose penalties for noncompliance. When Deng Xiaoping proclaimed the policy of allowing peasants to become "wealthy" through their own enterprise as a stimulus to economic development, some families found that they could afford to pay the fines for unauthorized children and proceeded to have more. In recent years the authorities have been trying to compensate for the lost control by devising a national "family planning management system" linking the central authorities with the grass roots and bringing all childbearing under firm government control: the system has not yet been perfected.

Official Policies on Birth Control, 1949–1983

The People's Republic of China was a late convert to the belief that population growth needed to be controlled. In 1949 Mao Zedong argued that China's already large population was "a good thing." Even if it multiplied many times, he argued,

increased production would solve all problems because the productivity of the masses under the inspiration of socialism was infinite. Birth control was denounced in the press as "antihumanitarian" and as a way of "killing off the Chinese people without shedding blood."

When the 1953 census of the PRC came up with a total about 100 million larger than expected, party leaders had second thoughts. In the middle 1950s they instituted a state-supported family planning program that was mostly voluntary, although even then there were signs that the central authorities were inclined to make it as nearly compulsory as possible. But in 1958, when the grossly exaggerated statistics showed a doubling of food grain production in a single year and sharp increases in the industrial sector, Mao reverted to his previous view that population was an asset, not a liability, for national development. Birth control languished. In 1959–1961 a nationwide famine that caused some 30 million deaths in China ended rhetoric about the unlimited productivity of the masses under socialism. In 1962, with the support of Premier Zhou Enlai, the birth control program was quietly revived.

The work was interrupted again in 1966–1968, this time by the upheaval of the Cultural Revolution, a struggle for power within the party leadership. In 1969 birth control was reinstated, and since then official support has survived a number of major changes in Chinese political life. In 1971 the State Council under Zhou's direction set a limit of two children per family, superseding a previous three-child limit.

Compulsion in the program has increased and diminished a number of times in response to changing perceptions of the urgency of population control and the reaction of the Chinese masses to the tactics used. A major escalation took place in January 1979, when the one-child policy was announced. At first the requirement was "one child, two at the most, with a period of three or four years between them," but before the year was half over the two-child option was withdrawn. In the spring of 1980 some localities said that "nobody should bear more than one child." The new requirement was reinforced by the adoption of special provincial regulations based on the draft of a law that was widely discussed but never adopted.

The one-child limit evoked strong popular resentment, and in the spring of 1980 the authorities issued new warnings against the use of coercive tactics in family planning, which, they said, would harm the program. But by the summer of 1981 concern over coercion had been replaced by concern that population growth was "out of control" in many areas. The authorities called for "rigorous enforcement" of family planning requirements, "decisive and urgent measures," and "forcible" implementation, which sounded like invitations to resume coercive tactics. In the fall of 1982, census results showed a bulge in the childbearing age cohort, which meant that a baby boom was imminent. In November a national conference was told that family planning must be implemented "resolutely" for a long time to come.

Coercion reached a peak in 1983, when the authorities demanded that all women with one child have IUDs inserted, all couples with two or more children be sterilized, and all women pregnant without official permission have abortions. Some 20.8 million sterilizations were performed in 1983, three-quarters of them on women.

Party Document No. 7

Public reaction to this savage campaign was so strong that again policies had to be moderated. New instructions, contained in an unpublished directive of April 1984 known as Party Document

No. 7, called for measures that were "more realistic," "fair and reasonable," acceptable to the masses, and easier for the local cadres to carry out. The cadres were told to "improve their work style" and "refrain from coercion," and the number of couples allowed to have a second child was increased slightly. But Document No. 7 also said that local population targets consistent with the national goal of keeping the population under the 1.2 billion mark in the year 2000 must be attained. This put the cadres in a dilemma because given strong public opposition to the program, it was impossible to substitute persuasion for coercion and still attain the targets. The actual policy at any particular time depended upon which of the conflicting instructions were being stressed in central directives. The emphasis shifted back and forth in the next two years.

In much of the country the local response to these ambiguities was to ease up on birth control. The central authorities had not intended this. A *People's Daily* article insisted that "family planning work must not be weakened and relaxed," and other sources warned against "wavering" and demanded that targets be attained on schedule. In the fall of 1984 the authorities attempted to tighten control, but by the end of the year the softer line initiated by Document No. 7 was again echoed in the media. At the start of 1985 there was some confusion in the provincial instructions, but as the year progressed the main trend was toward greater compulsion.

The central authorities were becoming increasingly troubled by the failure of the local authorities to enforce family planning restrictions and expressed fears that the impending baby boom could erase previous progress. They were also concerned about uncontrolled childbearing among rural migrants to urban areas, who were not under surveillance of family planning cadres, and a growing tendency among local officials to falsify birth statistics to conceal the extent to which population growth exceeded the assigned targets. In May 1986 a new, harder line was taken.

Party Document No. 13

Like Document No. 7, the new directive was never published, but some of its contents are known. The main message of Party Document No. 13 was that local authorities must "strengthen their leadership" and bring population growth under strict control. Family planning efforts were to be focused on rural areas that had fallen behind the rest of the country in population control.

Dissemination of the new guidelines was followed by a round of supplemental directives from provincial authorities calling for a tightening up of family planning work, strict control of population growth, adherence to the one-child limit, and the "resolute" use of abortion. Areas that had relaxed their family planning efforts after 1983 were told that they must regain a "tight grasp" of the work.

Reportedly many local areas had been freely granting permission for second births to couples who could not qualify under the established criteria. After the central authorities permitted a few localities to experiment with such a policy, other localities simply abandoned all restrictions on second births. To regain control of the situation the local authorities were directed to reinstate the 1983 policies of inserting IUDs in all women with one child, sterilizing all couples with two or more children, and aborting all unauthorized pregnancies.

New regulations adopted at provincial and lower levels contained stiffer penalties for noncompliance and were to be strictly enforced. The regulations for a district in Guangzhou Municipality (Canton), for example, specified that if a woman with one child "failed" at birth control she not only had to have an abortion

but must also be sterilized. New measures were devised to impose family planning restrictions on rural immigrants to cities; others imposed collective penalties on villages and factories that had unauthorized pregnancies, to bring community pressure to bear on those not in compliance.

The press carried open-ended injunctions to "take immediate action," adopt "resolute and effective measures," and "produce immediate results." Broad hints that any method that got results was acceptable were contained in such instructions as "take every effective measure" and "all measures that are favorable to population control...may be tested." Similar blank checks had been issued to family planning cadres by the higher authorities in 1983 and undoubtedly contributed to the extremely coercive methods used at that time.

In 1989 for the first time the Chinese media carried articles openly calling for coercion in family planning. The first was an article in a Beijing newspaper in January urging that "suitable coercion and control be implemented in China's family planning." In April the New China News Agency quoted an Agriculture Ministry official as saying that "only coercive measures can be effective in alleviating the problems caused by [the] population explosion." The official added that "temporary coercion is actually a philanthropic and wise policy." In August an article in a Shanghai social science journal advocated compulsory abortion for all women who became pregnant before the age of twenty-five and for all women pregnant without official permission. Those who avoided abortion or concealed pregnancies were to be given prison terms or harsher punishments, including death sentences. The author declared that compulsory abortion was "entirely in accord with the spirit of the constitution."

Recommendations contained in signed articles do not constitute official policy. The writers made it clear that their positions went beyond current policy. But the appearance of such proposals in the controlled Chinese press suggests that the authorities may have been preparing the people for increasingly compulsory measures.

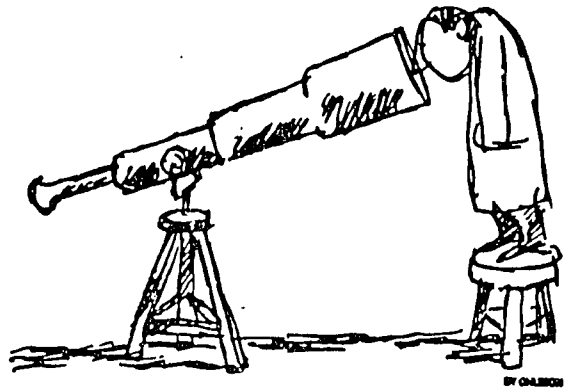
Meanwhile popular opposition to the one-child policy continues. In 1988 two national opinion polls showed that 70 percent of all couples in the childbearing ages (90 percent of those in rural areas) still wanted more than one child and that 88 percent wanted both a boy and a girl. Even in Beijing almost 80 percent of a sample of married women wanted two or more children. In January 1989 an article in the national family planning journal deplored the increasing "contradictions and hostilities between the cadres and the masses" over birth control, some of which led to acts of violence against family planning cadres.

Despite the intensification of coercion in the Chinese program since 1986, the UN Population Fund agreed in January 1989 to fund a third five-year program of assistance to China's population efforts. The Chinese leaders have interpreted this support as an endorsement of their family planning efforts, and this interpretation seems entirely warranted. Foreign organizations and individuals that indiscriminately laud the Chinese program or provide financial or technical assistance to it place themselves in the position of supporting its violations of human rights. It is time for a careful review of the issue of human rights in family planning and a reconsideration of the "population crisis" ideology that undoubtedly explains the tolerance that family planning advocates and other humanitarians have sometimes shown toward coercion in the Chinese program.

John S. Aird is a former senior research specialist on China at the U.S. Bureau of the Census.

Jim Hoagland

Our Strange View Of Asia



The folly of treating Japan as an enemy and China as a client

The talk about the new international order often misses this crucial point: There isn't one. And there will not be one until the United States and European nations free themselves from old thinking and hidden racist attitudes toward Asia.

In Asia, American and European actions perpetuate a post-World War II order built on treating Japan as an enemy and China as a client. The United States expresses gratitude to the butchers of Beijing and resentment to the democrats of Tokyo for their respective roles in the Persian Gulf crisis.

The wooing of China to prevent a veto of the 12 United Nations Security Council resolutions on the Gulf raises one of those fundamental questions that diplomats, politicians and journalists fail to grasp amid the daily minutiae of getting things done.

Why, we should ask, does a bloodstained Asian Communist dictatorship with declining economic power hold one of the Security Council's five permanent seats, with its veto power and special responsibility for ensuring global peace, while a democratic, pacifistic and now rich Asian nation with enormous global influence does not?

The answer has nothing to do with China's population of 1 billion or its nuclear arsenal, which came long after the United States, Britain and the Soviet Union used their status as victors of World War II to agree upon and dictate the membership of the Security Council, the world's most exalted political body.

China is on the council because Franklin D. Roosevelt wanted to reward and bolster Chiang Kai-shek's Nationalist regime immediately after World War II. Japan and Germany were to have no role in an organization formed in large part to administer the consequences of their military defeat.

A half-century after World War II, permanent membership in the Security Council is still organized on this "enemy-client" basis. While the Bush administration pursues a new international order with innovation in Europe and muscle in the Middle East, it shows nothing but outdated thinking in Asia.

The Gulf crisis has stripped bare the anachronistic quality of American thinking and of the Security Council's permanent membership. Washington pampers Beijing while scolding Tokyo for producing "only" $4 billion in aid to the U.S.-led effort.

That is to see the world upside down and to ignore the fact that World War II is finally ending. Japan and Germany have rehabilitated themselves by every possible measure. China's use of its Security Council seat for extortion during the Gulf crisis disqualifies Beijing from holding such power.

The Chinese rulers cynically stepped up their persecution of pro-democracy dissidents as the Nov. 29 vote on the use-of-force resolution in the Security Council neared. They bet that their old friend George Bush would reward them for abstaining, instead of condemning them for punishing the brave young patriots whose only crime has been to call for reform and freedom at home.

They were right. Bush met with Chinese Foreign Minister Qian Qichen in Washington the day after the Security Council vote.

Paternalism and fear, the unconscious twin strands of racism, wind through contemporary Western attitudes to China and Japan. China's poverty and backwardness stir pity, while Japan's success stirs enmity. Both cloud Western policies and attitudes toward the Orient.

The end of the Cold War was celebrated a few weeks ago in Paris by the white world, that is, by the nations of Europe, North America and the Soviet Union. Japan's exclusion from this celebration went unnoticed as speaker after speaker rose at the CSCE summit to extol the establishment of "the postwar order."

But "the postwar order" was more than the division of Europe. The two big wars the United States waged during the Cold War were, after all, both in Asia—in Korea and then in Vietnam.

Only when the winners-losers distinction of World War II is erased with the acceptance of Japan and Germany back into the ranks of the major powers at the United Nations will the postwar order pass. Only then will the reality of Japan and Germany as economic giants and political pygmies fade. Only then is it likely that Japan and Germany will take on full roles in international conflicts such as the Gulf crisis.

This is especially important for Japan, which has not been able to achieve the kind of reintegration into the international community that unification within the European Community and NATO has brought Germany.

A valuable step along the road of ending the Cold War in Asia should come next April when Soviet leader Mikhail Gorbachev visits Tokyo. He should clear the way on that visit for settling the dispute over Japan's four Northern Islands that the Soviets have occupied since World War II.

Americans wrought up over Japan's lack of responsibility in trade and economic issues may find it perverse to suggest "rewarding" Tokyo with more international power and prestige now. But the history of the past 45 years shows that this is the best way to make sure Japan lives up to its international responsibilities and really does stop being an enemy.

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Far Eastern Economic Review
November 29, 1990

THE 5TH COLUMN

Cut the Cambodian knot

By William Colby

The tangle of forces in Cambodia continues unabated. Four self-appointed Cambodian movements contest for power diplomatically, militarily and subversively. The five permanent members of the UN Security Council (and Australia) laboriously negotiate with each other, the four Cambodian factions, Vietnam and the Asean neighbours. Almost all have accepted the idea that Cambodian legitimacy should be determined by a free vote by the Cambodian people. But the process by which such an election can be held is still elusive.

The Khmer Rouge, who murdered well over a million of their fellow Cambodians, continue to refuse to accept a ceasefire unless it is accompanied by the removal of the Vietnamese-imposed Hun Sen government in Phnom Penh. The Hun Sen government refuses to abdicate but does agree that a strong UN presence at its side in Cambodia would be appropriate.

The Permanent Five — the US, the Soviet Union, France, Britain and China — are seeking a "comprehensive agreement" among the Cambodians which would establish a ceasefire and effective UN control of Cambodia for a period of two to three years, during which elections could be arranged "on a level playing field" among the four Cambodian factions — and presumably yet other factions, if they appeared.

A full year of negotiations, including direct US-Vietnamese and US-Cambodian discussions, seem to have moved the parties no closer to the desired comprehensive agreement than rickety acceptance of membership in a Supreme National Council of uncertain authority or even life expectancy.

Patient efforts to establish the Supreme National Council on a consensus basis continue to founder on the intransigence built into the recent and bloody history of the region.

Following the establishment of a Khmer Rouge government led by the murderous Pol Pot in Phnom Penh in 1975 and its subsequent two years of attacks across the border into Vietnam, the forces of Hanoi struck back in 1978 by invading Cambodia, overcoming the Khmer Rouge and setting up their own friendly regime.

Hun Sen: no abdication.

A coalition of forces — with the ousted Khmer Rouge as its strongest single contingent — continued to wage a guerilla war against the Vietnamese-backed government in Phnom Penh. In September of last year the Vietnamese and Phnom Penh governments declared that a long-promised withdrawal of Vietnamese troops had been completed, though there was no international control mechanism to oversee this. Since then fighting has continued as the Khmer Rouge and the two non-communist guerilla groups (led by Norodom Sihanouk and Son Sann), who each claim the Vietnamese have not fully quit Cambodia, have struggled to gain positions of advantage. The peace process has progressed with painful and frustrating slowness.

The sooner elections can be arranged, the better

Meanwhile, the Khmer Rouge build their military strength and organise increasing segments of the countryside under their discipline — hardly an auspicious portent for elections.

There is a way to cut through the Gordian knot of these intertwined relationships — early elections under UN sponsorship throughout Cambodia, with many international observers, managed either by the Supreme National Council or by whatever Cambodian party actually controls the territory in which they are held. That council is supposed to have the participation of all four Cambodian factions, but Khmer Rouge recalcitrance makes its planned function less likely as the months pass. But it does offer a vehicle to preside over elections if the other three agree to do so — even in the face of the Khmer Rouge refusal.

Alternatively, each faction could conduct elections in whatever area it controls, with the UN and international observers setting the basic rules of access, fairness, honesty, etc.

The world has had a great deal of recent experience in encouraging and monitoring elections. When they were open and honestly conducted, they clearly reflected the people's will, even when they were conducted under the authority of one of the contending factions. Nicaragua, Burma, and Chile are cognent examples, and the US and the Soviet Union seem to be leaning towards acceptance of this possibility for Afghanistan.

If the election is stolen, as is the case after the fact in Burma and plainly was in Panama and by the late Ferdinand Marcos in the Philippines, the authorities who indulge in such skullduggery or defiance of the popular will lose any claim they may have had to legitimacy in international circles. The East European experience equally bears this out, from the successes in East Germany, Poland and Czechoslovakia to the questionable results in Romania and Bulgaria.

It may be useful to have a single UN authority manage the election, as in Namibia, but it is certainly not necessary. Measured against the slow (the current schedule envisages three years) and expensive (current estimates are more than US$1 billion) process of setting up fully UN-controlled elections, and the danger that the Khmer Rouge will continue to increase their presence and power in the interim, it is clear that the sooner elections can be arranged, the better. Six months would not be an unreasonable period of preparation.

If each party were asked to conduct elections in the area it controls, any one could obviously refuse or steal them, but in so doing it would demonstrate its illegitimacy before the world. The ones which conducted them properly would produce a victor, or the basis for a coalition, which would have a fully legitimate claim for support from the international community against the efforts of the recalcitrant — probably the Khmer Rouge.

How the balance would be decided between Sihanouk, Hun Sen and Son Sann is impossible to judge, but it seems inconceivable that the Khmer Rouge would attract substantial free support. Thus the process would achieve two important results, establishing a legitimate Cambodian government and ending the nightmare that the Khmer Rouge might return. ■

William Colby *was the Director of the US Central Intelligence Agency from 1973-76.*

LOS ANGELES TIMES, November 20, 1990

Recognize Pyongyang and Break a Dangerous Logjam

■ Korea: Our interests lie with the South. Its prosperity and stability will be enhanced by U.S. relations with the North.

By ALAN D. ROMBERG

It is time for the United States to normalize relations with North Korea. U.S. interests in Korea properly remain grounded in support for the economic prosperity, political democratization and national security of our ally in South Korea. But establishment of diplomatic relations with Pyongyang would be a major step forward in securing those goals.

Since South Korean President Roh Tae Woo's 1988 declaration calling for a new era of cooperation between North and South, the United States has met 13 times with North Korean diplomats in Beijing. Following Roh's lead, this dialogue has been designed to help bring Pyongyang out of its self-imposed isolation and into peaceful intercourse with the rest of the world.

The discussions have borne limited fruit. Nonetheless, North Korea has made clear that it would like to upgrade the dialogue. The United States has responded that it would be willing to consider improvements, but first it wants progress on some key issues, most important being Pyongyang's acceptance of full-scope International Atomic Energy Agency (IAEA) safeguards on all its nuclear facilities. Although North Korea's signature of the Nuclear Non-Proliferation Treaty in 1985 obliges it to negotiate a safeguards agreement with the IAEA, Pyongyang has refused to do so until the United States withdraws its alleged deployment of nuclear weapons from South Korea and otherwise stops "threatening" the North with nuclear war.

The door to possible improvement in this logjam was opened in recent weeks by a number of factors, not least among them the establishment of diplomatic relations between Moscow and Seoul. Compounding the problems arising from Pyongyang's flawed economic policies—and thus North Korea's pressing need for outside economic resources—this diplomatic blow has led the North to open a new, high-level dialogue with the South and to call for normalization of relations with Japan.

Without expecting unrealistic changes in North Korea's political and economic system, we should adopt an approach that meets each side's principal concerns while protecting its basic interests. Such an approach might include:

- U.S.-North Korean agreement that normalization is fully consistent with eventual Korean unification, and U.S. endorsement of any unification agreement.
- Reiteration of the American commitment to South Korea, and also a pledge that the United States would neither initiate nor support aggression against the North—along with a North Korean non-aggression pledge toward South Korea.
- Affirmation of U.S. willingness to withdraw all its forces from Korea when and if the situation between the North and South permits, and agreement that Washington and Seoul will consider what reductions may be possible in the meantime as North/South tensions subside.
- Reference by the United States to a (by then) announced agreement with South Korea that no nuclear weapons will be stationed or stored in South Korea, and to the South's longstanding agreement with IAEA on full-scope safeguards.
- Reference by North Korea to (by then) announced negotiations with the IAEA for full-scope safeguards, including effective, comprehensive inspection and reiteration of its policy not to develop, manufacture or otherwise obtain or allow the introduction of nuclear weapons into North Korea and its pledge not to employ or threaten to use nuclear weapons.
- A U.S. statement that, assuming fulfillment of the North's non-aggression and non-nuclear pledges, it had no intention to use nuclear weapons in Korea.
- Support by both sides for negotiations between North and South Korea over military exercises and deployments that seem threatening to the other and over further confidence-building measures, with the United States pledging to cooperate with agreements reached.
- Mutual condemnation of international terrorism and commitment to cooperate with counterterrorist efforts.

South Koreans might be nervous about the prospect of improved U.S.-North Korea relations, and some—but by no means all—American defense officials might object to the proposed position on nuclear weapons. But such an approach may hold the best opportunity to deal with the priority issue of a possible North Korean nuclear weapons program while at the same time drawing North Korea into the world community, reaffirming U.S. commitments to South Korea, placing emphasis on progress in north-south relations as the principal requirement for U.S. force reductions, and underscoring that such reductions are a matter to be agreed between Washington and Seoul, not Pyongyang. It would also make clear to Koreans—north and south—that the United States is not opposed to reunification.

It is far from certain that North Korea would accept these positions. But there is nothing to be lost in the effort, and much to be gained in terms of long-term peace and stability on the Korean peninsula. At a minimum, Washington, Seoul and Pyongyang should all be called upon to give some substance to their rhetoric.

Alan D. Romberg is a senior fellow at the Council on Foreign Relations in New York.

WASHINGTON TIMES, December 5, 1990

COMMENTARY

B. J. CUTLER

Do not pass Goh

Goh Chok Tong, 49, a soft-spoken economist, has just become the second prime minister in Singapore's history, and thus has one of the world's worst jobs.

How can the post be so bad? Is not the city-state at the tip of the Malay Peninsula a clean, bustling free-market success with the highest living standards in Asia?

Well, yes. But Lee Kuan Yew, 67, the elected autocrat who took over Singapore as a sleepy British colony in 1959 and transformed it into an economic tiger, has stepped aside, not gone away.

Mr. Lee is a man of remarkable achievement. He has crushed a strong underground Communist Party and suppressed racial strife among Singapore's dominant Chinese and minority Malays and Indians. He has fostered education, commerce, public health and cleanliness — especially cleanliness.

Goh Chok Tong

If one of the island's 2.7 million citizens gets caught littering, he is subject to a $500 fine. Equally stiff penalties are imposed for smoking in a restaurant or bus or failing to flush a public toilet. The death penalty is sometimes inflicted on drug smugglers.

Though Mr. Lee was glad to get the British out, he has clung to one of their colonial laws that allows the government to arrest and detain indefinitely anyone that it says is a threat to security. Opposition politicians who win elections fall in that category.

According to Asia Watch, an American human rights group with a good record for spotlighting injustice, Singapore oppresses the domestic and foreign press, non-Lee political parties, Christian churches, students and lawyers, among others.

The government "has mistreated detainees," Asia Watch says, "jailed them again for complaining about mistreatment" and imprisoned lawyers for defending its victims.

Given his Big Brother tactics, it is unsurprising that Mr. Lee was re-elected prime minister eight times, so often that he is known simply as "P.M."

The Lee government is noted for sticking its nose in all aspects of Singapore life. It worries, for instance, that educated women have trouble finding husbands, which could lower the national IQ. So it runs a dating service for female college graduates (with unimpressive results).

Mr. Lee also worries about stronger Asian states — China, Japan and Vietnam — that sometimes behave as predators. So as Filipinos shout "Yankee Go Home!" outside Clark Field and Subic Bay Naval Station, Singapore has invited the U.S. armed forces to drop by more often for visits and training.

The new prime minister, Mr. Goh, was tapped for the post by Mr. Lee in 1984 and sworn in Nov. 28. His predecessor will stay on as "senior minister without portfolio" and head of the People's Action Party, which has 80 of the 81 seats in parliament.

Also, Mr. Lee's ambitious son, Brig. Gen. Lee Hsien Loong, 38, known as "B.G.," becomes deputy prime minister and will run the country when Mr. Goh is abroad. If Mr. Goh feels like a thin slice of cheese between two heavy pieces of bread, it's understandable.

Mr. Lee plans to offer "advice" to the younger generation and to "intervene" when he deems necessary.

"Even from my sickbed," he said, "even if you are going to lower me in my grave and I feel that something is going wrong, I'll get up."

No wonder Mr. Goh seems sandwiched. B.G. impatiently awaiting his turn and P.M. threatening to take over from beyond the grave. Truly a rotten job.

B.J. Cutler is foreign affairs columnist for Scripps Howard News Service.

Japan, Korea, the Philippines: Ambivalence about U.S. Role

Japanese perception of the United States as a declining power has been reinforced in recent years by both actual U.S. economic performance and the "declinist" theories propounded by U.S. authors, particularly Yale University historian Paul Kennedy, according to Nagayo Homma. Kennedy's book, *The Rise and Fall of the Great Powers*, was a surprising bestseller in Japan, and his theory of imperial overreach was accepted rather uncritically as an explanation of the U.S. predicament, Homma commented. Japanese foreign affairs specialists have begun talking about the possibility and desirability of the replacement of the United States as the *hegemon*—the dominant state of the regional system—by a single nation or nations, with Japan as a possible candidate, Homma noted.

Many Japanese are, however, concerned that their country might supplant the Soviet Union as the chief adversary in U.S. foreign policy, Homma said. This fear is buttressed by recent U.S. public opinion polls indicating that Japan, because of its economic might, is seen to pose a greater threat to American well-being than the USSR. Japanese discussions on the future framework of Japanese-American relations are still at an exploratory stage amid a rhetorical escalation on both sides of the Pacific, Homma stated.

Despite some proposals for a substantial reorientation of Japanese foreign policy, the government under Prime Minister Toshiki Kaifu has reaffirmed the present U.S.-Japanese security framework, while acknowledging the possibility of adjustments to meet new strategic requirements. Within this new context, the U.S. military presence in East Asia will remain a crucial stabilizing factor, in no small part because of lingering regional suspicions of Japanese intentions forty-five years after the end of World War II, Homma concluded.

Korean perceptions of the Korean-American relationship have been shaped by two real but conflicting images of the United States, according to Yersu Kim. "One is the angelic image of America, a young and powerful nation founded on high-minded moral principles, intent on justice in internal as well as in international affairs, and ever-sensitive to the plights of small and weak countries. . . . Another image of America is that of a devil, intent on world domination and the spread of its crass materialistic culture, a young nation that has, in big-power arrogance, grown insensitive to the needs and sensibilities of smaller and weaker nations, ever ready to resort to force."

The devil image of the United States, Kim argued, was fueled in the early 1980s by the widespread belief that the Seoul government's often brutal suppression of domestic dissent could not have been carried out without American complicity. Dissatisfaction with the U.S. role was largely expressed in terms of dashed expectations toward the United States as the guarantor of human rights and democracy. Radicals sympathetic to North Korea went much further, charging that the South Korean government had become a puppet totally subservient to the colonialist intentions of the United States, but this view failed to win mass support. One new danger, however, is that U.S.—Korean differences over trade could spill over into the area of security cooperation.

Kim concluded that "the Korean image of the U.S. is today intimately connected with the fundamental issues affecting the destiny of Korea in the coming decades—the issues of reunification, democracy, military command structure, and the future of the Korean economy. All these issues have become fluid now, both as the result of changes in the international as well as the domestic environment, but also to a significant degree as a result of an ideologically motivated challenge to the dominant image of the U.S. in Korea."

In the Philippines, the coincidence of the end of the cold war and negotiations over the future of American military facilities at Clark Air Base and Subic Naval Base has generated a public debate about the future of the U.S.-Philippine relationship. The bases have become the political lightning rod for both advocates and critics of the existing framework of relations, observed Carolina Hernandez. Recent public opinion polls indicate that "elite and popular views tend to vary somewhat. The ordinary man in the street would very likely look at the bases in terms of long-standing Philippine-American relations and the size of the compensation package. The workers in and around the bases would have supportive views for the retention of the bases with the extent of support rising proportionately with the degree of dependence on base-related jobs. . . . [As for elite opinion,] the Philippine Senate is more anti-base, whereas the House of Representatives, dominated by traditional interests, would be pro-base," said Hernandez. In the Philippine Senate which must ratify any agreement, ten senators are on record as favoring termination of the bases when the existing agreement runs out in 1991, twelve advocate a multi-year phaseout, and only one senator favors extension of the lease under "the right conditions," Hernandez noted.

Philippine officials in the Aquino government hope to use the base negotiations to put the bilateral relationship on a new basis by replacing "the former problematic colonial foundation with a more independent and equal one," Hernandez stated. Most Filipinos, she concluded, want a more comprehensive relationship with political, economic, cultural, and even environmental components to supplant a cold war relationship that has been primarily military in character.

The conference "U.S. Policy in the Pacific Basin: Changing Economic and Security Relationships," sponsored by the Asia Program and the Division of International Studies, was held September 26-27, 1990. Among the speakers were Nagayo Homma, Professor of History Emeritus, Tokyo University; Yersu Kim, Professor of Philosophy, Seoul National University, and a Fellow, The Woodrow Wilson Center, and Carolina Hernandez, Professor of Political Science, University of the Philippines.

Roger Matthews assesses the challenges facing post-election Pakistan

Bhutto down but not out

The chances of a fledgeling democracy developing wings in a country where the army still knows that it knows best must always be slim. But survival of the system can be greatly enhanced by an electorate which sometimes delivers what the men in uniform want, even if the voters' pragmatism needs to be reinforced by a touch of skullduggary along the way.

Hence, after just 20 months in office, Ms Benazir Bhutto failed to be re-elected prime minister of Pakistan in elections she had not sought and which from the outset were stacked against her. Ms Bhutto and her Pakistan People's Party may feel justly aggrieved at the summary manner of the government's dismissal by President Ghulam Ishaq Khan and their subsequent harassment. But given the frightening raft of problems facing the country, Pakistan has come through the experience in better shape than had been feared.

Perversely, despite the vulnerability of former office holders in Pakistan, it may also turn out not to have been such a bad election to lose. Severe though the setback was, Ms Bhutto's party was much less heavily defeated than the distribution of seats in the National Assembly suggests. While the PPP lost more than half the 98 parliamentary seats it won in 1988, its overall share of the popular vote declined by a little over 1.5 per cent to 30.04 per cent, just 0.[illegible] per cent behind the victorious but disparate group of parties in the Islamic Democratic Alliance.

Whether or not, as Ms Bhutto alleges, some official sleight of hand helped to produce the published results, President Ishaq Khan must be reflecting that had he waited another few months the outcome could have been even more to his liking and that of his military and civil service friends. The failures of Ms Bhutto's administration would by then have become more obvious and, more important, she would have been grappling with what are bound to be the unpopular economic consequences of President Saddam Hussein's invasion of Kuwait.

Whichever way Pakistan faces, it has been seriously damaged by Mr Saddam's action. Internationally the Iraqi leader has again raised the uglier profile of Islamic nations, their potential for belligerency and the type of weapons which they can deploy. Unhappily, it was just at this time that the US was having to decide whether it was satisfied that Pakistan was not seeking to acquire nuclear weapons technology, to which is tied continued American aid.

The Pakistani establishment is convinced that the October 1 decision to suspend civil and military aid worth nearly $600m a year was an overtly political act in support of Ms Bhutto and had little to do with the nuclear issue. But the new government is unlikely to wish to sustain the growing mood of anti-Americanism in Pakistan generated by the suspension. Despite threats at senior level to retaliate by ceasing to service its debts, the official line will have to become more conciliatory.

The finance ministry in Islamabad has estimated that oil at an average of $32 a barrel will in a full year cost the country an extra $2bn. There is no scope for further drawing down foreign reserves as they are at a basic level, equivalent only to a few days' imports. The ministry thinks it may be able to absorb about half of the additional $2bn, but will still need $1bn in extra external financing, a sum equivalent to 20 per cent of Pakistan's annual export earnings.

The interim government headed by Mr Ghulam Mustafa Jatoi had no intention of courting electoral unpopularity and so did nothing about petrol prices. At the very least they will have to be raised an initial 20-25 per cent by the new government. More must follow.

This is but the short-term tip of an iceberg of structural economic problems which Pakistan's political class, in its single-minded commitment to denying its enemies and justifying itself, has found little time to address. There are currently about 110m Pakistanis, of whom nearly 70 per cent are illiterate. They have a per capita income of about $350 a year, close to the poverty level as defined by the World Bank, and are adding to their numbers by more than 3m a year. It is difficult to find evidence of a birth control programme, yet the government must be aware that there are more than 1m young people a year appearing on the job market. Worse, Iraq's invasion of Kuwait has forced hundreds of thousands of Pakistanis to return home, few of whom will find work and whose lost earning power will further widen the current account deficit.

The extent of the overall economic problem, especially when taken together with the [illegible] blights of an alarming level of heroin addiction and growing lawlessness encouraged by the cheap weaponry which flowed into the country during the Afghan war, was scarcely reflected in the election campaign.

Mr Mian Nawaz Sharif, who heads the electorally successful Islamic Democratic Alliance, concentrated instead on the need to create an ill-defined Islamic welfare state and to reduce sharply Pakistan's dependence on foreign loans. He asserted simultaneously that Moslems believed solely in the sovereignty of Allah and it was Allah alone who fed his creatures. Politicians elsewhere must wish their responsibilities could be so simply shared.

It is the sort of contradictory message which also further confirms Pakistan's tendency to look towards its western Asian neighbours. While Indonesia, the world's most populous Islamic nation, is beginning slowly to follow the impressive example of the newly-industrialising eastern Asian nations, Pakistan appears stuck in the development attitudes of more than two decades ago. Import substitution policies and industries producing uncompetitive goods behind high tariff barriers are unlikely to arrest its relative economic decline.

Mr Nawaz Sharif, who looks set to be the next Prime Minister after his nomination last night by the Pakistan Moslem League, the main force within the Alliance, is a largely self-made businessman with a strong political base in the Punjab. As such he may better appreciate the issues facing Pakistan than the landowning elite which together with the army have dictated the country's course since independence. It is said he supports the creation of private investment banks to offset the dead hand of the state banking sector and might move towards dismantling some of the bloated state corporations.

Higher spending on rural infrastructure, especially for electricity and water, is vital to boost food production and to create the estimated 600,000 jobs needed every year outside the main urban areas. But the most modest estimates indicate that the military takes about 40 per cent of the national budget each year and would make life difficult for a prime minister who proposed a cut.

While the Soviet army was entrenched in neighbouring Afghanistan the army had a stronger case to make, one that it supplements today with warnings about possible Indian aggression, especially in Kashmir. It has also agreed to send 5,000 troops to Saudi Arabia, purportedly to defend Mecca and Medina against Iraq. But with the reduction in east west tension brought about by the sharp changes in Soviet policy, the need for such a large military budget is more difficult to justify. Whether the army thinks such justification is necessary is a separate issue.

It is one, however, that the new premier will soon have to consider. Mr Jatoi had hoped to continue as prime minister and he held attractions for the military because, although he managed last week to reverse his previous defeat at the polls, he has a narrow power base. Mr Sharif, by contrast, can claim to be a populist leader through his control of the Punjab. However his Alliance has been united only in its desire to defeat Ms Bhutto and its prospects for holding together under the pressure of government cannot be highly rated.

Previously, the army tried and ultimately failed to rule Pakistan successfully during the 11 years of General Zia ul-Haq whose death in a sabotaged military aircraft in 1988 set off the present flurry of democratic activity. So, although Benazir Bhutto may currently look like the Polly Peck of Pakistani politics, as a long-term recovery stock the Pakistani People's Party could still be worth watching.

Supporters of the Islamic Democratic Alliance carry posters of General Zia and celebrate their victor over Benazir Bhutto

WASHINGTON POST, October 9, 1990

Thant Myint-U

Burma's Fight For Freedom

Nowhere else in the world is the human rights situation as bad as in Burma. Nowhere else have people fought so hard for their freedom and yet still suffer under the threat of terror and repression. And nowhere else will the rest of the world care less, unless it becomes too late.

On the same day that President Bush delivered his address to Congress on the new international order, a crowd of Burmese students demonstrated in Mandalay for democracy and human rights. Eleven people were killed. Hundreds have been arrested in the past two weeks alone, including the leadership of the National League for Democracy, the country's largest political party. More demonstrations are expected these next few weeks, and every day Burma moves closer and closer to civil war.

The unrest began two years ago when millions of people marched in Rangoon, Mandalay and other Burmese cities demanding an end to the 26-year military dictatorship of Gen. Ne Win, which has impoverished what was once the richest nation in Southeast Asia. Gen. Ne Win responded by gunning down as many as 10,000 unarmed civilians, many secondary school students as young as 12 or 13.

Since the crackdown in September 1988, tens of thousands of people have been arrested, executed or have disappeared. Military tribunals have replaced civil courts, gatherings of more than four people are forbidden, and schools and universities have remained closed. Young men live in constant fear of being taken away for porter service in the remote jungles, where they are used as human minesweepers and made to carry army supplies until they die. Torture is both severe and widespread, and imprisoned students are subject to beatings and electric shocks and kept in solitary confinement.

And yet the people of Burma carry on in their fight for democracy and believe that the world—especially the United States—is on their side. Last May, the military, thinking that it had jailed and intimidated enough opposition activists, held "free and fair elections." The military lost, winning only 10 of 492 seats. Since May, the military has moved step by step to invalidate those elections, and the resulting anger has brought Burma back to the point of another violent explosion.

Though Burma's government has followed an isolationist foreign policy, Burma is not isolated, and the international community and the United Nations can do a lot to prevent further bloodshed. First, multinational companies, including many American companies, can stop funding the regime through their investments in the military's projects. Many of these foreign companies are engaged in timber and mineral extraction, and the resulting environmental damage (Burma could lose all its rain forests in five years) threatens the whole region.

Second, the United States can take a harder line on the military's suspected involvement in the heroin trade, involvement which may be providing Gen. Ne Win with much-needed cash. Certainly the United States should end all talk of resuming anti-narcotics assistance to the military regime, as suggested by the DEA and others in Washington.

Third, the United Nations as a whole can speak out on human rights, end bilateral and multilateral assistance and perhaps move toward comprehensive sanctions. The military has shown time and again how sensitive it is to foreign criticism, and pulling away outside support for the regime could make all the difference in ensuring peaceful democratic change.

In early August, China began providing Burma with more than $1 billion worth of arms. Burma is fighting ethnic insurgencies that have already spilled into Thailand and India. A bloody and sustained confrontation between the military and the people could eventually have serious international repercussions. Better to act before the situation reaches crisis proportions. The United States and the rest of the world can do more to help.

The writer, grandson of U Thant, is secretary of the Burma Fund and a senior fellow at the International Center for Development Policy.

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EASTERN EUROPE
QUARTER 4, 1990

WASHINGTON ECONOMIC WATCH

A Digest of Development Policy Information

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THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release December 12, 1990

FACT SHEET

WAIVER OF THE JACKSON-VANIK AMENDMENT

The President has decided to waive for the Soviet Union application of the freedom of emigration provisions contained in the Jackson-Vanik Amendment (Section 402) to the 1974 Trade Act. The Jackson-Vanik amendment effectively bars access to official credit and credit guarantee programs to countries which restrict emigration. The President made this decision:

- Based on the liberalization of Soviet emigration policy in recent years by which an estimated 360,000 people will emigrate in 1990;

- After receiving assurances that this policy will continue; and

- To make food available to the Soviet Union in the form of up to $1 billion in Commodity Credit Corporation (CCC) credit guarantees for the purchase of U.S. agricultural products.

The President's waiver will be valid until at least July 1991, at which time he will need to determine whether to extend the waiver.

While the President has taken this action on Jackson-Vanik, he does not plan at this time to send the U.S.-Soviet Trade Agreement, signed during the Washington Summit in June 1990, to the Congress. Only when the Trade Agreement is approved by Congress and takes effect could the Soviet Union receive MFN trading status.

The immediate effect of the President's action is to make the Soviet Union eligible for export credit guarantees under the CCC General Sales Manager program for the purchase of American agricultural products. This form of food assistance responds to Soviet requests for credit guarantees and will help the Soviet authorities address current food shortages. The waiver will also restore Soviet eligibility for Export-Import Bank credits and credit guarantees.

- However, the Stevenson Amendment to the Ex-Im Bank Act and the Byrd Amendment to the 1974 Trade Act limit credits and guarantees to $300 million, with a subceiling of $40 million and other restrictions on Ex-Im Bank credits or guarantees in support of the fossil fuel industry.

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In accordance with the requirements of Jackson-Vanik, before formally executing a waiver the President will report to Congress his determination that a waiver will substantially promote its freedom of emigration objectives in the Soviet Union. This report will also state that he has received the required assurances on Soviet emigration practices.

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release December 12, 1990

FACT SHEET

Export Credit Guarantees for the USSR

The President's decision to waive the Jackson-Vanik Amendment to the Trade Act of 1974 makes the Soviet Union eligible for export credit guarantees provided by the U.S. Department of Agriculture (USDA). Export credit guarantees are offered for agricultural products by USDA's Commodity Credit Corporation (CCC) to promote U.S. agricultural exports. The principal program, entitled GSM-102, offers repayment terms of up to 3 years and normally covers 98 percent of the commodity value of a transaction.

Operationally, CCC issues a guarantee for financing which is provided through normal commercial channels. Since the largest portion of risk is thereby transferred to CCC, the program allows commercial credit to be extended to participating countries in larger amounts and on more favorable terms than would otherwise be possible. While credit terms are more favorable, interest rates are not subsidized in the program and are usually near the so-called London Interbank Overnight Rate (LIBOR).

A total of $5.0 billion is currently authorized annually for GSM-102. Actual sales to 25 countries totaled $4.0 billion in FY 1990, roughly 10 percent of all U.S. agricultural exports.

Any agricultural commodity entirely produced in the United States is eligible for coverage under the program. The program has been used to help finance purchases of wheat, feed grains, oilseeds, vegetable oil, livestock and dairy products, cotton and a variety of other commodities.

The largest participants in the program in FY 1991 are Mexico ($1.2 billion) and Algeria ($675 million).

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Agricultural Export Assistance to the USSR by Selected Countries

Country	Government Donations		Government Direct Credits		Government Guarantees	
	Value[1]	Volume[2]	Value[1]	Volume[2]	Value[1]	Volume[2]
Canada[3]	3.8	3	850	--	400	--
Australia	--	--	yes	--	--	--
Germany[4]	908	448	--	--	134	77
Netherlands	--	--	--	--	yes[7]	--
Belgium	--	--	--	--	yes[7]	--
France[5]	--	--	--	--	294	3,200
Thailand	--	--	51	200	--	--
Italy[6]	2,000	--	--	--	900	--
Spain[6]	--	--	--	--	1,500	--

Notes:

1. Millions of U.S. Dollars
2. Thousands of Metric Tons
3. Canadian direct credit of $850 million has not been utilized to date.
4. Germany has begun shipping commodities under the new agreements.
5. France has made sales of 500,000 MT of barley and 900,00 MT of wheat and 150,000 MT of wheat flour.
6. Italy and Spain offered large credit guarantees, but the agricultural portion is unknown.
7. Yes: Countries have offered credit, but no agreements have been made.

# # #

IMF / World Bank / Organization for Economic Cooperation and Development / European Bank for Reconstruction and Development
December 1990

The Economy of the USSR

I. Introduction

At the Houston Economic Summit in July 1990, the Heads of State and Government of the seven major industrial democracies and the President of the Commission of the European Communities requested that by the end of the year the IMF, the World Bank, the OECD and the designated president of the EBRD, in close consultation with the Commission of the European Communities, undertake a detailed study of the Soviet economy, make recommendations for its reform, and establish the criteria under which Western economic assistance could effectively support such reforms. Our main findings and recommendations are summarized in this study; a series of background papers, pulling together the substantial amount of material that has been collected and which underpins our views, will be issued shortly.

Members of the four organizations met with a wide variety of civilian interlocutors at both the union and republican levels, and were received with much courtesy and helpfulness. The staffs of the Ministry of Foreign Affairs and the State Foreign Economic Commission of the Council of Ministers organized most of the discussions. The Gosbank, Goskomobrazovaniye, Goskomstat, Goskomtrud, Goskomtsen, Gossnab, Gosplan, Ministry of Finance, Ministry of Foreign Economic Relations, the State Commission for Economic Reform of the Council of Ministers, Vneshekonombank and many other organizations and individuals provided, at an already exceptionally busy time, unstinting assistance. The authorities discussed the various reform proposals that have been tabled in recent months and their implications; they also released much information that had hitherto been unavailable outside the USSR, but have not provided information on gold and foreign exchange reserves.

As requested by the Heads of State and Government, we have maintained close contact with the Commission of the European Communities throughout the course of this study. Information has been exchanged on a regular basis; a number of joint meetings were held in Moscow; and meetings were also held in Brussels, Paris and Washington.

II. Summary

The deceleration of economic growth, evident from at least the early 1970s, has recently turned into a fall in output and employment, accompanied by evident and growing imbalances. The old planning system has broken down but has not been dismantled; meanwhile, the structures vital to the functioning of a market have yet to be put in place. This will require an early and effective clarification of the division of responsibilities between the union and the republics.

Three points are worth stressing. First, there is no example of a successful modern centrally planned economy. Second, attempts to enhance performance under the old system have proved to be counterproductive: central control was reduced but market signals and discipline were not established. And, third, the revolutionary opening up

of public debate has cast doubts on earlier achievements while exposing the extent of the economic deterioration and creating uncertainty.

Ideally, a path of gradual reform could be laid out which would minimize economic disturbance and lead to an early harvesting of the fruits of increased economic efficiency. But we know of no such path, the more particularly given the difficult starting conditions. Indeed we doubt that a return to central control is a viable option, and would urge the authorities to move rapidly to give substance to their commitment to a market economy. This involves addressing simultaneously issues of stabilization and structural reform.

In our view, the restoration of financial stability will require a very sharp reduction in the deficit of the general government—the equivalent of the state budget—from its 1990 level of some 8 percent of GDP; the absorption of excess money holdings; a strong hold on credit creation; and movement towards positive real interest rates. In the short run this should be supported by an incomes policy which would set both a floor for social reasons and a ceiling on the growth of incomes. Given the weaknesses in other control instruments, incomes policy seems indispensable at least for the transition.

Financial stabilization by itself does nothing to establish a market. It must be accompanied by rapid and comprehensive price liberalization, which is clearly the appropriate response to shortages (though a few prices for key industrial inputs might be adjusted progressively to world levels, perhaps over three years after an initial sharp adjustment). At the same time there should be rapid progress towards trade liberalization. Rents and prices of a few essential consumer goods may also need to continue to be subsidized to a limited extent in the near term. This would provide an effective safety net to the population, a significant part of which is estimated to be below the poverty line. A rationalization of the price structure would be facilitated by a broadening of the parallel market for foreign exchange, and within, say, a year, the unification of the exchange market for current account transactions.

But stabilization and price reform together will only set the scene for a meaningful supply response if they also are accompanied by the establishment of private ownership rights and the elimination of the panoply of controls which currently prevent competition and discourage the efficient use of resources. Smaller firms should be privatized quickly and directly; ownership reform in larger enterprises would generally begin with their commercialization;[1] all of this in the context of the imposition of a hard budget constraint on enterprises remaining under state ownership and accompanied by an opening up to foreign trade.

The authorities face an enormous task, involving reforms of the legal, financial and trade systems and also of vital sectors of the economy, especially agriculture, distribution, energy and manufacturing. These changes cannot be made in a matter of weeks. But the imperative is to make sufficient progress at the beginning so that reform is seen as an irreversible break with the past and the process gains an unstoppable momentum. The necessary economic reform program cannot be implemented without an initial decline in output and employment, but delays in implementation would lead to an even larger and longer decline. It is therefore essential that a safety net be in place at the start of the program.

The rest of the world can help the reform process. Technical assistance, in which the private sector could play a substantial role, could be provided over a wide area and would be of great value in preparing for the introduction of markets. There is also a case for humanitarian assistance, provided that the distributional problems can be solved, as well as for well defined programs in the environment and energy areas. General balance of payments assistance or project assistance may be useful when a comprehensive program of systemic reforms has begun to be implemented, leading to a closer integration of the economy of the USSR into the world economy.

WALL STREET JOURNAL, December 13, 1990

The Cost of Giving Up Jackson-Vanik

By Fucer W. Robinson Jr.

With the waiver of the Jackson-Vanik amendment yesterday afternoon, the Bush administration made a strategic blunder on a par with its untimely wooing of Saddam Hussein earlier this year.

In the case of Iraq, the U.S. government provided billions of dollars in taxpayer-guaranteed credits—ostensibly for the purchase of grain—just months before Saddam swallowed Kuwait. Now, the administration has decided to give a similar sweetheart deal to another questionable regime: Mikhail Gorbachev's. While the Soviet leader has not demonstrated the kind of heinous behavior evidenced in Baghdad—although signs of a military crackdown in coming days may signal a change there—his government has not delivered the kind of systemic economic reform that President Bush just this July insisted was a precondition for such American largess.

The amount of the subsidy is not yet clear. It will likely come in the form of $1 billion to $3 billion in government-guaranteed farm credits, restored access to U.S. Export-Import Bank loans, equal tariff treatment on Soviet imports and possible investment insurance. The Soviets have publicly requested about $2 billion. But Sen. Robert Dole (R., Kan.), an influential friend to U.S. agriculture, has gone them one better by recommending the immediate disbursement of some $3 billion in farm-related loan guarantees alone.

The White House is still holding its cards close to its chest. And the administration is suggesting this is just a temporary deal to help the Soviets through their "winter of discontent." But in fact, there is every reason to believe the initiatives that will follow the Jackson-Vanik waiver will evolve into the equivalent of permanent entitlement programs.

It is doubly unfortunate that clearing the way for Soviet access to this gravy train has meant the abandonment of a key element of trade and human rights policy. In 1974, Sen. Henry Jackson pioneered a new concept: linking trade status to a respect for fundamental human rights. Thanks to the Jackson-Vanik amendment, trade served as one of the principal levers that helped the nations of Eastern Europe, Free emigration, a Jackson-Vanik condition, played a direct role. The most striking example of this was East Germany: The repressive Honecker regime could not withstand the hemorrhage of its best and brightest and so was compelled to permit the radical reforms that led to the new democratic Germany.

In what is likely to be a doomed effort to shore up Mr. Gorbachev, Mr. Bush is now dispensing with Jackson-Vanik until next June as an explicit reward for Soviet cooperation on the crisis in the Gulf. For three reasons, this is a mistake for both the Soviet people and the U.S.

First, this step relieves any pressure on the Soviet Union to accord its people what Henry Jackson called "the touchstone of all human rights," the right to emigrate. In recent years, the Soviet Union has considerably loosened emigration for some groups, mainly ethnic Germans and Soviet Jews. But it has welshed on its repeated promise to codify emigration as a legal right. In the absence of fundamental reform, millions more Soviets are being denied the opportunity to seek better lives elsewhere, as East Germans did with such beneficial results in their country. At a time when evidence of an incipient and possibly brutal crackdown is becoming unmistakable, this U.S. policy shift could prove disastrous.

Second, the White House flip-flop on Jackson-Vanik means sluicing money into a still unreformed command economy. This is a tantamount to knowingly investing taxpayer resources into a project as foolhardy as America's S&Ls. Indeed, some bankers even refer to the Soviet Union as the "Red Bear S&L." In any case, it could make earlier losses stemming from late-1970s loans to the Gierek regime in Poland pale by comparison.

Third and perhaps most significant, large-scale U.S. and Western financial assistance will retard, not catalyze, fundamental reform in the world's second-biggest economy. Through this step, the White House is strengthening central authorities in Moscow at the expense of democratic forces in the 15 Soviet republics. The U.S. is signaling—whether wittingly or not—its acceptance of the recentralizing policies of Mikhail Gorbachev.

In waiving Jackson-Vanik, the Bush administration is subordinating more deserving and more needy recipients of American taxpayer aid—starving Africans and the struggling democracies of East Europe come to mind, or even America's own homeless. Worse yet, in so doing the administration is permitting the Soviets to avoid rearranging their priorities. This gives them no incentive, for example, to make massive shifts from their still-bloated military-industrial sector to improve their citizens' quality of life.

In fact, the Jackson-Vanik decision smacks of an unfortunate convergence of interests. U.S. agriculture and business interests are eager to jettison Jackson-Vanik so as to transfer to the taxpayer the risk of doing business with the Soviet Union while retaining the profits. The White House wants to make a political statement of support for Mr. Gorbachev. For his part, Mr. Gorbachev wants unencumbered access to Western resources, which are essential to sustain his unreformed economy.

The U.S. will surely regret abandoning the principled approach to human rights and trade policy embodied in Jackson-Vanik if in the next few weeks or months blood spills in the Soviet Union.

Mr. Robinson heads RWR Inc., an international consulting firm in Washington. Frank J. Gaffney Jr. of the Center for Security Policy contributed to this article.

THE NEW YORK TIMES, SUNDAY, DECEMBER 16, 1990

Why Prop Up Gorbachev?

By William Taubman

AMHERST, Mass.

After years of hesitating, President Bush has now moved to bolster Mikhail Gorbachev by providing him with up to $1 billion in loans for food and other agricultural goods. Such credits would have made sense some time ago, when perestroika was being introduced and Mr. Gorbachev's popularity was soaring. But now they are likely to provoke the kinds of questions that bombarded me recently in Moscow.

"Why are you Americans propping up the Soviet empire? You supported the democrats against the Communists in Eastern Europe. Why don't you do that here?"

Muscovites I talked with contended that a stable, unitary Soviet Union under President Gorbachev is no longer a real option. Almost no one had a good word for his policies and, while none expect him to fall tomorrow, all assume his time is running out.

Obviously, this situation presents a dilemma for the U.S. Most of Mr. Gorbachev's policies have served our interests. But it is not in our interest to prop him up when his own country has turned against him, and to end up on the wrong side when he passes from the political stage. Moreover, if we can smooth the transition to a post-Communist era, we can help the Soviets as well as ourselves. No one inside the country or out would benefit from its Lebanonization, which would create anarchy and send a tidal wave of refugees to the West.

What then is the proper response to Mr. Gorbachev's requests for aid? Emergency food and medical aid is entirely in order. But we should channel as little of it as possible through the central Government in Moscow:

Don't funnel aid through Moscow.

most of the aid poured into the quicksand of the central supply system will be lost, stolen or allowed to rot. Moreover, our dealing exclusively with the center helps exacerbate tensions between Moscow and the republics and deprives us of leverage in shaping the post-Gorbachev future.

The Bush Administration should channel aid — and encourage private agencies to follow suit — to four emerging groups and institutions: the governments of the republics, local governments, new political parties and emergent entrepreneurs.

All four have defects and shortcomings. Yet they, not Mr. Gorbachev, are the future. They desperately need our support, and we can influence their development even as we strengthen their hand.

Intensely nationalist republics are hostile not only to Moscow but often to each other and to ethnic minorities within their borders. U.S. assistance to the republics should therefore be earmarked for projects that bring nationalities together and promote respect for human rights.

Reform governments of Moscow, Leningrad and other large cities have promised much, delivered little and are now being blamed unfairly for food and other shortages beyond their control. Emergency food aid should be offered to them directly, along with assistance for housing and urban infrastructure.

Democratic-minded political parties are springing up as rapidly and randomly as Russian mushrooms. (I attended the founding meeting of the Republican Party of Russia, consisting mainly of former Communists, at which a well-intentioned delegate urged sending "fraternal greetings to our brotherly Republican Party in the United States.") But these parties are prone to demagogy and strident nationalism. Even more than material support and organizational know-how, they need lessons in coalition-making and conflict resolution from American political parties.

Many of the new entrepreneurs have backgrounds in the black market or the party bureaucracy. But they, along with state enterprises that are declaring their independence from central ministries, need Western investment and managerial expertise. Washington should offer to insure such investment now, dropping its precondition of a new Soviet law on emigration.

If we help emerging post-Communist institutions while continuing to deal with President Gorbachev on international issues, we can escape the dilemma. The Soviet leader may not like this approach. But provided we are tactful and diplomatic, he is not likely to reject it.

Mr. Gorbachev still insists that an open society is his goal. If he were to decide to use force, that would bring on the very civil war that he aims to prevent while offering no incentive to provide sorely needed goods and services. Moreover, the military forces he used would almost certainly replace him with another leader more to their liking. Therefore, he too has a stake in the health of new democratic institutions.

It is not for Americans to decide Mr. Gorbachev's fate. But less bolstering of him personally, and more attention to other emerging institutions, would serve Soviet interests as well as our own. □

William Taubman is professor of political science at Amherst College and co-author of "Moscow Spring."

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NEW YORK TIMES, December 14, 1990

ON MY MIND | A. M. Rosenthal

U.S. Food and Soviet Freedom

President Bush now has taken directly on himself the responsibility for the lives and futures of all those millions of Soviet citizens who want to leave their country. The duty now becomes his not to feed them but to free them, not to save their Government but to allow them to escape from it.

Whether Mr. Bush acknowledges it or not, that is the moral and political consequence of his decision to send $1 billion worth of food on credit to the Soviet Union without condition — and to channel all of it directly through the faltering Government of Mikhail Gorbachev.

The American public has never questioned the plain human importance of sending food to the passengers of the foundering Communist ship.

But before we break our arms clapping ourselves on the back in admiration of our humanitarian souls, one moment's pause. That generosity of spirit does not always extend to people who are not white or European. The President and the American people have shown no uncontrollable passion about feeding starving Sudanese or Bangladeshis. But let that pass — for the moment.

The question about helping the Soviet Union was never whether, but how, when and through whom. Those questions remain and grow more important by the day.

Under the Jackson-Vanik law, which Mr. Bush waived, credit was not supposed to be extended to any country until it guaranteed and legalized the right that every American takes for granted — the right to get up, pack up and get out. Mr. Gorbachev has failed for five years to allow that to all Soviet citizens. For more than a year, specific legislation has been stalled in Moscow, waiting for his action. He knows the line would stretch millions long, from Leningrad to Vladivostok.

Happily for Soviet Jews, for the state of Israel and for the cause of freedom, Mr. Gorbachev is permitting Soviet Jews to leave for Israel by the thousands. But the hope of those who want freedom for all the Soviet people and the ethical meaning of the law was that the Jewish exodus would be the beginning of an era of guaranteed free Soviet emigration, not its end. It does not strike me as becoming for Israeli leaders or American Jewish organizations or anybody else to say "I'm aboard, Jack, pull up the gangplank."

And this is critical to remember: Almost every day Mr. Gorbachev tightens a restriction here, orders a clampdown there. The alert and valuable Center for Security Policy in Washington points out that on Nov. 27 he gave the Soviet armed forces the legal authority for a crackdown against Soviet civilians whenever he chooses to order it.

Don't pull up the gangplank.

Three days later, the K.G.B. created a special organization to order the distribution of food. The very same day, Mr. Gorbachev authorized Communist-run "workers' committees" to monitor food distribution in cooperation with the K.G.B., and to hold kangaroo courts. And so on and so on.

The democratic opposition to Mr. Gorbachev — and more and more Western specialists on the Soviet Union — fear that the inability of the Kremlin to govern in the face of public contempt will bring a national crackdown in six to eight months, maybe earlier.

Meanwhile, delegations to the United States of Russians, Georgians, Armenians, Ukrainians and Balts plead that at least some American aid be sent directly to the Soviet people through local governments and democratic political organizations. Ask any Soviet citizen if he trusts the shattered Communist central Government to distribute foreign aid when it cannot even distribute food grown in the Soviet countryside.

Despite signs of a coming crackdown, why did Mr. Bush waive the longtime American condition of free emigration? Why did he refuse the fervent requests that some aid go directly to opponents of the Soviet system, not just its panicky officials? Despite Soviet denial, was Kremlin political support in the Persian Gulf involved — maybe just a tiny bit?

For friends of the Soviet people, the goal should not be to stop American food aid, but to try to make sure that it is used by the right people for the right reasons.

Wisely, the President acted with some caution. He put a six-month time limit on the free-emigration waiver. If a Gorbachev crackdown does not come earlier, Mr. Bush has until May 1991 to live up to an old promise made to all imprisoned people: The United States will not allow American assistance to become a barrier to freedom instead of a path. □

THE NEW YORK TIMES, MONDAY, NOVEMBER 12, 1990

From Uruguay to Moscow

By Jagdish Bhagwati and Padma Desai

One wouldn't normally speak of the world trade negotiations and Mikhail Gorbachev's perestroika in the same breath. Yet, by a strange conjunction of circumstance, the problems that are threatening to undo both undertakings fit like pieces in a jigsaw puzzle: the solution to one is the mirror image of the solution to the other. This raises the prospect of a unique policy initiative.

The four-year-old Uruguay Round of multilateral trade negotiations is now entering its last feverish lap in Geneva and Brussels, and faces failure because of the inability to liberalize agricultural trade. The sticking point is that liberalization would contract state-supported agricultural "surplus" production, chiefly by the European Community.

On the other hand, Mikhail Gorbachev, whose five-year-old perestroika is now shifting stormily into high gear in the Soviet Union, faces growing disorder from empty shelves reflecting a "deficit" in bread and meat supplies in the state shops in his cities.

Thus, a mutual-gain policy materializes: a grain and meat sale arrangement, with long-term credits that would enable a foreign-exchange-strapped Mr. Gorbachev to come readily on board.

Jagdish Bhagwati and Padma Desai are professors of economics at Columbia University and authors, respectively, of "Protectionism" and "Perestroika in Perspective."

The liberalization of agricultural trade is critical. Agriculture is currently excluded from the discipline of the Geneva-based General Agreement on Tariffs and Trade, beginning ironically with the waiver granted to our agriculture in 1955. In consequence, it is shot through with price supports, export subsidies, import quotas and other interventions here and elsewhere.

Replacing governments with markets in agriculture would bring gains in efficiency, estimated for the O.E.C.D. countries alone at $900 per average family each year. In the U.S., there would be the added advantage of dismantling the huge agricultural subsidies that drain our strained budget.

A plan to prop up world trade and Gorbachev's perestroika.

Beyond that, agricultural liberalization also holds the key to the Uruguay Round's success. It offers key developing countries — including Argentina, Brazil, Chile, Indonesia and Thailand — significant gains that can be used to extract from them concessions on trade in services and in protections for intellectual property — both important issues for the U.S.

Unfortunately, the European Community continues to resist. Powerful farm lobbies intimidate the French and German Governments, which, in turn, carry immense clout in the European Community.

The French farmers' recent vandalism against trucks carrying British lamb, and Community action banning imports of U.S. pork — on the utterly flimsy ground of unsanitary conditions at our slaughterhouses — are evidence of the problems we confront. The Community's offer on agriculture, tabled at the 11th hour last week, falls way below what is needed to cut a successful deal at the Uruguay Round. A powerful incentive to push the Community into further concessions is necessary.

Here is where the Soviet Union fits in. It could provide a new and substantial, if temporary, market for excess European production, cushioning the shock to European farmers of a reduction in trade barriers. The road to Moscow, for once, offers promise rather than peril.

We propose an agreement in which the Europeans would sell large amounts of grain and meat to the Soviet Union over a period of, say, five years. The Soviet Union would be granted long-term credits, so that repayment (in convertible currency) would begin in the sixth year. This would enable Mr. Gorbachev to import significantly more than he would otherwise be able to afford, strapped as he is for foreign exchange.

Being credit-financed, the sale would naturally gravitate to those who can afford the credits — the European Community and the U.S. This would insure support for the Community's agriculture during the transition to liberalized trade. And the pact would run out after five years, ultimately leaving the world's agriculture closer to the market forces that a successfully concluded Uruguay Round would achieve.

Mr Gorbachev could certainly use an additional 20 million tons of grain and meat annually, close to half again what the Soviet Union imported last year.

The reason for the food shortages, paradoxically, is that perestroika has succeeded on the farms. They produce more, but, free now to reject procurement contracts they earlier could not refuse, the farms sell little at low Government prices. Instead they sell in the market, where they earn the higher prices that in fact stimulate greater production.

Having procured less grain, the Government has correspondingly less processed bread and meat to distribute in its shops. What follows is the unseemly scramble for vanishing sausages and missing bread in the state shops.

The imports under the agreement we propose would largely fill the gap left by the lagging procurement, which, at 59 million tons of foodgrains, fell 27 million tons short of target in 1989. It would pay a double dividend for perestroika.

It would immediately make food available in state stores, helping contain the revolution of diminishing expectations about what Mr. Gorbachev can deliver. It would also soak up excess expenditures, reducing a huge budget deficit (now running at 10 to 11 percent of gross national product) that is beginning to drive an inflationary spiral.

Most important, Mr. Gorbachev would get the extra edge that he needs as he gets down to the urgent task of overhauling his moribund economy. □

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REMARKS TO THE
EMERGING MARKETS ADVISORY COMMITTEE
BY DEPUTY SECRETARY JOHN ROBSON
TUESDAY, OCTOBER 23, 1990
WASHINGTON, D.C.

Thank you, Richard (Breeden). It is a great pleasure to be included among the EMAC participants at this conference. There are many critical issues to discuss here, and I appreciate your invitation.

To say the least, 1989 and 1990 have been dynamic years for international finance. On virtually every continent, we are witnessing political and economic changes that will influence foreign and domestic markets well into the 21st century.

In the new democracies, political reform was quick and, in most cases, has occurred relatively peacefully. But, the reform is far from over. As President Bush has said:

> "...the eclipse of communism is only one half of the story of our time. The other half is the ascendancy of the democratic idea."

And, for all nations, we believe, the democratic idea must include a free-market economy. Already we are witnessing profound economic reform in Eastern Europe and Latin America, where countries are rebuilding economies from the ground floor up.

Since last year, East Europeans have been busy creating the institutional framework that will transform their economies. We've seen the introduction of concepts such as private property and privatization. Other new laws allow freedom of decision in pricing, production, and the hiring and firing of employees -- decisions that were traditionally controlled by the government.

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Of necessity, some Eastern European countries are establishing market institutions before they have a market. For example, countries have adopted regulatory laws -- with little or nothing to regulate.

And one of the major obstacles confronting the emerging economies is simply getting a grasp on the concepts of a free market -- concepts we take for granted. I recently met with Stanislav Shatalin -- the Soviet economist-reformer. At one point, I mentioned the word "equity", and one Soviet leaned over and asked us to define the term.

They need our help. And the advanced industrial democracies have an important obligation -- and opportunity-- to fill in the developing framework.

So far, we've responded quickly to facilitate the process of economic reform in Eastern Europe. For its part, the United States Government is doing all it can to lend assistance in tangible and important ways. We have already committed $1 billion to Poland and Hungary, and the Administration has requested $300 million more for Eastern and Central Europe in FY 1991.

For Latin America and the Caribbean -- where democracy and free-market economies have taken hold broadly but with considerably less fanfare than in Europe -- President Bush has launched the Enterprise for the Americas initiative to stimulate investment and trade and to address official debt burdens.

In addition to bilateral assistance, we are working closely with the IMF, the World Bank and other international financial institutions. Just last week, President Bush announced that we are asking the IMF for increased lending to the Eastern European region by as much as $5 billion. The President also stated that we have asked the World Bank to accelerate the $9 billion of lending it has committed -- especially for the energy sector.

The U.S. is also providing technical assistance in many ways, including: tax policy, banking and securities market regulation and privatization. In one case, for example, we are now working with the World Bank and the Yugoslav government and private sector to set up a banking and finance training institution in Yugoslavia.

But, clearly, the emerging free-market economies cannot rely only on foreign governments for advice.

Instead, reforming nations are looking for advice and assistance from Western business leaders. They need help from all sides: investment and commercial bankers, attorneys, accountants -- all types of executives will be helpful in establishing these emerging economies.

I'm proud to say that many American firms have already pitched in. Chairman Breeden and all of you were moving in tandem with the President when you established EMAC. The EMAC, the Financial Services Volunteer Corps (FSVC), and the Polish- and Hungarian-American Enterprise Funds have already been helpful.

The Polish-American Enterprise Fund recently announced a commitment to invest $19 million to provide capital to small businessmen and farmers in Poland. That sounds modest, but it's a real move forward for entrepreneurial activity.

Clearly, private sector assistance and investment are the way to go. But the efforts of government and the private sector can be synergistic.

EMAC's goals are entirely harmonious with the objectives of the U.S. and the peoples of the emerging market economies. We need firms and professionals who are ready to jump in and lend help where and when it is needed. You, the members of the EMAC, are America's economic "minutemen" -- executives who can organize assistance programs quickly and successfully for countries that ask for guidance.

A perfect example of this guidance is the group of experts on Employee Stock Ownership Plans (ESOPs) that visited Hungary earlier this month. The Government of Hungary is seriously considering the use of ESOPs as one method of privatizing state assets.

When our embassy called the Treasury Department passing along Hungary's request for advice and assistance, we turned to the SEC and the EMAC to find firms willing to help that nation take the first step. Within only a week, three firms had representatives with bags packed and ready to go to Budapest.

That mission returned last week, and we have heard high praise from the Hungarian Government.

But, there is more to do -- much more. We have hardly touched the surface of the deep pool of demand from both the governments of reforming countries and their fledgling private firms. Of particular relevance to this group, they need and seek our guidance in establishing financial markets that operate legally, efficiently, and to the benefit of all.

Your participation in this advisory committee is an important part of that effort. We know you all have expressed a willingness to help. We know you have the expertise and the resources to make a significant difference. The challenge EMAC faces now is to get that expertise and those resources in the hands of these emerging market economies.

I understand you have created five working groups within EMAC, each with specific skills and backgrounds to offer nations with developing free markets. Let me offer some thoughts on possible projects your groups might undertake.

First, the working group on Securities and Futures Markets. Stock exchanges exist in only two East European countries, and they are rudimentary. The Budapest exchange, for example, has only 15 or 20 listed stocks to trade. Yugoslavia has 2 stock markets operating and one still in the planning stage. All six East European countries want modern exchanges, and they all need help. That's where you can come in.

-- Adopt a new Eastern European securities firm or intermediary. You could offer to sponsor travel to the U.S. by officials from newly formed or privatized firms. Show them how your companies conduct underwriting and trading and explain the concepts of corporate finance.

-- Provide training for the operators of the new stock exchanges in Hungary, Poland and Yugoslavia. Or, conduct a symposium for regulators, officials, and business owners to learn basic aspects of securities development and issuance.

Your working group on Clearance and Settlement Systems can provide urgently needed assistance. Retail banking -- as we operate it in the U.S. -- is a mystery to these nations. For example, in Yugoslavia this year, banks had clearance processing codes printed on checks for the first time. But many will not have automated processing equipment installed until 1992.

To help, you could donate technology to upgrade the capacity of these new banks. Our old equipment is at least 25 years ahead of what exists in Poland or Hungary. As you upgrade your computer systems, consider how Polish banks and market operators could make use of old equipment. Equipment and "back-office expertise" are greatly needed.

You can also help to encourage savings. For 50 years, the safest place for Eastern European families to put their money has been either under the mattress or out of the country. They've got to get that money out of the mattresses, into the banks, and loaned out to businesses of all sizes for investment capital. So, these countries must instill a sense of confidence among their people that banks are safe, efficient and useful institutions.

Perhaps your working group on Financial Intermediaries and Institutions could consider programs to encourage more citizens to deposit their money in the new or recently privatized banks. For example, your firms could publish brochures -- that working people can understand -- to explain how banking and savings work in a market economy.

Savings incentives are also critical. We can help banks and securities dealers to encourage more savings by designing new marketing techniques. Product ideas will go a long way toward building a retail banking system.

Privatization of state-owned enterprises is also central to the success of transitions to a free-market economy. Yet, most of the reforming nations are struggling with this politically and technically difficult problem. Surely, your working group on Financial Structures and Corporate Finance can provide advice on privatization. For example:

-- Make your best professionals available as short-term technical advisors.

-- Or, go to Eastern Europe and present lectures on basic finance and company valuation techniques.

Finally, your working group on Accounting and Professional Responsibility can advise these nations and private businesses on methods of bookkeeping and financial analysis. If the countries are to compete in the global marketplace, their accounting systems must move toward internationally accepted standards.

The fact is that the areas where Western expertise could be applied to help these emerging market economies are nearly endless. Yet, it is important to remember that this exchange of ideas produces important benefits for American firms as well.

We believe these emerging democratic nations have what it takes to establish a successful economy: potential industrial strength, economic incentive and well-educated populations. What they need and want to get there are American know-how and investment.

If I were still in the private sector, looking for investment opportunities in Eastern Europe would be high on my corporate agenda. And, I would try to get involved as soon as possible.

Yes, the waters are a little choppy for American firms investing in these new democracies. But business is competition, and if you wait until the sea is perfectly calm and the risk profiles are low, then we're going to lose out. American firms cannot wait until Japan, France, Germany and others have capitalized on this opportunity.

Your support, investment, advice and technical assistance will be invaluable. You will benefit, the emerging market economies will benefit, and economic reform throughout the world will be encouraged. I look forward to working with all of you as we move these nations toward democratic societies and market economies that work for everyone.

Thank you, and good luck on your new and exciting mission.

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Executive Summary

Purpose

The extraordinary and rapid developments in Eastern Europe represent a major turning point in Europe's postwar history. As East European countries now move from centrally planned economies to decentralized market-based economies, the United States and other countries are providing assistance. To help decisionmakers in determining appropriate U.S. assistance for the region, GAO is providing information on international economic assistance to five East European countries—Poland, Hungary, Czechoslovakia, Bulgaria, and Romania. Specifically, GAO's objectives were to determine (1) which countries and multilateral donors are providing economic assistance, (2) what assistance is being provided, and (3) what the socioeconomic problems and opportunities are in these five countries.

Background

Because communist countries have never before made the transition from a planned economy with a one-party political system to a market economy with a democratically elected government, there is no model for doing so. However, East European countries are beginning to take such steps as establishing market-based prices, reviving the private sector, and restructuring the public sector. The United States and other countries are providing assistance to facilitate economic and political change and help maintain peace and stability in the region. Both the public and private sectors in donor countries are providing assistance through bilateral and multilateral arrangements.

Results in Brief

The United States, Germany, Japan, Italy, France, and the United Kingdom are providing about three-fourths of the $8.5 billion in aid committed to Poland and Hungary as of May 1990. Aid commitments are in the form of grants, loans, credits, advice, and in-kind benefits. This assistance covers a wide range of activities in such fields as economics, finance, education, agriculture, and the environment. In addition, aid is needed to encourage political reform.

Donor countries have moved quickly to provide assistance to Poland and Hungary and to make plans for other East European countries. In addition, multilateral organizations, such as the World Bank, the International Monetary Fund, and the Organization for Economic Cooperation and Development, have begun to provide aid.

Some of the major economic problems facing East European countries are declining gross national products, large foreign debts, antiquated industrial bases, and over-reliance on the Soviet Union. Conditions vary

by country, but all have economic growth potential. Growth, however, is highly dependent upon substantial foreign investment. The region has a large and relatively highly educated, low-paid work force and is highly industrialized.

Principal Findings

Bilateral and Multilateral Donors Provide Many Types of Aid

Over 30 U.S. government agencies are providing almost $700 million in assistance to Poland and Hungary in areas such as economic stabilization and structural adjustment; private sector development; trade and investment; and educational, cultural, environmental, and democratization efforts.

The European Community and other donor countries are assisting Eastern Europe in the areas of agricultural and environmental development, training, and investment. Multilateral assistance includes establishment of (1) the $1 billion Polish Stabilization Fund to support Poland's currency as the government undertakes economic reforms and (2) the European Bank for Reconstruction and Development, which will provide loans for private sector projects, infrastructure development, and environmental efforts.

Poland and Hungary both have economic stabilization arrangements with the International Monetary Fund. The arrangement with Poland was completed in February 1990 and authorizes purchases up to $723 million to support the government's economic program aimed at decreasing the rate of inflation and promoting a market economy. The arrangement for Hungary, approved in March 1990, authorizes purchases up to $206 million to support the government's efforts to reduce domestic and external economic imbalances during the process of restructuring the economy.

The World Bank has provided $781 million in project loans to Poland, primarily for environmental, energy, and transportation activities and to support private sector export promotion and agroprocessing industries. The Bank has provided Hungary with three project loans, amounting to $366 million, to support Hungary's structural adjustment program and to modernize and expand agricultural enterprises and the banking system.

Economic Problems and Opportunities

Enterprises in the East European centrally planned economies were organized as large, state-owned monopolies. In the traditional centrally planned economy, virtually all the means of production are turned over to state ownership. The state's central authorities plan for the inputs and outputs of state-owned enterprises, with inputs generally being centrally allocated. Virtually all prices are fixed by the central planners, and foreign trade is controlled by state-owned organizations. These industries suffer from outdated technology, lack of competitive incentives, and shortages of production materials, resulting in low productivity rates. The East European countries have had little experience with commercial banking and securities markets, and their currencies have been nonconvertible, thus limiting trade and investment.

Reforms are underway, but the process of developing the financial systems that can aid domestic economic growth will be slow. Most of the countries in Eastern Europe—particularly Poland and Hungary—have large foreign currency debt levels which severely limit their ability to resolve domestic economic problems.

The countries also face massive infrastructure needs. Roads, telecommunications, railways, and port facilities are inadequate for expanded international trade. Years of depending on heavy industry for development, relying on environmentally damaging high-sulphur coal for power, and refusing to control or treat hazardous wastes have extensively damaged vegetation and water resources and have begun to affect health. Pollution-related cancers and infant mortality are increasing, as are the number of people dying from environmentally induced diseases. Health standards in general are considerably lower throughout the region than in Western Europe.

Per capita gross national product of the East European countries remains considerably below that of the United States, and standards of living are far below those of most West European countries. Key indicators of availability of common consumer goods show that East European standards parallel those of Greece and are a bit ahead of some Latin American countries.

Although conditions vary by country, the combination of comparatively low pay and high skill levels in a large labor pool of relatively highly educated workers offers opportunities to attract development capital.

Despite the immediate socioeconomic costs in undertaking economic structural reform, the East European countries must undertake certain

fundamental measures if they are to succeed in establishing and supporting a market economy. The success or failure of donor assistance to these countries depends at least as much on the host governments' implementing economic reform measures as on ensuring the effectiveness of the assistance strategies. The countries must place greater reliance on market-based prices, revive their private sectors, establish financial markets, and improve their infrastructures. Over time, the success of these efforts will undoubtedly vary among the countries, suggesting that a long-term perspective will be needed to assess the success or failure of donor assistance.

Recommendations

In this report GAO provides information on bilateral and multilateral assistance to five East European countries. GAO is making no recommendations.

Agency Comments

GAO did not obtain written agency comments on a draft of this report. However, during the course of the work GAO discussed its findings with officials of the Department of State who have been charged with coordinating all U.S. government assistance to East European nations. GAO has incorporated their comments in this report where appropriate.

The Baltic Republic's Push for Independence: Implications for U.S. Policy

by Vita Bite

SUMMARY

On Mar. 11, 1990, Lithuania, the largest of the three Baltic republics, declared itself independent of the Soviet Union and elected a non-communist head of state. Estonia and Latvia soon followed with their own independence declarations sparking a test of wills with Moscow. The extraordinary speed and extent of radical changes in the Baltic area raise a great deal of uncertainty and suggest potentially far-reaching consequences not only for the Baltic area, but also for the Soviet Union and for U.S. foreign policy in the region.

The Baltic republics are of an economic and geographic importance to the Soviet Union that exceeds their small size and population. Moreover, actions in the Baltic states may have catalytic consequences in other Soviet republics, many of which are also experiencing growing independence movements. Developments in the Baltic republics thus pose a major challenge for Soviet leaders. For several years Soviet President Gorbachev encouraged Baltic public activism in support of political and economic restructuring. However, as the Baltic movements developed increasingly nationalist-independence goals, Gorbachev has been confronted with a dilemma. Using force to put down peaceful Baltic movements for independence would undermine his efforts at *perestroyka* domestically, and good relations with the West internationally. At the same time, he must maintain credibility in the Soviet Union as an effective leader who will prevent fragmentation or disintegration of the U.S.S.R.

Soviet responses to Baltic actions have included: public denunciations, economic pressures, a limited show of military force, and demonstrations by non-Balts. Foreign journalists and diplomats were ordered out of Lithuania at the end of March 1990. In mid-April, 1990, Gorbachev began a far-reaching economic blockade of Lithuania. At the end of June the Lithuanians agreed to a 100-day moratorium on the restoration of Lithuanian independence while negotiations with the Soviet Union are held. The Soviets lifted the blockade on July 2, 1990. Recent preliminary negotiations between Soviet and Baltic officials over independence appear to be stalled as the Soviets press the Balts to participate in discussions for a new Soviet federation.

The U.S. Government has never recognized the legality of the Soviet Union's 1940 annexation of the Baltic States. The Congress has supported the U.S. position backing Baltic self-determination. At the same time the U.S. Government has come to link prospects for a stable and peaceful U.S.-Soviet relationship with the success of Gorbachev's reforms. Even after the imposition of the Soviet economic blockade of Lithuania, President Bush opted to encourage dialogue, but did not take actions against the Soviets for fear of undermining Gorbachev and worsening the Baltic situation. Many U.S. policymakers fear that strong U.S. encouragement for Baltic independence might be viewed as encouragement for the dissolution of the Soviet Union and end the current good relations with the Soviet Union, thereby undermining the positive reform efforts of Gorbachev. Thus, the United States also faces difficult policy choices as the Baltic push for independence continues.

United States-Soviet and East European Relations: Building a Congressional Cadre
by Dick Clark
August 25-31, 1990
The Aspen Institute

Conference Report

Dick Clark, Director and Moderator

Michael Mandelbaum, Assistant Director and Rapporteur

The first conference on Eastern Europe for Members of Congress took place from August 27 to 30, 1990 in Prague, Czechoslovakia. Eight Members of the House of Representatives and eight Members of the Senate took part, along with ten elected parliamentarians from Eastern and Western Europe and 12 scholars.

The premise of the conference was that the revolutionary developments of 1989 in Eastern Europe—or more properly Central and Eastern Europe—have created new and unprecedented challenges and opportunities for the United States in the region. The Members of Congress are not always as well informed as they would like to be about this part of the world mainly because of the extraordinarily heavy demands on their time. The purpose of the conference was to provide them with an opportunity to inform themselves.

The discussions at the conference were designed both to enrich the Members' understanding of the history and the current problems and prospects of the region and to address issues of policy with which they must deal, but without simply recreating the ongoing debates in Washington. There was no illusion that differences could be resolved in a few days' discussions, no matter how cordial, and no consensus statement on desirable directions for American policy was issued. There is the hope that the discussions can lead to a better understanding not only of the issues but of the different approaches to them represented in the Congress, and so help in the search for common ground on which an effective American policy toward the region must rest.

For the first session, the background reading was the paper by James Brown on "Eastern Europe: Political Generalizations and Country Snapshots."

If 1989 was a year of revolution in the region, it was noted, 1990 is a time of reconstructing—or perhaps more properly constructing for the first time—Western-style political and economic systems.

The two tasks were interrelated. The revolutions of 1989 were not simply economically-motivated uprisings; the people of the region took peacefully to the streets on behalf of national independence from the Soviet Union and the rights and liberties enjoyed by their counterparts in the West. But economics are crucial for the political future. Unless successful market economies are established, democracy may not flourish. Good citizens, it was asserted, need square meals.

Two distinct political models for the immediate future are being debated. One involves maintaining the broad social consensus that made the revolutions possible. This can preserve the heady sense of community and idealism of 1989, and will so help the public accept the economic sacrifices that the transition from a planned to a market economy requires. On the other hand, maintaining political unity at all costs may turn out to be an excuse for the return of authoritarian rule of some sort. And it can also be a formula for political and economic stagnation; progress may require a lively opposition to goad the government.

The alternative vision of the political future involves creating several political parties immediately, which would then vie for power, as in the West. Such a system would better represent the various social and political forces in these countries than a broad national coalition; but their competition might generate so much friction and ill will that it would paralyze the government.

Ultimately a multiparty system is the preferred political destination everywhere. Whether it should have two major parties, as in the United States and Great Britain, or several, as in many Western European countries, is a matter of debate. Stability is built into a two-party system; one party or the other always has a majority. A system of several major parties better expresses the political diversity present in any society. Whichever is preferable, it is clear that a system of many political parties is not desirable. Immediately after the democratic revolutions in several of these countries, forty or fifty parties were formed; but there is encouraging evidence of rapid consolidation to a more manageable number throughout the region.

Successful, stable democratic political systems require a democratic political culture. This consists of widely shared values,

among which the most important are the minority's acceptance that the majority has the right to govern and the majority's acceptance that the minority has the right to operate freely, oppose the government, and compete for power in free elections.

In economic terms, there is consensus throughout Central and Eastern Europe on the direction in which to move. All the countries favor creating a market economy. They differ on how far and how fast to move in that direction.

In making the transition from a planned to a market economy they face a common problem. The transition will impose hardship. Prices and unemployment are bound to rise in the short term. This could lead to widespread resentment and political instability. Some have suggested that for the sake of imposing the necessary economic sacrifices, political power ought to be concentrated in a few hands. But this risks restoring some version of the dictatorial rule that the 1989 revolutions eliminated. If economic reforms produce too much distress, however, demands may well be heard for an authoritarian figure to take charge. There is a precedent for the rise of a "strong man" in the interwar history of several of the countries of this region.

All of the countries face enormous environmental problems. Among the worst legacies of forty years of Communist rule is environmental deterioration that goes far beyond anything that has occurred in the West. The task of stopping and undoing the damage to air and water is urgent, and the case for immediate Western assistance a powerful one.

Romania, it was suggested, differs from other countries of the region in that the 1989 revolution was incomplete. A government composed of former members of the Ceausescu regime is in power in Bucharest and is not, it was charged, fully committed to democracy.

As for the Soviet Union, its direct role in Central and Eastern Europe has shrunk dramatically, in large part because it is preoccupied with internal problems, chief among them the question of whether the union of the several republics will endure and if so, on what basis. The transition from a planned to a market economy to which its neighbors to the west are all in varying degrees committed is also on the political agenda in Moscow. But in the Soviet Union the commitment is thus far weaker, and the obstacles to the successful creation of a market economy greater. It was suggested that the outcome of economic change in Central and Eastern Europe will have an important "demonstration effect" in the Soviet Union, and that therefore one way the West can encourage Soviet market reforms is to help make them successful in Central and Eastern Europe.

The second session of the conference, on the political agenda in the region, took as its point of departure Charles Gati's paper, "After Communism, What?"

The discussion began by postulating a division of what in the Communist period was known as Eastern Europe. Central Europe was said to comprise Poland, Czechoslovakia, and Hungary. (East Germany also belongs to this category, but will disappear as a separate political entity with German unification.) What deserves to be called Eastern Europe, it was suggested, includes the countries of the Balkans: Bulgaria, Romania, Albania, and the Serbian part of Yugoslavia.

With the collapse of Communism the differences between these two groupings are becoming increasingly pronounced. These differences have deep historical roots. For most of their modern history the countries of Central Europe were part of the Western, German, Christian Hapsburg Empire. Eastern Europe, as defined here, was by contrast under the sway of the Eastern, Turkish, Muslim Ottoman Empire. One consequence is that Communism struck somewhat deeper roots in Eastern Europe. It came as a vehicle of economic advance rather than, as in Central Europe, economic backwardness. And some Eastern European countries, notably Bulgaria, have an historically greater affinity for Russia, which Bulgarians have seen as their liberator from the Turks.

It was also noted that important differences are apparent *within* Eastern Europe as it is defined here. Bulgaria now seems closer to democracy than Romania. Its recent elections were evidently freer, the support for former Communists, particularly in rural areas, may be more genuine, and elements of the leadership are arguably more committed to genuine democracy.

In Central Europe, it was suggested, there are grounds for optimism that Western-style parliamentary democracy will take root. The future looks promising. Still, the three countries of the region do confront a number of problems.

They must build functioning democratic institutions. In the wake of the revolutions, executive powers in each country are relatively weak, no doubt partly in response to the stifling executives of the Communist period. But executive power is necessary to carry out the tasks of government. Central Europe must also build judiciaries independent of politics, which can protect and enforce the rights and liberties that have historically been available on paper, but not in practice, in this part of the world.

The three countries face knotty personal questions. In deciding how many officials and employees of the old regime to retain they must avoid dismissing so many that they lack the competence needed to run their countries but must also avoid keeping so many that they lack a critical mass of people genuinely committed to Western values and procedures. They must also decide how far to go in settling accounts with the past. Massive purges of Communists are no doubt desirable, but it may be equally undesirable to allow even the most corrupt former officials to escape a public accounting of what they did in power. Ultimately what these countries need most is a new generation of leaders, but this cannot be created overnight.

The countries of Central Europe need to be clear about their vision of the future. There is a danger that they may be attracted to the false promise of a "third way" between the Communist systems they have abandoned and the political and economic ways of the West, which could lead them into authoritarian political rule as in the interwar period.

These countries must also cultivate democratic values, particularly the tolerance that has seldom been prominent in the history of the region. They must learn that spirited political competition does not preclude civility and cooperation once con-

tests for power are decided. And the West must recognize that vigorous political competition in these countries, including harsh rhetoric, is not necessarily a sign of intolerance or the weakness of democratic structures.

Of particular importance in Central Europe is tolerance of ethnic and national minorities; the historical record is not a good one.

One way of blunting excessive nationalism and chauvinism in the region, it was suggested, is regional cooperation, which might also have economic benefits of the sort that the countries of Western Europe have derived from the cooperation that they have practiced since the end of World War II.

The conference's third session concerned economic change. Paul Marer's paper, "Lessons of Successful Market Economies and the Political Economy of System Change in Central, Eastern, and Southern Europe," provided the background for the session.

All the countries of the region, it was noted, are committed to creating a market economy within their borders. This is an enormously complicated and difficult task, and one without any real precedent in economic history. It was compared to leaping across a wide ditch. It involves a series of radical steps that, to achieve maximal effect, must be undertaken simultaneously.

One of them is putting the country's economic assets into private hands. Without private ownership the incentive to increase the value of assets, which is one of the chief engines of growth in a market economy, is missing. "Privatization" in Central and Eastern Europe, however, raises a series of difficult questions: At what price should the assets be sold? Should those whose property was confiscated by the Communists forty years ago or their heirs have special rights? Should every citizen have some claims to ownership? If so, what claims? How much should foreigners be permitted to purchase?

The transition from a planned to a market economy also involves breaking up the monopolies that dominate the economies of these countries. But this raises all the questions of ownership, and others besides. The process will inevitably throw many people out of work, which leads to two further requirements of a successful transition.

New firms must be created. The countries of the region need entrepreneurial activity which cannot be conjured up overnight. They must also revise and expand their social safety nets to protect those upon whom the transition will impose hardship, a task all the more complicated because in Communist countries welfare has been built into the system of employment. A worker gets his housing, for example, from his employer. To foster the mobility of labor that is essential in a functioning market economy, this system must be changed.

The transition raises a series of problems involving the external economic relations of the countries of Central and Eastern Europe. Their ties with the Soviet Union, through the Council on Mutual Economic Assistance (CMEA) have been short-term assets—enabling them to exchange relatively shoddy manufactured goods for cheap energy—but long-term liabilities—locking them into production processes and trading patterns that perpetuate economic backwardness. Central Europe must sever the old ties with Moscow, but not so rapidly as to produce sudden, grievous economic injury.

The countries of the region are burdened in varying degrees with external debts, with Poland and Hungary being the most seriously affected. They also run balance of payments deficits that are likely to worsen from a double oil shock: the world price has risen because of the events in the Persian Gulf while the Soviet Union, from which these countries purchase most of their petroleum, is now demanding payment in hard currency.

Finally, all these countries have a powerful interest in making their currencies convertible. Unless Western firms can repatriate locally earned profits, they are unlikely to invest on any appreciable scale.

Should the West give economic aid to the countries of Central and Eastern Europe? It was variously suggested that any aid be strictly conditional on the implementation of the measures that a transition requires, that providing a standby fund to support convertibility can, as the Polish experience demonstrates, be useful, that cleaning and protecting the environment deserves special emphasis, that the countries of Eastern Europe bear particular responsibility here, and that the period of transition is a uniquely urgent one.

Security issues were the topics of the conference's fourth session, which James Thomson's paper, "European Security in the 1990s and the American Presence in Europe," introduced.

Assuring German security, it was asserted, is now the central task of European international politics and diplomacy. In the future as in the past, if Germany is insecure the rest of Europe will be insecure as well. In the future, German insecurity will inevitably raise the question of German nuclear weapons.

How can Germany remain secure? Three options are prominent. One is a common European security order. The concept is attractive but vague and untested. And whatever the details of such an order, it would require considerable consensus among the major powers of Europe to be effective. Soviet participation in such a consensus cannot be guaranteed, if only because the future of the Soviet Union itself is so uncertain.

A second option is a neutral Germany. But neutrality is not tantamount to disarmament. A Germany cut off from ties of alliance with other powers, especially the United States, might well drift toward military independence—including, perhaps, nuclear weapons—which would alarm the other European powers.

The best possible option for the short term, therefore, is the third, the maintenance of the existing American security guarantee within the context of a wider Atlantic alliance. The present arrangements are tried and true and acceptable throughout Europe, east and west.

To endure, the force structure of the Cold War need not necessarily remain the same in all its details. Fewer American forces in Europe will surely be adequate to keep Germany and the rest of Europe feeling secure. But at least for the foreseeable future, it was argued, some troops from North America must be stationed on European—and German—territory, as a sign of American seriousness of purpose.

In the coming decade, the American troop presence in Europe may be threatened from within the United States. General weariness with the four-decades-long burden of defending the Europeans, constraints imposed by the budget deficit, resentment at what is seen as an inequitable distribution of the burden of defense between Europe and the United States, and the lack of a clearly defined and powerful adversary may all subvert public support for keeping forces on the continent. Threats may also come from within Europe, from a general feeling that the United States is out of touch with political developments there as well as from German restlessness at playing host to foreign military forces for so long.

German security is the foremost security issue for the next decade but there are others. Turmoil in the Soviet Union could spill over into Europe. In Central and especially Eastern Europe ethnic and national conflicts could flare. There is a need to avoid excluding the formerly Communist countries of the continent and especially the Soviet Union from the design and management of the continent's security, and a growing feeling in Europe that the structures of security ought to be expanded in response to what is plainly a new era and a new order on the continent. The Conference on Security and Cooperation in Europe (CSCE) might usefully play an expanded role, as might the United Nations. NATO's responsibilities could be extended, as could those of the European Economic Community.

The fifth and final session revolved around the question of America's part in the ongoing changes in Central and Eastern Europe, and took as its point of departure Madeleine Albright's paper, "The Role of the United States in Eastern Europe."

The United States, it was suggested, has a political interest in stability in the region if only because it is in Europe, historically the center of American international concerns and the cradle of the two great wars of this century. There is a moral obligation, as well, to support the creation of the kinds of political and economic systems that Americans urged upon the people of these countries throughout the Cold War. And although American economic interests in this part of Europe have historically been modest, if radical economic reform is successful the opportunities for trade and investment could be considerable.

The Western Europeans also have political and economic interests in and moral obligations to their neighbors to the east. Indeed, the stakes of America's postwar allies in the establishment of stable democracies and vital market economies in Central and Eastern Europe are probably greater than those of the United States. But the United States has some special advantages in helping to foster such developments, which stem from the enormous good will toward all things American in the region. It was the United States that opposed Eastern Europe's oppressor, the Soviet Union, during the long decades of the Cold War; and it was the United States that insisted that human rights be part of the East-West agenda. Both policies are deeply appreciated in the formerly Communist countries of Europe.

What can and should be done for the people of the region? Sustaining the American military presence in Europe would make them feel more secure, since it would insure that Germany and Russia, to whose foreign policies the peoples in between have often fallen victim, were not the only major powers on the continent.

The alleviation of the external debts with which their former Communist regimes saddled several of these countries would contribute to their economic recovery. And all need immediate assistance, it was again stressed, with their acute environmental problems.

Perhaps the greatest American contribution can come through cooperation on the environment, technical assistance, training, and education. Central and Eastern Europe are woefully short of people with skills and experience in public administration, democratic politics, and the operation of market economy. Programs to give people from the region such skills could help make the difference between success and failure in the political and economic experiments on which these countries have embarked. Over the long term, programs to bring students from the region to American universities for undergraduate and postgraduate training could pay rich dividends. Such programs would not be expensive, but they would establish a network of personal and professional ties between the United States and Central and Eastern Europe for the next generation.

East Europe's Trade Advantage Lies In Its Labor Skills, Says CEPR Study

Southern members of the European Community (EC)—Greece, Portugal, and Spain—have little to fear from the integration of Eastern Europe into the European trade matrix, according to a recent study by the Centre for Economic Policy Research (CEPR), a nonprofit, economics research organization in London. The report, entitled *Monitoring European Integration: The Impact of Eastern Europe*, contends that Eastern Europe's labor force is more highly skilled than that of the EC-South and that its manufactures are concentrated less in the sensitive labor-intensive sectors such as clothing and footwear than in more sophisticated goods.

The study also maintains that there is scope for a substantial increase in East European trade in natural resources and agricultural products. And it notes that a major macroeconomic implication of reform in Eastern Europe is the likelihood of a massive turnaround in Germany's current account as it is forced to borrow from abroad to finance a transfer of resources to Eastern Germany.

Two of the ten contributors to the study, Francesco Giavazzi of the Università di Bologna and L. Alan Winters of the University of Birmingham, presented highlights of their findings at the IMF Visitors' Center on November 15 as part of the Center's Economic Forum series. Richard Portes, Director of the CEPR and a Professor at Birkbeck College in London, also participated in the seminar. He noted that the study is the first of an annual series on European integration, with each year's report to be devoted to a particular theme.

In introducing the panelists, Jacob A. Frenkel, Research Director and Economic Counsellor at the IMF, noted that unlike the usual practice of examining the impact of economic developments on a particular region, the CEPR study looks at the impact of one region's development on another region. "In this, it is unique," Frenkel observed.

Trade Patterns and Policies

Winters began the discussion by presenting the major conclusions of the first part of the report, which focuses on developments in trade patterns and trade policies. Given the dearth of reliable data on trade in Eastern Europe, Winters offered four approaches, which, he said, "taken together, can shed further light on the trade potential of a reformed Eastern Europe." These approaches are

- to look at historical trends preceding the socialist experiment;
- to use data on resource endowments and assume that the trade potential reflects countries' different endowments of factors of production, in accordance with the Heckscher-Ohlin explanation of comparative advantage;
- to deduce the future allocation of resources from these factor endowments; and
- to assume that Eastern Europe, once transformed, in some respects will be similar to western market economies today, and on that basis draw inferences from current West European trade patterns.

Regardless of the approach used, the evidence leads to the same conclusions, according to Winters. First, he noted, "the East's comparative advantage in manufactures probably lies higher up the skill and non-labor intensity ladder than the EC-South's," which implies that East European trade is unlikely to threaten trade patterns of the EC-South. Second, he said, "Eastern Europe is likely to generate significant net exports of energy as its own energy consumption is curtailed and of agricultural goods as its supply expands."

Human Capital. In a review of the comparative advantages of Eastern Europe, Winters looked first at human capital, specifically these countries' endowment of skilled labor. Based on data compiled by the International Labor Organization, he observed that member countries of the European Free Trade Association (EFTA) and northern member countries of the EC have around 20 percent of their workforce in professional, technical, and related occupations, compared with 15 percent for Eastern Europe and 10 percent for the EC-South. While these figures may not be reliable, they do suggest that the East European countries lie somewhere between the rich and poor members of the EC.

A similar picture emerges, Winters pointed out, if the workforce is broken down by level of educational achievement. Approximately 9 percent of Eastern European workers have a university or college education and a further 19 percent have secondary/high school or industrial education. These statistics place Eastern Europe somewhere between the EC-North plus EFTA and the EC-South.

To the extent that these data can be interpreted, Winters noted, "they suggest that Eastern Europe has a greater proportion of research-skilled workers in the total workforce than either the EC-South or UMI [upper-middle-income countries, comprising Argentina, Hong Kong, Mexico, South Korea, and Turkey], and possibly even greater than Western Europe." The human capital factor endowment of Eastern Europe therefore suggests that among manufactures, it is high-technology goods rather than labor-intensive goods that represent this region's area of comparative advantage.

Richard Portes of the Centre for Economic Policy Research: presenting the first in a series of reports on the impact of European integration.

Energy and Agriculture. Winters contended that in both the energy and the agricultural sectors, the Eastern bloc countries have the potential to increase their output significantly. They already account for disproportionate shares of world production and exports of coal, gas, and oil. At the same time, the intensity of energy use in the socialist countries is at least twice that in the member countries of the Organization for Economic Cooperation and Development (OECD). Winters proposed that a decline in Soviet and East European energy intensity to, for example, 500 tons per million dollars of GDP—a

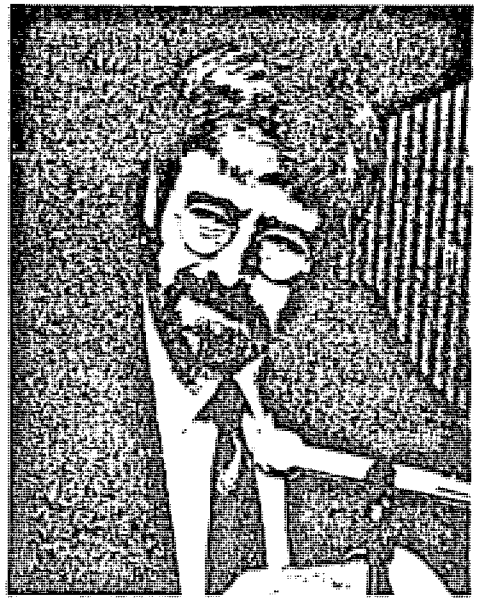
figure higher than in the OECD, given Eastern Europe's energy-intensive heavy industry stage of development—would generate an exportable surplus of 1,200 million tons of oil equivalent (mtoe). Even allowing for an increase in income of 50 percent, nearly 500 mtoe of exports would be available, equivalent to 6 percent of world energy consumption or nearly half of the production of the Organization for Petroleum Exporting Countries (OPEC), according to the report.

The liberalization of the East European economies also has the scope to increase agricultural production substantially. Winters contended that "while their consumption of agricultural output will also increase, it will almost certainly do so by less than their production, so Eastern Europe will be able to increase its level of net exports of agricultural produce significantly." Portes noted that this increase in agricultural exports from Eastern Europe "promises to be one more nail in the coffin of the EC's Common Agricultural Policy [CAP]." Although a liberalized Eastern Europe may offer an outlet for certain EC surplus produce—wine, for example—it would not be enough to offset fully the increased imports. Also, East German agriculture will be entitled to the generous support provided by the CAP, increasing expenditure by over ECU 1 billion, the report estimates. And if other East European countries also aspire to membership, it would certainly stretch the CAP to its breaking point, it contends.

Policy Challenges for the EC. Successful economic reform of Eastern Europe and the U.S.S.R. will have large effects on the volume and pattern of international trade, particularly within Europe, according to the report. While trade brings economic gains to all, changes in the patterns will cause problems for some, notably those producers who face intensified competition. The policy challenge, the report emphasizes, will be "to cushion the transitional effects and to contain the political pressure for protectionism."

Macroeconomic Implications

The second half of the report, which was highlighted in remarks by Giavazzi, discusses the macroeconomic significance for the European Community of the process of reform in Eastern Europe. It focuses first on the key characteristics of East European countries from a macroeconomic perspective, and describes a plausible scenario for

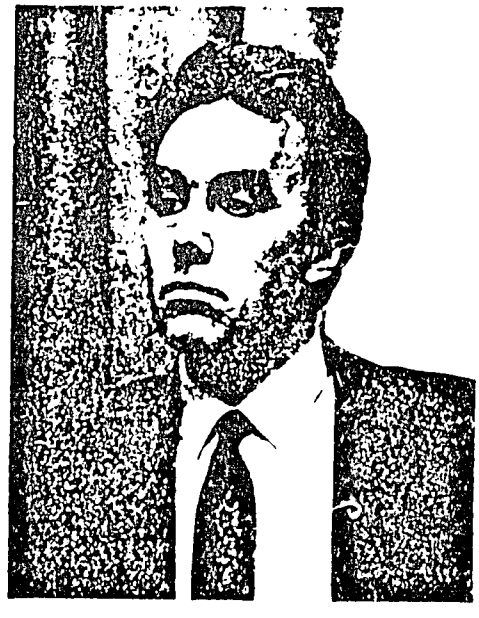


L. Alan Winters: "Eastern Europe is likely to generate significant net exports of energy as its own energy consumption is curtailed."

the Eastern bloc economies and the implications of this scenario for the West.

The report contends that at the outset of the recent reforms, the East European countries (Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania) were characterized by six main features:

- Degree of openness: East European countries have not been particularly open; primarily they have traded among themselves and with the U.S.S.R.
- Income per capita: according to some estimates, each of the East European countries' per capita GDP is lower than (or at most equal to) that of Portugal.
- Human capital: the main cause of Eastern Europe's poor economic performance is probably not in its endowment of human capital, but rather in its level and adequacy of physical capital;
- Physical capital: an increasing proportion of investment has been devoted to expanding the capital stock rather than to modernizing the existing plants; replacement investment has been cut; and the retirement of old equipment has been slowed down.
- Prices: East European countries have experienced heavily distorted prices.
- External debt: the external debt of East European countries is substantial, which, in principle, should severely limit their ability to borrow for consumption purposes in the near future, as it has done in the recent past.



Francesco Giavazzi: additional export demand "will cause the West German economy to overheat and will fuel inflation."

Based on these six characteristics, the report concludes that "the decisive factor in developments in Eastern Europe will be investment." While some of this needed capital will come from international organizations, whose lending to Eastern Europe will mostly be linked to specific projects, the bulk of the funds will have to come from the private sector in the West, attracted by potentially very high returns.

Rebuilding Capital Stock. The report contends that "it is reasonable to think that the productivity of physical capital will shoot up as a very limited amount of capital is initially combined with a well-trained labor force." A favorable scenario that would enable the East European countries to double their GDP in ten years implies an average annual growth rate of income per capita of about 7 percent. Under this hypothesis, the joint GDP of the six East European countries would jump from the current 1988 estimate of $265 billion to $530 billion or (with a constant population) $4,700 per capita. Based on a capital-output ratio of 2.5, the value of the physical capital needed to achieve that level of output would be $1,350 billion, or $135 billion a year.

The report observes that there are "important asymmetries in both the supply of and the demand for capital goods." For a variety of reasons, "Eastern Europe's demand for capital goods will be skewed heavily toward West Germany, which also happens to be the country best equipped to supply such goods," it maintains. In his remarks, Giavazzi focused on the question of whether West Germany has the spare capacity to meet this surge in export demand for its capital goods.

Data on the capital goods sector in Western Germany and on the economy as

a whole suggest that additional export demand "will cause the West German economy to overheat and will fuel inflation," according to Giavazzi. Unemployment has been falling, and evidence on capacity utilization in manufacturing points to the possibility of serious bottlenecks. The most appropriate response to this scenario, according to the report, would be a substantial appreciation of the deutsche mark.

The report contends that the opening of Eastern Europe will lead to an increase in world interest rates. This will not be sufficient, however, to keep aggregate demand in West Germany in line with supply. West Germany attracts a disproportionate share of demand from the East, and whatever rise in interest rates is required to balance savings and investment within the OECD will still imply a substantial increase in the demand for West German capital goods. Moreover, as major investors in the East, West Germans will be better off than before, and will thus wish to increase their consumption.

The increased demand for consumer goods will coincide with the increased demand for capital goods, Giavazzi pointed out. Thus, West Germans will need to import a lot of consumer goods to sustain their desired consumption level—even more so because domestic production of consumer goods will have been crowded out by the boom in the capital goods sector. Giavazzi emphasized that the market mechanism that brings this about at full capacity is a substantial appreciation of the real exchange rate.

In addition to the special effects on West Germany of changes in Eastern Europe, there are also the effects of German Economic and Monetary Union (GEMU). GEMU began with monetary union on July 1, 1990, and was completed by the formal integration of East and West Germany on October 3, 1990. The report concludes that, "in itself, GEMU implies a *lower* real value of the deutsche mark than would have obtained in the [above] analysis . . ."

Giavazzi pointed out that labor mobility is the overriding consideration in analyzing the effects of GEMU. The continuing threat of migration means that living standards in the East cannot remain too far below those in the West, even though productivity differences initially will be large. For the West Germans, "the central issue is the speed and extent of convergence of living standards; and the extent of the transfers required to bring this about," the report observes.

Convergence and Transfers. The report notes that complete convergence of living standards between East and West Germany is not required to reduce the incentive to migrate. Moving is expensive, and labor income (that part of income that can be affected by relocation) is only about 70 percent of total income. Thus, it concludes, "a plausible estimate is that by the end of ten years, Eastern Germany will have attained a productivity level equivalent to about 80 percent of that prevailing in West Germany immediately before GEMU."

In the shorter term, a sharp increase in living standards in Eastern Germany is needed to prevent migration westward, and living standards must rise before productivity improves. The issue, according to the report, is through which mechanism the transfer from Western Germany is to be achieved. One possibility is that wages in Eastern Germany rise rapidly and far in advance of productivity. A preferable channel, the report contends, "is through subsidies to wages, consumption or investment in Eastern Germany financed out of Western German taxes." It recommends that Western Germany compute the permanent income equivalent of the transfers and raise tax rates immediately and permanently by this amount. In the early years, the excess cost of transfers over tax revenues should be financed by external borrowing. In later years, the excess of tax revenues over the cost of the diminished transfer costs could be used to pay back the borrowed funds with interest.

German economic and monetary unification and reform in Eastern Europe will have opposite effects in the long run, the report observes. The per capita income in a united Germany will entail a lower per capita demand for German goods because it implies a fall in per capita wealth. On the other hand, the special position of German industry in the reconstruction of Eastern Europe will increase German wealth, and thus the demand for German goods. The report argues that in the long run, the GEMU effect (lower average per capita income) will dominate and that the deutsche mark must eventually depreciate.

Copies of *Monitoring European Integration: The Impact of Eastern Europe* may be obtained for $20.00 each from the Centre for Economic Policy Research, 6 Duke of York Street, London SW1Y 6LA, United Kingdom.

GATT Negotiations Go Down to the Wire

(continued from front page) **U.S. Agricultural Policy.** Rossmiller contended that U.S. farm legislation—including the most recent bill that passed Congress in October 1990 but had not reached the President's desk as of mid-November—has generally had the effect of transferring income from consumers and taxpayers to producers. Agricultural support expenditures in the United States are based on a system of target prices that tend to be above market

Resources for the Future's George E. Rossmiller: farm support budgets are "out of control."

prices, a loan rate at which the Government will accept produce as repayment, and control of the number of acres eligible for support payments.

Directly reducing target prices is "politically unacceptable," Rossmiller observed. But, he said, some of the changes in the 1990 bill—most notably a cutback in the number of acres eligible for support payments—could reduce U.S. support payments and make farmers more sensitive to market forces for most agricultural commodities. However, little progress is likely to be made in the areas of dairy and sugar supports.

U.S. budget reduction guidelines adopted in October 1990 call for a 25 percent cut in agricultural supports, which would amount to about $13.6 billion over five years, from a baseline of $55 billion projected in the documents accompanying the 1990 Farm Bill. These cuts include a $1.4 billion decline in agricultural support mandated for the fiscal year ending September 1991, Rossmiller observed.

Intra-European Negotiations. A number of

The Heritage Foundation Backgrounder

The Heritage Foundation 214 Massachusetts Avenue N.E. Washington, D.C. 20002 (202) 546-440(

The Center for International Economic Growth

November 13, 1990

YELLOW LIGHT FOR EASTERN EUROPE: BEWARE FOUR ECONOMIC DEVELOPMENT MYTHS

INTRODUCTION

Socialism has left Eastern Europe in economic and environmental ruins. Dilapidated 40-year-old factories grind out goods whose quality is vastly inferior to Western and even many Third World products, all the while polluting the air and soil. A traveler in Poland is unlikely to see any tractors in the course of a four-hour drive through the countryside, even though agriculture is the strongest sector of the economy. In the Soviet Union there are only 50 cars for every 1,000 citizens. By comparison, eight decades ago in 1909, one out of every 34 farmers in Iowa owned an automobile, and by 1930 for all America that number had risen to one out of every 1.3 households.

The breadth of poverty and underdevelopment in Eastern Europe is greater than most in the West imagine. These countries now face the daunting and unprecedented task of transforming centrally planned economies into free-market systems. How this can be done, in what sequence, and at what pace is not easily prescribed. Such a radical transformation never before has occurred. Nations have been transformed from capitalist to socialist, but not the reverse.

Decades of Evidence. Yet some things are known about what works and what does not work in promoting economic growth. Decades of experimentation with statist development programs by governments in Africa, Eastern Europe, and Latin America amply demonstrate that extensive state controls of the economy, state planning, and massive subsidies and credit for preferred industries do not work. These policies perpetuate poverty, not eliminate it. Variations of statist intervention and central planning produce equally poor results.

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

As American government officials and American businessmen and economists head off to give East Europeans advice on how to restructure their collapsed economies, they must keep in mind what has worked and has not worked in the past. The lessons of history should be like a flashing yellow traffic light warning of four myths of economic development that, if translated into policies, will keep Eastern Europe impoverished. The myths are:

Myth #1: Significant government spending on roads, tunnels, airports, wastewater treatment, and communications is necessary for economic growth in Eastern Europe.

Myth #2: Privatization will not succeed in Eastern Europe because of a lack of capital and stock markets.

Myth #3: Massive Western financial assistance is needed for Eastern Europe to develop.

Myth #4: Rigid austerity measures and prolonged economic pain are necessary to set East European countries on the road to the free market.

As with all myths, these simply are wrong. Unless they are exposed as such, Western governments and development banks will dole out flawed economic advice along with their economic aid, prompting East Europeans to perpetuate the mistakes of others. Unless the myths are exposed, the International Monetary Fund (IMF) likely will urge East European governments to raise taxes to balance state budgets. This will constrain economic growth. So will the World Bank if it pursues government-to-government lending policies in Eastern Europe as it has done in the Third World. These loans will politicize East European economies further and increase their bloated government bureaucracies.

East Europeans have suffered enough. Their suffering should not be prolonged by economic policies that have been discredited by decades of experience. They should heed the warning of the blinking yellow light.

FOUR ECONOMIC DEVELOPMENT MYTHS

As teams of economists formulate economic reform plans for Eastern Europe, and as the United States Congress debates foreign aid to the region, policy decisions must be based on empirical evidence, not on myths. Otherwise economic growth in Eastern Europe could be retarded and American taxpayers' money could be squandered.

The four prominent myths that could impair economic development in Eastern Europe are:

Myth #1: Significant government spending on infrastructure like roads, tunnels, airports, communications systems, water systems, and wastewater treatment plants is necessary for East European economic growth.

REFORMS OF FINANCIAL SYSTEMS IN EASTERN EUROPE
Financing of Development Workgroup

December 20, 1990

Rapporteur's Report
by Aaron Schneider

Speaker: Millard Long--Chief,Financial Policy and Systems Division, The World Bank

I. Reform Financial Institutions?

A. Financial sector efficiency was unimportant in previously planned economies -- reforms are now necessary with newly created marketplaces.

B. Reform of financial sector is crucial to repayment of the foreign debt, and foreign loans cannot be secured until the debt is lessened. Only Romania and Czechoslovakia have repaid enough of their debt to be eligible for loans.

C. While reform of financial institutions is important, it cannot be seen as a cure-all to the states' problems. Many states are under the impression that reform of the financial sector will fix real sectors, such as industry. Both sectors need to be improved simultaneously if any real advances are to be made.

II. Structure of financial institutions

A. Previous to marketplace reforms:

1. Central Bank was the primary institution lending to firms.

2. Savings Bank was involved in limited mortgage lending but sent most of its deposited capital to the Central Bank.

3. Foreign Trade Banks were engaged in most overseas borrowing and lending, but most Trade Banks are now insolvent due to virtually unpayable foreign loans. Insurance in these Eastern European states while cheap, was not particularly reliable.

B. Recent changes in financial systems:

1. The banking system has been modelled after the German Deutsche Bank. By law, universal banks will manage all facets of financial life.

2. The Central Banks have been fragmented in order to increase competition, obtain a reasonable economy of scale, and acquire better management.

3. More recently these fragmented banks have commercialized and begun accepting deposits.

C. Structural Problems

1.In general, many of these states are underbanked, undertrained, and undermanned; a large expenditure would be necessary to correct such flaws.

2. Poland wants to privatize immediately. But many have advised against it; people are untrained in financial management.

III. Threats to market stability:

A. Fragmented Central Banks have specialized, loaning only to specific regions or industrial interests.

1. Czechoslovakia: only two banks, designated by geographic region, were established.

2. Bulgaria: 70 banks ravaged by poor management and weakened by specialized loans have destroyed any credible competition.

B. Some people argue that the market will repair the imbalances in the structure of the banking system.

1. This will be a drawn out process especially in Czechoslovakia and Bulgaria.

2. Another factor impeding market stability is the premature privatization of these fragmented banks -- Bulgaria has already begun selling shares to its banking institutions.

IV. Financial Challenges

A. Financing is needed from the Central Bank, which has been fragmented. One suggestion is to break up the Savings Banks to balance lending and borrowing. Also, foreign and domestic financing can be sought.

B. The Foreign Trade Bank owns some shares, borrowers own some shares, but the Central Bank still controls most. The Central Bank does not vote on reforms, and will eventually sell out its holdings. Public enterprises have bought many shares, but the Bank owns these public enterprises. Problems with present ownership situation:

a. Uncertainty where the capital really lies.

b. Tight interdependence between industry and banking could prove to be costly.

c. Lack of a regulatory institution. Fraud and mismanagement are serious problems.

IV. <u>World Bank Involvement</u>

A. The Bank aims at granting financial sector loans to all reforming socialist states, but lack of time and manpower have

made this difficult. Technical assistance loans are granted when financial sector loans cannot be created.

B. Loans to date:
1. one large technical assistance loan to Hungary
2. two financial sector adjustment loans to Yugoslavia and Poland
3. large base technical assistance loans to both Bulgaria and Czechoslovakia

V. Actions by Individual States

A. Structure of banking itself is being changed. Before, there existed only a central institution, the state bank. Now, the central bank remains, but there also exist many commercial banks.

B. Changes in the laws surrounding bankruptcy and commercial and central banking activities.

C. Western accounting systems are being implemented through technical assistance programs.

D. Training programs have been implemented -- Advisors from the US Federal Reserve have been sent to teach.

E. Foreign assistance is actively sought. Advisors, twinning programs, and even foreign partners have been utilized to bolster the banking system.

VI. Future Issues to Address

A. Public ownership of bank shares creates uncertainty -- a securities market is needed.

B. A contractual insurance institution is needed.

C. Macrostability:
1. One contribution to high inflation are deposits are more favorable in foreign exchange than weaker domestic currency. But disallowing deposits in foreign exchange could cause capital flight.
2. Heavily subsidized loans in the housing sector have driven up the interest rate. 60% of the subsidy is funded through capitilization.

TRANSITION

VOLUME 1, NO. 8, NOVEMBER 1990

Socialist Economies Unit • Country Economics Department • The World Bank

Yugoslavia: The Dilemma of Reform Amidst Political Turmoil

It is hardly possible to analyze Yugoslavia's economic problems without an understanding of its present political predicament — not even the Soviet imbroglio provides a suitable parallel. Yugoslavia's peculiar intricate web of conflicting nationalities, religions, and values prevents its quarreling leaders from devising a blueprint for action. And since there are hardly any rules, there can be no coherent game. At the same time, some leaders of Yugoslavia's six constituent republics seem to have a vested interest in keeping nationalist emotions at the boiling point. In fact, many Yugoslavs are warning that a civil war may be but a few steps away. (Thus, it is likely that the country's fragmented body politic will provide generations of PhDs with a classic case-study on the Hobbesian state of nature.)

In the largest republic, Serbia, the recent imposition of internal duties on goods from Slovenia and Croatia is seen by foreign observers as an attempt to underline a "Serbs under siege" atmosphere. The first multiparty elections in Serbia are scheduled for December 9.

In Croatia, the restless Serbian minority, more than a half-million strong, is providing the government, run by the Croatian Democratic Alliance (HDZ), with the distraction needed to stifle internal debate.

In fact, it is fair to say that the outcome of the Serbian-Croatian confrontation will determine the fate of Yugoslavia. Together they comprise almost two-thirds of the country's population. Other groups—Slovenes, Bosnian Muslims, Kosovo Albanians, Macedonians — will take sides along an apparently fundamental divide: federation or confederacy. The Slovenes are siding with Croatia for now.

However, the political divide of contemporary Yugoslavia is not always what it seems. The so-called feder-

alists are often unreformed centralists who long for the old days of a vertically-structured state hierarchy. The so-called confederalists are for the most part pure separatists who do not want any "Yugoslav" solution at all; at this stage they find it tactically prudent, however, to put forth models of "loosely-connected sovereign states."

The Predicament of Markovic

The only "all-Yugoslav" institution left besides the army, which keeps a low profile, is the federal government of Prime Minister Ante Markovic. After years of tinkering by ineffective bureaucrats, Markovic was chosen two years ago to lead the country, based on his promise to introduce a comprehensive economic reform package. But Tito's legacy of "workers' self-management" was an economic system of decentralized control by local Party *apparatchiks*. They controlled production and investment decisions and hired or fired management. Meanwhile, the external debt, $20 billion, was still growing. Local political oligarchies had thwarted the development of an internal Yugoslav market: less than 2 percent of Yugoslavia's total capital investment crossed internal borders. But Markovic's most pressing problem was massive inflation, which by the end of 1989 exceeded an annual rate of 10,000 percent.

Markovic advanced on several fronts, introducing positive interest rates and liberalizing prices and trade. In December 1989, his anti-inflationary program took shape, based on restrictive monetary policy. The Yugoslav dinar was pegged to the German mark at the rate of 7 to 1 and made fully convertible.

By early spring of 1990, inflation had been reduced to zero, and foreign currency reserves soared. Further liberalization of imports was followed by legislation to facilitate the inflow of foreign capital.

However, six months later, the Markovic program is in trouble, in spite of political and financial support he elicited from the West. The first worrying sign was the re-emergence of inflation: in the second half of this year retail prices hiked up again, and the inflation rate, despite the government's initial success in holding it down, has almost doubled. This makes another devaluation more or less inevitable in the near future, or the foreign trade deficit — which already stands at $2.2 billion — will continue to grow. Industrial production has declined more than 10 percent compared to 1989, and some half-

million people are employed by enterprises that are in the throes of bankruptcy. Rapidly falling living standards are adding ammunition to the attacks by the growing ranks of Markovic's critics, who claim that his program is harming their particular republic or ethhic group. This now translates into some republics' attempts to undermine Markovic by acting unilaterally; the introduction of internal tariffs by Serbia and Slovenia is the most recent example.

The Dilemma of Privatization

It is a matter of historical record that major property transactions in Yugoslavia in the past half-century were not effected through contract and credit, but through force and quasi-legal expropriations. In a manner all too familiar to other formerly Communist countries, land and the means of production were confiscated, collectivized, or nationalized in the late 1940s.

Unwillingness to embark on a program of privatization, or even to formulate such a program, was apparent in Serbia from the outset of the current reform movement. This is not surprising since that republic's leadership is uneasy about the very concept of a free market economy. Milosevic's government still insists on the preservation of "social property," that unique product of Tito's "self management socialism" that means neither state nor private ownership of property or assets.

In Croatia the government still has no formal economic program, more than a half-year after taking power. Instead of undergoing privatization, bankrupt and successful enterprises alike are experiencing management changes imposed from above.

Drazen Kalogjera, a well-known free marketeer, gave up his post as Minister of the Economy in September, in protest over the government's unwillingness to embark on a free enterprise course. Savka Dabcevic-Kucar, an economist who was herself accused of "Croatian nationalism" and disgraced by Tito when she headed the Croatian Communist Party two decades ago, is especially concerned about stalling the privatization of public enterprises: "We must not replace Bolshevik statism with this neo-Bolshevik variety under a Croatian label. This course may inflict huge new damage on the economy of Croatia," she said.

Even the once-successful Republic of Slovenia is facing huge economic problems, with an inefficient economy and some of its most prominent companies folding under staggering losses. The most painful examples are Iskra Electronics and Communications Corporation, and Elan, the world-renowned ski and winter sports equipment manufacturer. The new non-Communist government has been accused by the local press of massive corruption and patronage in its haphazard privatization drive. The Slovene version of Hungary's "spontaneous privatization" is effectively ensuring transfer of resources into the pockets of those few Slovenes with cash and influence, often former Communist officials and managers.

According to many economic experts, the problem of ownership in Yugoslavia, because of the peculiar nature of Tito's legacy, is more difficult than elsewhere in Eastern Europe. There the transformation of state-owned enterprises into joint stock holding companies — which may still be owned by the state — is seen as the necessary first step toward privatization. Paradoxically in Yugoslavia, such transformation may lead to increased state control. The governments of the individual republics have the means, legal and fiscal, to ensure the transfer of "social" property into state hands — without any commitment to eventual privatization. In Croatia the first legislative steps in this direction have already been taken, with the recently enacted Ordinance on the Means of Protection of Croatian Interests during the Process of Conversion from Social to Other Forms of Ownership. Ivo Jakovljevic, a Zagreb columnist, sees this move as a "specific and hidden confiscation of the social property by the new ruling party."

As a man committed to fundamental reform and privatization, Yugoslavia Prime Minister Markovic is facing considerable odds. To bolster his internal political base, he has founded a party called the Alliance of Reformist Forces of Yugoslavia. It has drawn up an all-Yugoslav agenda based on "realism," economic pragmatism, and supra-national free-market economics. So far, however, it has failed to attract mass support.

Politically centrifugal forces, spurred on by nationalist animosities, threaten both individual aspects of the reform and its strategic objective: for Yugoslavia to join the modern, economically efficient, European democracies. It remains to be seen whether a viable "pro-Yugoslav" force could emerge, capable of transcending nationalist hostility while furnishing all players with a guarantee of unhindered development along "European" lines — while still under the same governmental roof. However, it is also conceivable that a confederal Yugoslav Common Market will provide an organizational framework in line with the reformers' objectives.

Srdjan Trifkovic

The author is a journalist and Doctor of History and writes regularily on Yugoslavia for U.S. publications. The issues discussed in this article generate an ongoing debate in Yugoslavia. The views expressed in the article are solely those of the author and should not be attributed to the World Bank or its affiliated organizations.

The more things change . . .

In the office of Soviet Deputy Prime Minister Leonid Abalkin, a printed card on the conference table reads: "What is really important is the problem of stabilization of the ruble. We are working on this problem with our best resources and to it we attach decisive importance. To succeed on a sustained basis and, as a result, to have stabilized the ruble for good, will mean that we have won."

V.I. Lenin.

IMF NEWS BRIEF

FOR IMMEDIATE RELEASE

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IMF PUBLISHES ANALYSIS OF CZECH ECONOMY

The opening of the Eastern European economies is flooding the West with hitherto unavailable data on the evolution and present condition of those economies. Recently published by the IMF and derived from staff reports that supported Czechoslovakia's application to join the IMF in September 1990, The Czech and Slovak Republic (Occasional Paper 72) makes available to the public for the first time data assembled by IMF economists on the Czech economy. The paper traces the history of the Czech economy during the postwar period, noting its strengths as well as its weaknesses, and then focuses on the turbulent economic events that have racked the republic since 1985. It analyzes the economic forces at work in the reforms that put aside central planning in favor of a market economy in Czechoslovakia.

The paper includes information, derived from Czech sources, on the structure of government finances, the financial and banking system, and the exchange and trade system. An appendix of 30 tables marshals a vast array of otherwise unavailable data on various facets of the Czech economy. Up-to-date social and economic indicators, as well as some statistics on the use of energy, add to the emerging picture of an economy in transition.

Copies of Occasional Paper 72 may be obtained from Publication Services, International Monetary Fund, 700 19th Street, N.W., Washington, D.C. 20431, at a price of $10.00.

"There is no linear development in eastern European history, but rather a Sisyphus like labour of ups and downs, of building and wrecking, where little depends on one's own ingenuity and perseverance."
– Professor Jerzy Jedlicky, Institute of History, Warsaw, speech to Woodrow Wilson International Centre for Scholars, Washington, June 1990

"The prospects for freedom are secure; but those for democracy remain uncertain."
– Bronislaw Geremek, Solidarity parliamentary leader, Gazeta Wyborcza, May 1990.

John Lloyd examines the complex set of problems confronting the emerging democracies of eastern Europe

The dilemmas of freedom

The drama of the eastern European countries in the past year is of peoples who have been brought face to face with the sober truth about themselves. Having liberated themselves, wholly or in part, from the loosened grasp of a decaying system, they are now left to discover what is left for them, and what they are capable of.

Freedom comes with a terrifying legacy of technical backwardness – locked into dependence on the Soviet Union and their own low-quality non-markets, of vast debt, of ecological catastrophe, of a dearth of democratic political culture, of a habit of inversion and dependency, of the unfreezing of old ethnic and national rivalries and demands. The cauterising effects of their crisis eats away at the initial prestige of their liberators – Mr Lech Walesa, Mr Vaclav Havel and others of lesser lustre. There are no answers, only ever-more-insistent questions. And the questions expose hopeless dilemmas, where standing still is impossible and movement in any direction blocked by poverty, stagnation or popular resistance.

Three main sets of problems identified both by their own political and intellectual élites and by those in the west, confront them. The most fundamental is their poverty. Put at its simplest, these countries do not offer much. None, outside of the Soviet Union, has precious raw materials. None makes much that is saleable in developed markets, beyond knick-knacks and booze.

Inward investment has been slow, prompting a growing impatience in east European ministries which play host to analysts, accountants, experts, academics and journalists – but make few big sales. The last month of this year has seen one of the biggest: the initial 31 per cent stake taken by Volkswagen of Germany in the Czechoslovak car company Skoda (growing to 70 per cent by 1995). But Skoda is the best of the region's car producers, and Czechoslovakia's relatively good roads and central position make it relatively attractive. Nobody is queuing up for the steel mills, heavy engineering plants, tank factories, for the nauseous chemical complexes, nor for the coal mines which still clank on like something out of Zola. The new political élites began by looking to booming, post-totalitarian Spain as their model: now they fear they may just about make the standard of Mexico.

The year which began with more or less common assent that there was no alternative to a rapid adoption of market practices ends with the larger parts of these economies as statist as ever. The sheer size of the task seems to enforce delay: they do not want wholly to sell out to foreigners – even if buyers were waiting – but the domestic market does not have enough capital. The only people who know anything about running things were in the old nomenklatura: the new governments do not want to reward them, but have little choice. There is little notion of value of assets, and little in the way of banking institutions to provide support. Every time they ask the question "Where do we go?" they are met by the famous Irish answer: "Don't start from here."

This year has marked the end of the beginning; the coming two or three years will be the eye of the storm. The latest forecasts from Morgan Stanley investment bank show national income crashing – down 3 per cent this year and 10 per cent next in Czechoslovakia; 5.5 per cent this year and 5 per cent next in Hungary; 20 per cent this year (but up 4 per cent next) in Poland, and down 7 per cent this year and 10 per cent next in the Soviet Union. The fall in industrial output and investments in these countries follow the income trends, and so do the unemployment totals – with drops in employment over the next two years of 7.5 per cent in Hungary, 8.3 per cent in Poland, 6.3 per cent in Czechoslovakia and 9.8 per cent in the USSR. At its peak in 1994 unemployment may rise to 12m in the east European countries and 47m in the Soviet Union.

There are vast reserve armies of labour which everyone desperately hopes will not become actual armies which could be mobilised by would-be dictators or mafiosi to fill vacuums already yawning beneath the feet of the politicians. Between the collapse of one all-encompassing ideological system and the lack of an alternative secular – or religious – order, lie 1,000 hatreds and feuds which only require mobilisation.

This throws up the next knot of problems: will the political structures be stable enough to provide a bulwark against the economic shocks, and be able to continue the economic transition? The year ends with government turmoil in Hungary, with some loss of the authority of Civic Forum in Czechoslovakia and with the election of the ambiguous figure of Mr Lech Walesa as president in Poland; with continued stalemates in Bulgaria, Romania and Yugoslavia. Their common feature is only this: that none can rely on a bedrock of civil political culture which they can assume will tolerate reversals or, if they cannot, peacefully vote for an alternative.

In asking the east to become like the west, people in the west easily forget how much most of their government, most of the time, is about how to increase purchasing power. It is not about the core and inflammatory matters of nation, or ethnicity, nor the nature of the state itself. Nor, more practically, is there much concern for the loyalty of the bureaucracy, nor a problem of the competence of the state apparatus.

But the new governments of the east, which in their early days of office sometimes appeared blessed in their ability to write on clean sheets of paper, have discovered that the lack of these institutional constraints which channel and direct and often cramp government, is not so much a lack of unwanted constraint as a lack of needed institutions.

Mr Vaclav Klaus, the innovative Czechoslovak finance minister, says he has a mere handful of expert helpers who understand what he wishes to do. Mr Jacek Kuron, the Polish labour minister, has had to attempt to construct a chain of unemployment and social security offices from scratch, with neither domestic blueprints nor experienced staff. They are also faced with a unique problem: a relatively sophisticated people who have for some years now seen and admired western living standards on television, freed from the political restraints which kept them apart from the west, but who are now confronted with a barrier which was previously disguised: the just-as-effective economic barriers. The effect of this on the west has been to engender a certain shamefacedness, even guilt: for where it could properly, if rhetorically, make one with the masses oppressed under totalitarianism, it can do little for their oppression under poverty. But in the east, the effect may be murderous for the new politics.

Mr Gavril Popov, the mayor of Moscow, wrote in August of this year that in the new democracies emerging in eastern Europe and the Soviet Union, there were "contradictions" developing between the policies designed to lead to market relations (and thus greater inequalities than presently exist) on the one hand, and the people whose revolts ushered in the governments now instituting these policies.

"The masses long for fairness and economic equality. And the further the process of transformation goes, the more acute and the more glaring will be the gap between those aspirations and the economic realities. ... the interest (in economic transformation) is based not on an understanding of the new but on a hatred of the old – a destructive motive."

Mr Popov voices the central dilemma of the radicals in eastern Europe and the Soviet Union. It is easy to find, among even the bitterest critics of communism within its former citadels, men and women who fear the radical stratification of a society which (beneath the top layer of "them") was economically roughly equal, and in which workers could earn as much as the educated and the descendants of the old bourgeoisie.

It has been widely noted, in and out of these societies, how much envy, fiddling, black marketeering and frustration was bred by this imposed equality. Less stressed has been the concomitant sense of all being in the same boat. And even where this not also true, envy – and its active companion, levelling – now has huge supplies on which to feed, as the *nouveaux riches* of the east, operating usually in semi- or complete illegality, usually linked with and often drawn from the old nomenklatura, flaunt their wealth behind the padded wheels of their Mercedes.

This explains the continuing existence, and in many areas, growing strength, of the "discredited" trade unions. Neither in Poland nor in Hungary, nor in the Soviet Union, have these gone out of business: on the contrary, they act as a focus for what Popov has called a "left populism", and now, after decades of crushing independent action, they instigate and lead proletarian protest.

The last complex of problems concerns the west: what can it do? This past year has seen emerge, clearly, what is now the standard response: a wish, driven by fears of instability on the eastern borders of western Europe, to underpin the transition to democracy and the market – coupled with a reiteration of the doleful but inescapable injunction that the "return to Europe" on the part of the eastern European countries must be effected largely by these states themselves: that is that the sacrifices necessary to achieving a transition must come out of their own peoples' skins. All the loose talk of adopting models – the Scandinavian (for its high level of social protection), the Spanish (for its transition from authoritarianism), the British (for its privatisations) – is now discredited. There are pointers and examples, but the odysseys of the east have no counterparts elsewhere: they will create their own "models".

Professor John Kenneth Galbraith – still the leading thinker of the left in the US – describes in a forthcoming book the neo-liberal economic policies of the past decade in the west as "the politics of comfort". This was a period in which the economic enfranchisement of a vast mass of lower-middle and working-class people fed through into political demands for lower taxes and for a lesser emphasis on welfare and public provision.

Just as the west Europeans recognise this new politics, and as their parties of left and right accommodate to it, so they are joined by Europeans whose politics are those of discomfort, anxiety and tremulous hope: a space in which, as Mr Bronislaw Geremek has observed, freedom seems to be possible but democracy is less so.

Those who claim that the west has an obligation to assist, speak cant. There was never either an explicit nor an implicit promise of assistance. No one with any responsibility said it would be easy. The spur for the west is self-interest: the self-interest in avoiding a flood of supplicant refugees, or of a new reaction and renewed military adventurism, especially in the Soviet Union, coupled with the convenience of seeing a market-democratic system, with common mechanisms and reflexes, extended, and so increasing the likelihood that trade will grow and reducing the chance of war. Goodness, as that leading American theorist Mae West observed, has nothing to do with it.

This coming year will test how far the west can be enlightened in the pursuit of self-interest: a much deeper and more bitter test awaits the newly or partly-free.

The Gulf Isn't the Only Crisis

By Sam Nunn

WASHINGTON

Since Aug. 2, our attention to events beyond our borders has been confined largely to the Iraqi aggression in the Persian Gulf. In recent days, our preoccupation with Iraq has been magnified by the debate that was triggered by President Bush's announcement of new U.S. military deployments to the region.

However, three other ominous foreign policy problems — serious energy shortfalls in Eastern Europe; severe food shortages in the Soviet Union and the chronic ills of the Middle East — lurk just over the horizon. These problems lack the immediacy of the gulf crisis but if left unaddressed could spawn crises of even greater magnitude.

While the countries of Eastern Europe, including Czechoslovakia, Hungary and Poland, face potentially crippling energy shortfalls, their traditional supplier, the Soviet Union, is suffering its own oil production and energy problems. In addition, Moscow says it will soon shift to world prices and hard currency in its trade with former client states, which could mean billions in additional fuel costs for Eastern Europe.

These countries had planned to receive Iraqi oil in payment for past sales of Eastern European arms and other exports to Iraq. For the U.S., Japan and Western Europe, the U.N. embargo means we will not buy oil from Iraq. For Czechoslovakia, Hungary and Poland, the embargo means these countries will not receive the oil Iraq already owes them.

The world community cannot neglect Eastern Europe as it struggles to overcome an impending energy crisis that could doom its quest for market economies and even jeopardize its emerging democracies.

In addition to asking the International Monetary Fund and the World Bank to increase assistance to Eastern Europe, which the Administration is doing, I believe Saudi Arabia and our other friends among the oil producing states should be called upon to help. This should not pose an undue burden to the oil producers. Saudi Arabia alone has already realized a windfall profit of about $16 billion to $20 billion from higher oil prices and increased oil output.

We should urge the Japanese to help Eastern Europe with grants and low interest long-term loans, preferably through international organizations. This could be a much more meaningful Japanese contribution to stability than sending a few thousand Japanese troops to the Middle East.

As for the likelihood of serious food shortages in the Soviet Union, here is how a leading Soviet economic expert describes the domestic economic situation: "The market has collapsed, the budget deficit is dreadful . . . monetary circulation and the financial system are on the brink of complete disaster." Against this gloomy backdrop, much of the fall harvest has been lost because of bad weather, poor transportation and inadequate storage and processing facilities. Moreover, because the ruble has become virtually worthless, farmers are refusing to sell their output to the central Government.

Eastern Europe has no oil, the Soviet Union no food . . .

Should we help the Soviet people overcome a potential crisis of food supply as they struggle to move from a command to a market economy, from dictatorial one-party rule to representative democracy? The answer is yes: Chaos in a nation that possesses 10,000 nuclear weapons is not in our national security interests.

Two measures would help us as well as the Soviet Union. We should bring the recently initialed U.S.-Soviet trade agreement into force and waive the Jackson-Vanik amendment, which denies the Soviets most-favored nation treatment and U.S. Government credits. The President has said he would not initiate waiver action until the Soviet Parliament passes a suitable law governing emigration. Though the Parliament has not yet done this, Soviet emigration to Israel and other countries is booming. Free emigration is why the Jackson-Vanik amendment was originally passed. President Bush should forget the formalities and deal with the realities.

Waiver, rather than repeal, of the Jackson-Vanik amendment would keep its sanctions in our arsenal, in case Soviet emigration practices take a turn for the worse. Meanwhile, such U.S. Government programs as Commodity Credit Corporation credits, intended to facilitate the export of U.S. agricultural products, would be able to swing into action. This would help the American farmer and our economy while providing relief to the Soviet people as they weather a particularly difficult phase of their economic transition.

Second, the Soviet Union has underexploited proven oil reserves and inadequately explored potential oil reserves. This overall energy potential cannot be realized quickly. But it is a valuable and needed asset, and U.S. companies have the expertise to enhance current oil extraction and explore new oilfields in the Soviet Union.

The bottom line here is an exchange of the Soviet Union's energy resources for our agricultural products. To make this happen, we need to clear away outmoded legal and bureaucratic obstacles that handicap our businessmen and farmers and needlessly complicate such logical, mutually beneficial deals.

The third problem is the stability of the Middle East after the gulf crisis. There are four factors that predate the current crisis and exist independently from it, but which make it more complex and dangerous: the wide gap between the have and have-not Arab states; the Arab population boom throughout the region; the lack of democracy in Arab states as well as a lack of regional economic cooperation among the Arab countries, and the Arab-Israeli conflict.

Taken together, the problems make difficult the possibility of peaceful economic and political development within and among Arab states. The per capita gross national product in the region varies from more than $10,000 in the richest countries to under $1,000 in the poorest, with the bulk of the population living in the poorer countries.

A present Arab population of something over 200 million could swell to some 500 million by the year 2025, placing unprecedented demands on limited resources, including water. And at the moment there is neither a genuine working democracy among the Arab countries nor any significant regional economic cooperation among them. Interrelated problems of this magnitude defy easy solution. There is an encouraging historical precedent, however.

In the late 1940's, the United States responded to economic stagnation in Western Europe with the Marshall Plan, which offered economic assistance once the European countries developed a common plan for economic recovery. Despite the obvious differences between postwar Europe and today's Middle East, the Arab countries need to think in terms of a similar area-wide approach, financed primarily by the region's oil exporting countries.

Regional cooperation should help to ease population pressures and vast economic disparities among Arab states, which taken together with the absence of democratic government contain the seeds of desperation and confrontation. The United States and other democracies should work with the countries of the Middle East to assist their transition to genuinely representative government.

. . . And the Arab states need democratic reform.

Regional stability cannot be achieved, however, without settlement of the Arab-Israeli conflict. This is no time for high-profile initiatives that could exacerbate tensions between the Israelis and Arabs. But at some point the conflict will have to be settled through negotiations. Left unattended, the Arab-Israeli problem polarizes and radicalizes the peoples of the region. It provides cover for militarization and military rule in the area. It fuels an ever more lethal regional arms race.

This problem is distinct from the gulf crisis created by Saddam Hussein. Yet out of the current crisis could come a coalition of Arab nations willing to pursue peace directly with Israel. The goal of quiet and creative U.S. diplomacy should be to facilitate renewal and success of the peace process, in the light of changing Middle East realities. Benign neglect is not an acceptable option. □

Sam Nunn, Democrat of Georgia, is chairman of the Senate Armed Services Committee.

WASHINGTON POST, October 4, 1990

Jim Hoagland

Only a Partial Victory in Eastern Europe

When East Germany disappeared yesterday, so did a protected market for Czechoslovakia's aging and inefficient industries. Unification snuffed out 400 government-to-government trade contracts that had forced shoddy goods on captive consumers in East Germany.

The former Soviet satellites of Eastern Europe are finding the economics of liberation expensive and painful—even threatening their hopes of building open societies tied to the West. As the Persian Gulf crisis absorbs the international community's energy and resources, neglect is replacing glorification of the gentle revolutionaries who broke the Soviet empire.

Conservatives and liberals alike have used the East European uprising to score debating points and move on before the problems of transition multiply. The certainty on the right that the irresistible force of "Western values" cracked the Soviet empire is matched on the left by assurances that it was all the work of Mikhail Gorbachev. Only the people who did the work are left out of such self-serving equations.

"Freedom did not come to Eastern Europe as a gift from Moscow or Washington," writes journalist William Echikson in an important new book on the 1989 revolutions, "Lighting the Night." "It came from more than 40 years of struggle—a daily, grinding struggle against a corrupt and evil system." East Europeans "exposed communism's fraud and brought about its collapse."

They now pay the price of their success. Few tears are being shed over the collapse of the Soviet trade bloc Comecon, which was "a planned exchange of obsolete goods and inefficiency," in the words of Jiri Dienstbier, Czechoslovakia's foreign minister. But as rotten as the system was, it was at least a system that allowed barter trade. Eastern Europe is now sliding into a dangerous limbo marked by the lack of any sustaining structure for international trade.

"Neglect is replacing glorification of the gentle revolutionaries who broke the Soviet empire."

"We must now fight marginalization as we once fought the dictators," said one of the East European officials who have come in a steady trickle to Washington in recent days, seeking a hearing and help from the Bush administration. "The disintegration of Comecon and the Warsaw Pact is a dream come true for us. But it could become a nightmare if people decide after a year or two that things have gotten worse instead of better."

It is hard to believe that life could be worse than it was under the Stalinists thrown out by the people of Poland, Hungary, Czechoslovakia, Bulgaria—and to a lesser extent Romania. But the Persian Gulf crisis could help make it seem that way to populations that are going to see oil prices rise *and* oil supplies drop dramatically because their governments are too short of hard currency to pay for imported oil.

The barter deals that enabled the satellites to swap second-rate goods among themselves and to the Soviet Union for oil supplies end with liberation. Moreover, barter agreements for Iraqi oil—made directly or through the Soviet Union, which had sent weapons to Saddam Hussein for oil and then re-exported the oil to Eastern Europe—have collapsed because of the international economic sanctions.

Visiting East European leaders, such as Bulgaria's appealing new president, Zhelyu Zhelev, report that they get a sympathetic hearing from U.S. officials but no promises of increased help. Zhelev, an intellectual who is fighting to keep Bulgaria from falling back under the control of local Communists, almost got crowded off President Bush's Persian Gulf-dominated schedule last week, but finally did make it into the Oval Office.

The Bush administration continues to nudge the ex-satellite nations seeking financial and trade support toward Western Europe. Until now, this has been a matter of political priority as well as budgetary prudence. The Bush White House consciously set the absorption of East Germany into the West as its major priority in Europe and left the rest of Eastern Europe to follow in the wake of the German ship of state.

Unification has now been achieved on the terms the administration sought. It is time for Washington and the European Community to look again at what can be done to show the ex-satellite nations that they too fit into the long-term perspective of a prosperous, secure Europe.

Only a partial victory has been achieved in Eastern Europe. It need not—must not—be jeopardized by the commitment the Persian Gulf demands now. The people of Eastern Europe have shown that with them a little attention and help go a long way.

THE WASHINGTON POST November 28, 1990

Jeffrey Sachs

Electoral Tremors in Poland

The Polish election results last Sunday were an enormous jolt to the country. As expected, Poland's charismatic leader Lech Walesa came in first, though with less than half the votes. Shockingly, Prime Minister Tadeusz Mazowiecki—who had secured Poland's borders in a historic treaty with Germany, and whose economic team had set in motion the most far-reaching program of economic reforms in Eastern Europe—was sent to a humiliating third-place finish, coming in well behind an unknown Polish-emigre businessman, Stanislaw Tyminski. Walesa is the heavy favorite against Tyminski in the runoff elections in two weeks.

Mazowiecki's defeat was a painful end to a task that was surely thankless from the beginning. As the region's first non-Communist prime minister, Mazowiecki inherited a hyperinflationary, chaotic economy that was the worst in Eastern Europe. He showed remarkable courage in supporting the tough economic reforms of his finance minister, Leszek Balcerowicz.

These reforms successfully tamed the hyperinflation, created a convertible currency and established free markets and hundreds of thousands of new private businesses in the formerly planned economy. But the sudden switch to a market economy also raised profound anxieties, as most households throughout Poland wondered whether they would be able to stay afloat—much less prosper—in the new system.

The anxieties gave root to feverish and often extravagant fears that have gripped the Polish society this year. Mazowiecki, a lackluster communicator, was unable to combat these fears, and they contributed to his electoral debacle. There has been a persistent—and totally erroneous—forecast of a 20 percent unemployment rate, though the unemployment rate now stands at 5.5 percent, less than in the United States. Similarly, fears of plummeting take-home pay abound, though the average industrial worker earned $131 per month in October 1990 compared with $108 per month in October 1987.

Walesa sensed these deep fears throughout the country early in the year, and with his deft political touch harnessed them into political support on his way to the first-place finish Sunday. Rather than defending the government's tough economic policies—as Mazowiecki had counted on—Walesa criticized the government as insensitive to the common man's insecurity and argued that only with himself as president would the Polish society stay the course of change. Tyminski—who to this date remains a shadowy figure with reported contacts to Libya, the Polish Communist Party and Canadian extremist politics—went far beyond Walesa, telling the struggling families in rural Poland that Mazowiecki was turning the Poles into the "white slaves" of Europe.

Many of Mazowiecki's supporters are frightened that the election results signal the country's descent into an orgy of populism at one of the pivotal moments in Poland's history. This conclusion is understandable from embittered Mazowiecki loyalists, but it is surely too glib. There is an excellent chance that Walesa is right when he maintains that his remarkable political instincts will actually be the key to keeping the reforms on track.

Without doubt, Walesa's goal is the same as Mazowiecki's—a capitalist Poland within the mainstream of Europe. Even in the 1980s, when many in the anti-Communist movement were flirting with the idea of a "socialist market economy," Walesa was speaking clearly about the need for a capitalist system based upon private ownership. And more to the point, Walesa's campaign aides have made clear—at the cost of votes lost to Tyminski—that they expect to keep Balcerowicz in the job of chief economic manager in a Walesa government.

Not that the risks aren't present for a populistic explosion. Ironically, if Mazowiecki's supporters fail to rally quickly to Walesa, Walesa may be forced to retreat into political deals with more extremist or desperate parts of the society. If Tyminski continues his remarkable political ascent, he could push Walesa into a corner or even (though the odds are very long) catch him in the second round.

The West should be ready to respond with vigorous support to a Walesa presidency. Of course, Western governments should start by making clear that they have no time for populist dead ends in Poland. But it is even more important that Western leaders make clear to Walesa and to the Polish people that the West will help to see that Poland's brave reforms pay off: by ensuring Poland's access to Western markets for Polish exports, by finally arranging a reduction of the $44 billion in foreign debt run up by the Communist regime, and by promising that if Poland remains stable and democratic it can look forward to full membership in the European Community by the end of this decade.

The writer, a Harvard economics professor, is an adviser on Poland's economic reforms.

ASSOCIATED PRESS

REUTER

THE WALL STREET JOURNAL MONDAY, NOVEMBER 19, 1990

Less Pain, More Gain for the East Bloc

By CHARLES WOLF JR.

It is widely believed that the transitional costs of transforming the command economies of Eastern Europe, the Soviet Union and China into market economies will be extremely high, as well as protracted. This belief is what is behind the headlines announcing "economic crashes" in East Europe or "slow change" that is to come there. But this assessment is flawed by a fundamental measurement error. In fact, the costs and pain of the transition are likely to be considerably less than is usually presumed, provided the transformation is comprehensive and aggressive.

The error arises from comparing real levels of output, employment and prices in the post-transformation market environment with spurious recorded levels of the prior command environment. For example, it is said that Poland's gross national product has declined by 16%, unemployment has risen to one million and inflation has risen by 35% more than wages since Poland's "crash" economic program was initiated in January. Similar or greater disruptions have been forecast by President Gorbachev and Prime Minister Nikolai Ryzhkov if "radical" restructuring were to proceed in the Soviet Union.

All of these figures are wide of the mark.

Wrong Comparison

In a non-market system, like that of the Soviet Union or Poland prior to 1990, recorded output is typically overestimated due to several factors. The first is failure to allow for deterioration in product quality that predictably occurs when an enterprise's performance depends on meeting quantitative norms rather than producing net market value. The second is inclusion of physical, but valueless, output. That translates, for example, into shoes that consumers won't buy, or bulldozers that are too hazardous to use and too costly to fix. The third is fraudulent reporting—the padding of reported data (*pripiski*)—to meet or exceed norms and data manipulation for propaganda purposes.

Such factors probably account for overestimates of at least 25% in recorded gross national product in the Soviet Union and other non-market systems. East Germany's per-person GNP in 1987 was estimated—by Western organizations that aim for objectivity such as the Central Intelligence Agency and the World Bank—at 88% of West Germany's. More accurate recent estimates suggest a figure of less than 50%.

Similarly, comparisons between post-transformation and pre-transformation unemployment are misleading because they are based on unemployment that is visible in the market economy, but do not allow for the make-work, featherbedding and pay-without-product unemployment that is hidden in the pre-transformation, non-market system. The realities are suggested by the familiar Soviet joke: "We pretend to work, and they pretend to pay us."

Finally, it is misleading to compare post-transformation "inflation" with pre-transformation's apparent price stability. Transformation to a market system converts inflation that typically has been "hidden" in the non-market system—but that has reflected in long and uncertain queues, as well as declining product quality—into visible price increases in the market regime. The truth is that the "inflation" that is blamed on new regimes is really the legacy of the old communist governments.

It is true the Poles are suffering. But the real economic value of Poland's current GNP probably equals or exceeds that of the prior command system.

In the same way other economic troubles that weigh heavy on the reforming nations' current political leaders are what they have inherited rather than what they have created. We read reports of Poland's dire economic state daily. It is true the Poles are suffering. But the real economic value of Poland's current GNP probably equals or exceeds that of the prior non-market, command system.

Although the usual estimates exaggerate the transitional costs associated with transformation to a market system, the challenge of effectively transforming command economies to market economies remains formidable—formidable but tractable. Tractability depends on implementing jointly a package of six elements.

Monetary reform, to ensure control of credit and the money supply.

Fiscal control, to assure budgetary balance and to limit monetization of a budget deficit if one arises.

Price and wage deregulation, to link prices and wages to costs and productivity.

Privatization, legal protection of property rights and breakup of state monopolies, to provide entrepreneurial and labor incentives that reflect changing market prices.

A social "safety net" that protects those who may become unemployed as transformation proceeds.

Currency convertibility, to link the transforming economy to the world economy and to competition in international markets.

Many economists have focused on one or another of these elements to the near exclusion of the rest. But the truth is these elements are mutually supporting and interactive: The first two create the macroeconomic environment that enables the incentive mechanisms of the other elements to move resources toward more efficient uses. Each of the six elements is less likely to be effective without the reciprocal support provided by the other elements.

For example, if prices are deregulated without simultaneously establishing control of the money supply and imposing fiscal restraint, inflation and inconvertibility will result, if, as in Poland, both monetary and budgetary control are established, prices freed and convertibility introduced but privatization and the breakup of state monopolies are deferred, the transformation's effectiveness will be impaired. And without the necessary social safety net, the other measures may create a fear of widespread unemployment, social stress and political instability.

Trying to transform a non-market system to a market system without the synergy provided by all six elements is like trying to swim with one arm and leg rather than two of each.

Mr. Gorbachev's current attempt to combine the Ryzhkov and Shatalin plans scores poorly when viewed in this light. Controls would remain on prices of essential consumer goods, basic commodities such as oil and gas, and other key goods and services, such as transportation and communications. Budgetary spending would be curtailed, but subsidies for many enterprises would be maintained. State enterprises are intended to be privatized, but no timetable or operational plan for doing so is established. Convertibility of the ruble is to be "gradual," without any indication of when or how.

Poland's Missing Link

By way of contrast, Poland's efforts at systemic transformation have been much more far-reaching than what is planned in the Soviet Union. Yet even Poland's changes have been insufficiently inclusive. On the positive side, fiscal discipline has been imposed and the budget deficit has been reduced to 1% of GNP from approximately 8%. Monetary discipline has been encouraged by separating the Central Bank from the Treasury. Ninety percent of all prices have been decontrolled, and convertibility of the zloty has been maintained at a stable rate since January, with exports increasing, hard-currency imports declining, and a resulting trade surplus of more than $2 billion.

These are significant accomplishments, but they are not sufficient. To date, the Poles have only partially privatized. They have deferred the breaking up of state monopolies and delayed the wage reform necessary to create proper incentives for workers and managers. Hence, supply responses and sectoral resource reallocations have been inhibited, and output, employment, and inflation have suffered.

Still, if transformation to a market system is more tractable and the attendant costs are lower than is commonly assumed, why has progress been lacking (as in the Soviet Union), or limited (as in Poland)?

The question is genuinely puzzling. Part of the answer may be that many members of the unusually diverse chorus of ex-communists, socialists, social democrats and erstwhile central planners, who intone free market rhetoric, are often decidedly ambivalent about the desirability of real transformation. They seek reasons or excuses for delaying and temporizing, even while solemnly acknowledging the necessity for eventual systemic change.

Mr. Wolf is dean of the RAND Graduate School and director of RAND Corporation research in international economics.

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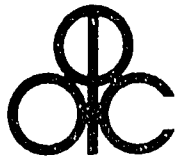

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LATIN AMERICA
QUARTER 4, 1990

WASHINGTON ECONOMIC WATCH

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THE WHITE HOUSE

Office of the Press Secretary

(Brasilia, Brazil)

For Immediate Release December 3, 1990

RESPONSES BY THE PRESIDENT
TO QUESTIONS SUBMITTED BY

EL MERCURIO (CHILE)
ESTADO DE SAO PAULO (BRAZIL)
EL PAIS (URUGUAY)
LA NACION (ARGENTINA)
EL NACIONAL (VENEZUELA)

November 30, 1990

Q: In the relations between the United States and Chile what are the main items that you would like to see resolved and in what manner?

THE PRESIDENT: More than anything else, I would like to convey to the Chilean people my most heartfelt congratulations and support for their transition to civilian democracy. It is a transition which was fraught with difficulties and challenges, but the people of Chile have carried it off with great courage, intelligence and dignity. Those of us who hoped and worked for this objective feel that the democratic ideal throughout the world has been enhanced by Chile's example. Equally important, Chile has managed to bring about its democratic transition without undermining the economic progress that it has made in recent years.

It is important to keep this larger context in mind as we look at specific items on our bilateral agenda. It is no secret that our agenda during the first months of President Aylwin's term has been dominated by issues left over from the past, principally by the questions of restoration of GSP to Chile, and a framework for settlement of the issues generated by the Letelier case.

Many Chileans have felt frustration or even irritation about the slowness with which these questions have been resolved. All I can say is that in democracies, things don't move as fast as they do under other systems; that is the price we pay for consultation and deliberation. The reassuring thing is that decisions do get made, however. I am happy that we have been able to begin the process of restoring GSP to Chile, and that the Chilean Congress has passed the "Cumplido" Law transferring jurisdiction over the Letelier case from military to civilian courts. This will make it possible to eliminate restrictions on defense cooperation, something we want to do.

Q: How do you plan to implement the Enterprise for the Americas Initiative, especially concerning trade, since you have a mainly Democratic Congress with protectionist attitudes and no trade agreement has been reached in Uruguay Round GATT talks? How will you address both issues? How do you expect Latin America to believe in a free market economy if measures are taken in the U.S. Congress to protect your economy?

THE PRESIDENT: The short answer to your question is that we have to work hard to get the results we want and believe are right, which will provide economic growth for both the United States and our hemispheric partners. We need our Congress to approve legislation for certain parts of the Enterprise for the Americas. This includes legislation for the restructuring of official debt, and for the investment fund we would like to see in the Inter-American Development Bank. Fortunately, the reaction in the Congress to the Enterprise initiative has been very positive, which pleases me enormously. We have already succeeded in getting one piece of the Enterprise legislation passed through our Congress, regarding P.L.-480 debt, despite our

budget problems and the "crunch" of legislation that we always face at the end of a legislative term. We are taking steps to implement this legislation and we are prepared to enter into negotiations with countries eligible under the legislation to reduce their P.L. 480 debt.

You have my commitment that I will be back to the Congress when it reconvenes in January, 1991, seeking passage of the other portions of the Enterprise legislation. I feel confident that a bipartisan spirit will prevail, because I am convinced that the vast majority of the members of Congress recognize the mutual benefits such an agreement could bring, and support good relations between the United States and our partners in this hemisphere. This is not to say that protectionist pressures do not exist. They do in our Congress, as they do in all legislatures of democratic countries. I have used my veto power (for example with the textile bill earlier this year) to prevent protectionist pressures at home from hurting our economy or damaging important foreign policy interests.

The other point you touched on is the Uruguay Round. I want you to know that I am making every effort to insure that these talks produce an outcome that results in expanding world trade substantially. Our position is clear -- we all need a successful conclusion to the Uruguay Round -- one that opens markets worldwide. I am glad that other countries in this hemisphere share this view and have worked hard to bring it about. We look forward to working closely with Chile and other trading nations to achieve good market opening agreements and substantial agricultural reforms.

Q: Mr. President, many Brazilians think that the prospect of better relations between Brazil and the United States that emerged from your personal contacts with President Collor earlier this year are fading under the difficulties of new trade frictions and the old debt problem. I would like to ask you two questions in this regard: Your government has recently joined the other G-7 members in demanding that Brazil "resolve its debt arrears problem with the commercial banks" before any further long term financial agreements can be negotiated. The Brazilian government argues that this approach is not acceptable because it would compromise the market oriented economic stabilization program that you have endorsed. The issue is likely to be central to your talks in Brasilia. How will you deal with it?

THE PRESIDENT: You've posed a very complex question, and I will try to do it justice. In the first place, I would like to tell you that I have the highest respect for President Collor and what he is trying to do to reform and modernize the economy of Brazil. To bring about such dramatic change in a huge country like Brazil, which has more than 150 million people, deserves respect and admiration.

Our relations with Brazil are based on the solid appreciation that we share a common commitment to democratic civilian rule and economic prosperity for our citizens. With such large, competitive, and varied economies as those of the United States and Brazil, there will always be some trade frictions. What most of you may not realize is the progress we have made in addressing these trade issues. As other problems crop up, they will need to be worked on. As long as I am President, the United States will seek to address these problems in a spirit of creative problem-solving.

With regard to your question about Brazil's debt, the United States is eager to see a long-term solution that is consistent with the international debt strategy, and will give Brazil the opportunity to grow and trade its way to economic health. This is a process of negotiation, and has to be seen as such. While I will want to discuss this issue with President Collor, I do not see it as "central" to my discussions in Brazil. This is one of many issues we will want to discuss, with the goal of understanding each other's position well and looking for ways to advance common objectives.

Q: The United States has proposed a framework trade agreement to Brazil and three other South American nations. But has rejected a Brazilian proposal to discuss such an important issue as the access to advanced U.S. technology in the context of the agreement. Why? Is it a commercial problem or a security related problem?

THE PRESIDENT: First of all, I must point out that the inspiration for doing a five-country framework agreement came from Brazil, Argentina, Uruguay, and Paraguay. Much as I might like to claim credit for this innovative suggestion, I cannot; it came from South America. We were pleased to move forward on this suggestion because it clearly advances the goals of regional and hemispheric economic integration that are at the heart of the Enterprise for the Americas proposal.

Second, I think you may be reading more into our position than there really is. The framework agreements we have negotiated with other countries are directed at trade and investment. There is plenty that we can do and need to do in these areas. While we are indeed willing to talk about trade-related technology questions, we were concerned that if we tried to do too much, we would end up with a structure that was too difficult to manage. There's a saying in English which says "Don't bite off more than you can chew;" I understand there is a similar phrase in Spanish, which says "El que mucho abarca, poco aprieta." We want the framework agreements to work on difficult issues, but not to have them solve <u>all</u> the issues.

Q: Mr. President, in Latin America there are numerous questions about the motives and objectives that led you to launch the Enterprise for the Americas Initiative. Would you explain your view of Latin America today, the motives that brought you to propose the Initiative and, if you could be more specific, in what fields and during what time period do you expect the most important aspects of the Initiative to be achieved?

THE PRESIDENT: With regard to this hemisphere, the first year of my administration was devoted largely to two subjects: restoration of democracy in Central America and the war on drugs.

With the triumph of democracy in Nicaragua, the end of dictatorship in Panama, and with the drug strategy launched, I became convinced that the United States needed to take a longer-range look at relations in this hemisphere. In part, I was also reacting to concerns expressed to me by the region's leaders, who told me they worried that the amazing events in Central and Eastern Europe would cause us to forget this hemisphere, and devote all our resources to Europe.

I gave these Latin American and Caribbean leaders my commitment that the United States would remain engaged in this hemisphere. As I told several leaders, the Americas are our common homeland, and we cannot forget this. For this reason, I asked my top economic and policy advisers to examine our policy in the region and give me ideas on innovative approaches the United States could take to complement economic reforms being implemented by Latin American and Caribbean governments.

The result of this review was the June 27 Enterprise for the Americas initiative. My goal was to propose a mix of long-term and short-term objectives, covering the areas of trade, investment, debt and the environment. In trade, I set out a challenge -- that we act together to create a free trade area for the entire hemisphere. To get there, we are already working on a free trade agreement with Mexico, and we have signed bilateral framework agreements with Bolivia, Colombia, Ecuador, Chile, Honduras, and Costa Rica. In response to a suggestion from Brazil, Uruguay, Paraguay, and Argentina, we have agreed to negotiate a multi-country framework agreement.

In the investment area, we suggested creation of new Inter-American Development Bank programs and an additional multi-lateral investment fund and to improve the hemisphere's investment potential. We are seeking congressional approval of funding to contribute to multi-lateral. On debt, we have secured passage through the U.S. Congress of the first element of our package for reducing official debt. As you know, one of the features of this proposal is to use interest paid on the remaining debt stock to fund environmental projects. As soon as the U.S. Congress reconvenes in January, we will be working for passage of the rest of the legislative package.

As we look to the future, however, we should not be doing so in terms of unrealistic deadlines saying that "on such an such a date, all of the region's problems will be solved." What we are offering is a commitment to work actively and creatively with this hemisphere, to consult frequently, and to seek solutions which lead to greater prosperity and well-being for all, in what we hope will be the world's first "hemisphere of democracy."

Q: Uruguay is a tiny country that, despite its important democratic tradition, many times to have been ignored by the United States. This presidential visit, for example, is the first one in 30 years. What brought Latin America to your attention, created an interest in visiting Uruguay and what benefits might Uruguay gain from this new relationship with the U.S.?

THE PRESIDENT: It has been too long since a President of the United States visited Uruguay. President Eisenhower visited Montevideo in 1960, and President Lyndon Johnson made a brief trip to Punta del Este in 1967, I believe.

Uruguay may be a small country, but it is one which has throughout its history played a creative and innovative role in world affairs. It is also a nation of immigrants, a fact that serves as a point of linkage with the United States. For example, I recently accepted the credentials of your Ambassador to the United States, Eduardo MacGillycuddy. Ambassador MacGillycuddy is a distant cousin of a United States Senator from Florida, Connie Mack. Ambassador MacGillycuddy's grandfather was a brother of the Philadelphia Phillies' baseball legend by the same name.

Let me offer another example. As I mentioned above, we are in the midst of trying to complete the most ambitious trade expansion program in decades. If this effort succeeds, it could expand world trade by $500 billion dollars. It is no accident that this round of world trade talks is called the Uruguay Round, after the country which served as sponsor for its launching.

I can point to other things as well. President Lacalle was the first President of this region to telephone me after I announced the Enterprise for the Americas initiative on June 27. His support has been a strong stimulus to me to make this proposal work. To make it work, we will need the help of institutions such as the Inter-American Development Bank, which is headed by another Uruguayan, Enrique Iglesias.

For all these reasons, I am eager to visit Uruguay, to consult with President Lacalle, and speak to the Uruguayan Congress. I would not speak only in terms of benefits to Uruguay from the visit. We are looking for answers that will benefit the whole hemisphere, such as the ones we can derive from a successful Uruguay Round and a free trade area stretching from Alaska to Tierra del Fuego.

Q: Argentina is working on the economic integration with Brazil and other countries in the Southern Cone and, at the same time, has started a process of deep restructuring of its economy and its institutional frame. What is your impression of

the fact that privatization of two big state corporations (an airline and a telephone company) has been achieved with the participation of American capital, but not of American management or technology?

THE PRESIDENT: I think the most important part of your question relates to what is going on in Argentina today. Difficult, sometimes painful, economic choices are being made by President Menem.

These choices involve the transformation of very large sectors of the Argentine economy. Like many other leaders of this hemisphere, President Menem is making the difficult choices and implementing economic reform policies to make Argentina more competitive and guarantee the country's long-term economic health. Privatization has played a part in this economic restructuring. As your question noted, instead of continuing to have the economy dominated by an inefficient state apparatus, which has stifled initiative and blocked economic growth, the Government of Argentina has adopted policies aimed at privatizing businesses such as the airline and the telephone company. This has reduced Argentina's debt burden, and brought back to these companies the incentive to compete for investment and for clients. Quite frankly, I believe that good airlines can and should depend on their passengers for their revenues, and not depend on the taxpayers.

As for the participation of United States investors -- whether this be in the form of capital, of technology, or of management -- as long as there is a level playing field, and by that I mean that the rules are the same for all investors, I think that rational economic choices will be made. That's what freedom to compete is all about, whether it is in Argentina or Alaska.

Q: At the final stage of the Uruguay Round of GATT, U.S. is standing again against subsidies and all kinds of protectionist trade barriers for agricultural products. Nevertheless, the Government is subsidizing some grain exports, with potential harm for Argentina and other countries in the Hemisphere, and is keeping some tariffs that make difficult the entrance of products like, for example, Argentine leathers. Is it possible that the Administration could modify these policies in favor of a more consistent attitude with respect to all forms of protectionism?

THE PRESIDENT: I know that the Commerce Department's decision to impose countervailing duties on Argentine leather was unpopular with the leather industry in Argentina. But here are some economic facts: by forbidding the export of hides from Argentina, prices for these hides in Argentina are driven down (because they can only be sold in the domestic market). This means that leather exported from Argentina commerce to other markets, such as the United States, is priced artificially low.

Argentina's competitors in the U.S. thought this was unfair, and complained to our authorities. Following a very detailed and open process in accordance with our law, in which the Argentine industry was represented by experienced counsel, the Commerce Department agreed that a subsidy was being provided by virtue of the Argentine government's policy prohibiting the export of hides. This is not an issue where the President of the United States can intervene to tip the scales one way or another. The solution is for Argentina to allow exports of hides, so that its leather will be priced according to the forces of the international market.

I should note that this has been a longstanding sore point in our bilateral relationship. Several years ago, we had negotiated a solution under the Section 301 provision, but because the agreement was not fulfilled by Argentina, U.S. industry felt it had no recourse but to seek relief under U.S. trade laws.

With regard to wheat, I assume you are referring to the Export Enhancement Program. This program was designed to keep U.S. wheat competitively priced with the wheat being sold by other producers, primarily the European Community. We hope that a successful outcome of the agricultural talks in the Uruguay Round will make this, and other export subsidy programs, superfluous.

Q: Venezuela has increased its oil production by half a million barrels daily to help in the Gulf crisis and is opening its doors again to U.S. private investment in the oil sector. Recently, President Carlos Andres Perez stated that his country deplored the speculation which was driving oil prices up and hurting the American consumer. He said it was not in Venezuela's interest, either, to be subject to ups and downs in prices and appealed for a meeting between the major oil producing nations and the leading consumer countries to work out some kind of stabilization program for international oil prices. The U.S. has not reacted to this proposal, made first two months ago. Although your country supports a market economy, it has joined in stabilization agreements in the past for various products. Would you consider this for oil, especially now that the market has been disrupted by the Gulf crisis and the future well-being of the Gulf nations, as well as other producers such as Venezuela, not to mention various of your own states which produce oil, and are dependent upon a steady and reasonable oil income?

THE PRESIDENT: You have posed a detailed question which requires a detailed reply. In the first place, I must pay tribute to the extremely positive role that Venezuela, and particularly President Carlos Andres Perez, has played in the months since Iraq invaded Kuwait. He worked hard with Saudi Arabia to insure that members of the Organization of Petroleum Exporting Countries (OPEC) increased supplies to cover the shortfall caused by the loss of Kuwaiti oil and the embargo on Iraqi exports. Venezuela and CAP have been a force for stability in oil supplies.

We have also welcomed President Perez' efforts to prevent wild swings in world oil prices. As he has correctly pointed out, these are bad for producers, and they are bad for consumers. A recession in the industrialized world will not help OPEC members such as Venezuela, and far-sighted leaders such as President Perez have been among the first to realize this.

I know that Venezuela has suggested convening a meeting between oil producing countries and oil consumers. Our reaction has been rather guarded. If there were an absence of communication between producing countries and consuming countries, bringing the two sides together might be worth studying. In the case of the oil market, however, producers and consumers are talking to each other all the time, sharing statistics and projections regarding both supply and demand, and doing so in a number of different contexts. These bilateral and other channels are in my opinion working sufficiently well that we do not have to create another formal medium of communication.

As for your suggestion for joint action by producers and consumers to "stabilize" the price, I do not believe this is an idea which is workable. Even if producers and consumers could agree on what a "stable" price should be, and I think this in itself would prove impossible, I have a more fundamental objection. I believe that in general market mechanisms are more efficient and effective, and this includes the market for oil.

One final point. I agree with President Perez that we need to increase the production of oil from areas of the world such as Latin America and the Caribbean, in order to diversify world supplies. I believe that private investment funds are available for this effort, and will go to countries which have hospitable investment climates. There is more that we can do in this area, and I look forward to discussing this issue with President Perez and his advisers when I am in Caracas.

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Q: Reliable opinion polls in Latin America reveal that people condemn Saddam Hussein but are against the U.S. going to war and favor a diplomatic resolution of the conflict. Will you reject any political settlement in the Gulf?

THE PRESIDENT: As you know, I just returned from a visit to Saudi Arabia, during which I visited with U.S. forces. So let me try to answer your question in the following way. On

August 2, 1990, Saddam Hussein attacked the tiny nation of Kuwait, occupied it with extreme violence, and then announced that Kuwait had ceased to exist -- that it had been incorporated into Iraq. Since August 2, there have been a flood of reliable reports that Iraqi occupation troops have been engaged in a systematic looting of Kuwait, dismantling buildings, seizing assets, and driving private cars back with them to Iraq.

The response by the international community has been based on two premises: first, that Iraq has committed naked and unprovoked aggression against Kuwait, and second, that Kuwait's status as a sovereign state must be restored. The only way that Kuwait's sovereignty can be restored is for the occupying Iraqi troops to leave Kuwait.

This position has been embodied in numerous resolutions of the United Nations Security Council. The community of Latin American and Caribbean states spoke out strongly in condemnation of the invasion of Kuwait, and in support of the sanctions that the United Nations imposed. Argentina has sent a force of two ships to the Gulf to cooperate with the multinational force, an action which we applaud.

The United States is not eager to see armed conflict in the Gulf. As President, I ordered American forces to the area to block Iraqi aggression, and to support the demands of the international community for restoration of Kuwait's sovereignty. We have not rushed to use force, preferring to give the international sanctions a chance to work, and to let the Iraqi leadership see clearly that they have the whole world arrayed against them.

However, for the international community's sanctions to be credible, they must be backed up with the possibility of coercion. Those who rule by force frequently understand only the language of force. The United States, acting in concert with countless other countries, has taken actions to insure that Saddam Hussein understands that the international community can indeed use coercion against him if he remains unwilling to understand the voice of reason and diplomacy. Force is not our preferred option, but it is a real option. Our preference is for Saddam Hussein to order his troops out of Kuwait, and thereby make possible the restoration of full Kuwaiti sovereignty.

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THE WHITE HOUSE

Office of the Press Secretary
(Brasília, Brazil)

For Immediate Release December 3, 1990

REMARKS BY THE PRESIDENT
TO THE JOINT SESSION OF THE BRAZILIAN CONGRESS

Brazilian Congress Building
Brasilia, Brazil

11:28 A.M. (L)

THE PRESIDENT: Mr. President of the National Congress; and Mr. President of the Chamber of Deputies; and to our two most articulate speakers, Senator Tito and Deputy Fiuza; and Mr. Acting President of the Supreme Court; esteemed Papal Nuncio; and members of the diplomatic corps; Mr. Archbishop; Honorable Ministers of State and Governors of the Federal District; and honorable deputies and senators. It is a privilege, it is an honor to join you in this great hall of democracy.

My thoughts today could have no better forum than this National Congress -- my words, no better audience than the people of Brazil. We meet at an extraordinary moment in our shared history. A time of serious challenges and important choices that calls for mutual respect, candor and collective will. I've met with many Latin and Caribbean leaders. And beyond any single issue that we've discussed, all of us have been galvanized by a new era of hope and opportunity throughout the Americas -- especially here in Brazil.

By pioneering bold new economic reforms and consolidating its democracy, Brazil today is poised to enter the 21st century as a leader among nations. That is a tribute to a leader whose friendship and vision I value and respect -- a man who represents a new generation of democratic leadership now sweeping across Latin America -- your dynamic new President, Fernando Collor de Mello.

President Collor has spoken eloquently of Brazil's rightful place at the table of the First World -- and I agree. I believe it is time, in fact, to end the false distinctions between the First World and Third World that have too long limited political and economic relations in the Americas. Let us instead speak of the New World.

This hemisphere has always found strength in diversity. After all, here I stand, addressing Portuguese speakers in English, because of an Italian sailing on behalf of Spain five centuries ago. What we hold in common transcends borders and translates into any language. The nations of the Americas all struggled and gained independence from the old ways of the Old World -- ended the injustice of slavery and colonialism -- and built republics of promise and renewal around the dignity and the power of the individual and the rule of law.

Now, as we approach the 500th anniversary of Columbus' discovery of Americas and the arrival of Cabral's Portuguese fleet in Brazil, this is our moment to chart the course for the New World -- a course of freedom, a course of democracy, a course of prosperity. We've all witnessed in wonder the dawn of democracy in Eastern Europe. But in the Americas, we, too, have seen extraordinary political and economic change that is transforming the face of this hemisphere; nowhere more so than right here, no more more so than in the great nation of Brazil. The changes you are carrying out in your

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economy reducing the size of the state, privatizing enterprises, combating inflation and liberalizing trade, are the keys to growth and prosperity in the global economy of the 21st century -- whose outlines we already see today. I am here to tell you that you are not only on the right path, but the United States wants you to succeed and supports your efforts every step of the way. I believe that we've just begun to press forward, toward the real promise of the Americas.

Territories may end at borders, but mankind's capacity for progress knows no bounds. Continents may end at the water's edge, but human potential knows only those limits set by human imagination. The Americas' role in the world is not defined by geography. It is defined by its people and its ideals. I truly believe that we are approaching a new dawn in the New World.

Our thinking must be bold; our will, resolute. Our challenge now is to hew out of a wilderness of competing interests a new kind of opportunity in the Americas. To fulfill the New World's destiny, all of the Americas and the Caribbean must embark on a venture for the coming century: to create the first fully democratic hemisphere in the history of mankind. The first hemisphere devoted to the democratic ideal -- to unleash the power of free people, free elections, and free markets.

Two weeks ago in Czechoslovakia, I spoke to a people that had paid dearly for its freedom. I talked about a new commonwealth of freedom, based on four key principles. This hemisphere already shares these convictions: an unshakable belief in the dignity and rights of man; the conviction that just government derives its power from the people; the belief that men and women everywhere must be free to enjoy the fruits of their labor; and, four, that the rule of law must govern the conduct of nations. Every nation that joins this commonwealth of freedom advances us one step closer to a new world order. We must persist until this victory for freedom and democracy is won completely.

It is also within our power to make this hemisphere the largest free-trading partnership of sovereign nations in the world. From the northern-most reaches of Canada to the tip of Cape Horn. We see a future where growing opportunity, the power of technology and the benefits of prosperity are developed and shared by all.

Change will not come easily. Economies, now dependent on protection and state regulation, must open to competition. The transition, for a time, will be painful. Many in the Americas will have to make serious adjustments to compete with Southeast Asia and to take advantage of the European market after 1992. But we are confident that solutions will be found --- by Brazilians, by Chileans, by Venezuelans -- by all of the Americas.

And the results -- growing economies and sound currencies -- will bring unprecedented prosperity and growth for all our citizens to share. That was the vision of the Enterprise for the Americas Initiative that we announced last June. And Deputy Fiuza, I listened very carefully to your strong speech in this regard. And I thank you for those frank and forceful comments. The initiative calls for a major hemispheric effort to unify the New World in the three key areas of trade, investment, and debt.

In trade, our first priority should be to promote long-term growth. And the most effective first step is the successful conclusion of the Uruguay Round, now in its final stages in Brussels. An end to export subsidies on agricultural goods and new openings for developing country exports mean new market opportunities and a higher standard of living for the farmer in Para, the textile worker in Santa Catarina, and the engineer in Sao Paulo.

But the Uruguay Round and bilateral trade agreements are only first steps. The Southern Cone Common Market, now developing under the leadership of your President and his colleagues in neighboring countries, is another major step toward the world's first

hemispheric free trade zone.

To promote new investment in the Americas, the dead hand of state control must be lifted. We must allow entrepreneurs the flexibility to adapt, create, and produce. So, as we chart a course for the future of the New World, let us hold firmly in our minds an unshakable conviction in the importance and benefit of free enterprise. Let us work together so that any man or woman who wants to launch a new enterprise views the state as an ally, not as an obstacle -- and all who pursue the fruits of the free market see other nations not as threats to sovereignty, but as partners in trade and mutual prosperity.

Individuals cannot succeed if government is burdened by debt. So the third leg of our Enterprise for the Americas Initiative is a comprehensive commitment to work with Brazil and others in Latin America to restructure U.S. official debt. Our new approach to official debt will complement commercial debt restructuring through the Brady Plan. I understand the importance to Brazil and, indeed, to the international financial community of reaching a new and effective agreement on commercial debt. I believe, through your program of economic reform, you have taken the first crucial step toward that goal. Global capital flows will be vital to your development, and we are ready to assist wherever possible.

We've submitted a request to our Congress for the authority to implement our proposals. But we know that real solutions must involve all of us in the Americas. That's why we envision a permanent partnership between all the nations of the Americas, to confront challenges that know no borders. We envision a hemisphere where a collaborative commitment is shared to protect our environmental legacy. There can be no sustained economic growth without respect for the environment. That's why the Enterprise for the Americas Initiative joins environmental protection with bilateral debt relief -- not as a challenge to national sovereignty, not as a challenge to the sovereignty, in this case of Brazil, but as an affirmation of shared international interests.

Senator Tito -- and I do appreciate, sir, your using this podium for a frank exchange here -- talked about partners in growth, I believe you said, sir -- partners in growth rather than shareholders of misery. That is what you want, and that is what we want.

I encourage Brazil and other creditor nations to convert debt into funds for the environment. The entire world stands in awe of Brazil's unique endowment of wildlife, trees and plants in the Amazon and the Atlantic rain forests. No nation on Earth -- none -- is as rich in flora and fauna, with all of their potential to provide future medicines and foods, and crops and fibers. Your hosting of the United Nations Conference on Environment and Development in 1992 places Brazil in a position of true global leadership. We hope that conference will mark the culmination of a number of initiatives to protect and wisely utilize the world's resources.

We also are challenged to make ours a hemisphere where sovereign nations are joined in collective determination to eradicate the disease of drugs. On this one, the time for blame is long over. We in the United States recognize that we must do more to reduce what seems to you as insatiable demand. And you understand that the spreading tentacles of the drug trade threaten any democratic society.

President Collor has taken a strong position against drugs for the sake of youth in Brazil. I know full well it is a demand problem as well as a supply problem for my country; and I pledge the full efforts of my government to continue to dampen demand. There is only one answer to the drug problem in this hemisphere. And that is to defeat these narco traffickers who prey on our children -- once and for all.

And finally, in this era of great challenges around the

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world, we want the Western Hemisphere to be a model to the world for security, stability, and peace.

Together, let us ensure that this hemisphere stands united to prevent the spread of nuclear weapons or new, more dangerous, ballistic missiles anywhere in the world. We hope that all countries in this hemisphere will follow Brazil's and Argentina's recent decision to bring the nonproliferation treaty, Tlatelolco, into force. I want to applaud, as many other nations have done, the recent announcement by Brazil and Argentina that together they will ensure that no nuclear program in their countries is used for anything but peaceful purposes. We applaud your decision to move forward on full-scope nuclear safeguards.

But your leadership today goes beyond this hemisphere. Just as Brazil made valiant contributions to the cause of freedom in World War II, you were among the very first to implement the sanctions against Iraq. I realize the sacrifices that Saddam's brutality has caused this nation and its people -- has caused many nations around the world. In this country, I was told this morning, the impact -- $5 billion in higher oil prices alone for one year -- $5 billion to your economy, struggling to move forward, because of the brutality and the aggression of Saddam Hussein. In Czechoslovakia, a country that knows about aggression, Vaclav Havel told me, $1.5 billion just because of the aggression of Saddam Hussein. I salute your leadership in the world's community and united stand against Iraq's aggression and in defense of the rule of law.

Our nations, long ago, achieved independence from the Old World. And so now let us work toward a new declaration of interdependence among the American nations of the New World. If, as Jose Bonifacio once said, "Brazilians are enthusiasts of a beautiful ideal," let us not limit the New World's potential with old thinking. After the half millennium we've had in this hemisphere to form our nations and find our way, let the nations of the Americas now fulfill their common potential.

Standing on this central plateau, soon to be the seat of great decisions, President Kubitschek said this: "I look once again at the future of my country and see this dawn with unyielding faith and unlimited confidence in its great destiny."

My friends, our neighbors, let the new dawn come to Brazil and to the New World, and let us fulfill the promise of these great lands.

Thank you very much. And may God bless the people of Brazil. Thank you very, very much. (Applause.)

END 11:50 A.M. (L)

The Enterprise for the Americas Initiative: Issues for Congress

by Nina Serafino and Betsy Cody

SUMMARY

On June 27, 1990, President Bush announced a new 3-pronged U.S. approach to help resolve the economic problems of Latin America. This approach had debt, trade, and investment components. Dubbed the "Enterprise for the Americas Initiative," the plan calls for the United States to: negotiate arrangements with selected Latin American and Caribbean countries to reduce their official debt to the United States, which totals about $12 billion, and make funds available through this restructuring for environmental programs; (2) stimulate private investment; and (3) take steps to promote extensive trade liberalization with the goal of establishing free trade throughout the Western Hemisphere.

As announced, the plan calls for immediate action on the debt reduction and investment promotion measures. Under the official debt reduction proposal, the Administration would seek authority to reduce the principal on and to restructure concessional (i.e., below market interest rate) loans made by the Agency for International Development (AID) and the P.L. 480 Food for Peace program to Latin America and the Caribbean. (These loans total about $7 billion.) It would condition reductions on a recipient's adoption of strong economic reform programs. The United States would accept interest payments on restructured loans in local currency, which would be placed in trusts to support environmental projects. The Administration would also seek authority to sell a portion of outstanding bilateral commercial credits under Export-Import (Exim) Bank and Commodity Credit Corporation (CCC) programs to finance debt-for-equity and debt-for-nature swaps. Under the investment proposals, the United States would encourage the establishment of two new programs to be handled by the Inter-American Development Bank (IDB) to reinforce private sector investment and lending, including the creation of an Enterprise for the Americas Investment Fund with an initial U.S. contribution of $500 million over 5 years.

The longer term trade measures are potentially the initiative's most important aspect; if implemented, they could result in a restructuring of important economic sectors throughout the hemisphere. The Administration's ultimate goal is the establishment of a free trade area throughout the hemisphere, but many analysts view that as years away, if not utopian. In the shorter run, the Administration's plan will also encourage trade liberalization through other means.

The 101st Congress passed legislation (S. 2830) authorizing the President to negotiate official debt reduction agreements for P.L. 480 loans. Similar legislation (H.R. 5855) covering AID loans passed the House, but was never considered in the Senate. (See **Legislation** for details.) The Bush Administration is expected to ask for reconsideration of its full official debt reduction and investment proposal in the 102nd Congress.

Potential Issues for Congress

Short-run Issues

Should the United States Reduce Official Debt? The Bush Administration proposes to reduce Latin American and Caribbean debt to support efforts to create free market systems, to stimulate economic growth, development, and trade liberalization, and to provide incentives for private foreign investment and for environmental preservation.

There is some question whether the long-term benefits to the United States are sufficient to compensate for loss of scheduled repayments -- up to $1 billion over the next 4 fiscal years, according to one estimate -- and to warrant setting a precedent for other countries that could prove costly to the United States in the long run. Although the United States forgave some $750 million in official debt for a number of poor sub-Saharan African countries under a congressionally-initiated measure enacted in 1988, those African nations on the whole were much poorer, and owed less than half (a total of $4.5 billion) of what Latin American and Caribbean countries owe to the U.S. Government. Total sub-Saharan African foreign debt at the time was $109 billion, much less than the $428 billion foreign debt of Latin America and the Caribbean (excluding Cuba) at the end of 1989. Moreover, most of the sub-Saharan African debt was official (68%) and 40% of it was government-to-government, rather than commercial or owed to multilateral institutions. Thus, forgiveness by the United States and other governments could have a relatively large effect on their economic condition. In contrast, many Latin American and Caribbean countries are considered moderate income countries. The U.S. official debt is a small part of their total debt, about three quarters of which is commercial. Consequently, the economic effect may be much less.

Nevertheless, U.S. officials hope that the U.S. action may encourage other governments to reduce Latin American and Caribbean nations' debt obligations to their countries. According to World Bank tables, Latin American and Caribbean official government-to-government obligations (including to the United States) totaled over an estimated $50 billion in 1989, or over 10% of Latin American and Caribbean total foreign debt. In addition, the initiative appears to target those countries in the most severe straits, and where debt to the United States is a relatively large portion of their debt. Administration officials hope that private investors will view the investment climate in these countries as significantly improved by the alleviation of future claims against these countries' incomes.

"Scoring" Debt Reduction Against the Budget. The Administration will seek authority to reduce or forgive the official debt of individual countries. The process of debt reduction raises related problems for the United States and for recipient countries. On the domestic side, the United States must decide a technical budgetary issue: whether and how to charge or "score" decreased returns from lent money against the U.S. budget. For recipient countries, decisions must be made as to how to restructure the reduced debt.

The only recent precedent where the United States reduced or forgave official debt on a regional basis is in Africa. In that case, the executive branch calculated

the amount of foregone principal and interest and noted it. Congress, however, did not appropriate new funds to offset the loss; thus it was not accounted for or "scored" against budget authority. Since the United States could potentially reduce much greater sums under the Enterprise for the Americas Initiative, the question arises as to whether this is an appropriate manner in which to handle official debt reductions.

There are two schools of thought on this matter. One argues that since an appropriation has already been made at the time the loan was authorized, there is no need for any further accounting against the budget. In addition, this school holds that no money would actually be lost because these loans are mostly AID development loans granted 5 to 25 years ago, and the United States has already decided that the possibilities for repayments on many of these loans are small. The other school argues that the appropriations for the original loans were made with the expectation that these loans would generate a future stream of income. Since the United States would not collect expected interest, it would forego income with debt reduction and thus provide foreign governments with a subsidy. This school argues that the United States would have to calculate the amount of income that a loan would have generated if it had been repaid, and Congress would have to appropriate new money cover the cost of the foregone income. (Both the congressionally-approved 1990 Farm Bill (S. 2830) and the House-passed Enterprise for the Americas Initiative legislation (H.R. 5855) require that appropriations be made to cover the forgiven debt. See **Legislation**.)

Although some argue that requiring new appropriations is the only means to reflect the actual cost to the United States of official debt reductions, others fear that it would tempt Congress to cut funding for new and continuing programs. Many believe that this would undercut the credibility of the United States in offering the plan and limit U.S. ability to assist needy Latin American countries.

The Debt-Environment Link. The Enterprise for the Americas initiative proposes that interest payments on the reduced debt obligations would be made in local currency and placed in special funds to be used for environmental and natural resource programs agreed upon by the United States and the recipient government. Although environmental and conservation groups are supportive of this concept, they have several concerns with the Administration's proposal. Chief among these concerns is that funds would be administered by the Treasury Department through its new Enterprise for the America's Facility. These groups believe that decisions should be made at the local level, with local nongovernmental organization (NGO) involvement and not in Washington. They contend that granting of funds is a programming decision and not a financial one. Several groups are pushing for more local and international NGO involvement in negotiating and implementing environmental agreements under the proposal.

The environmental community is also concerned about the type of projects the new investment fund of IDB would sanction. Several groups have proposed that legislative language to ensure that IDB-funded investment programs and projects be environmentally sound, and include investments in environmental cleanup technology. Similar concerns have been raised regarding the use of funds available from the sale of CCC or Exim credits for debt-equity swaps. The environmental community wants to be sure that funds provided for debt-equity swaps do not undermine environmental programs funded through environmental trust funds.

Another key issue raised by the environment and conservation community, and others, is whether the combined debt reduction and environmental funding provisions will provide sufficient help for Latin American countries. As proposed, these countries would continue to make principal payments in U.S. dollars. Although it has not been decided exactly how such payment plans will be negotiated, Treasury officials have indicated that they will base a country's new payment level in part on its past payment record and other "ability to pay" factors. Some are concerned that countries that have paid a higher percentage of their scheduled payments will in essence be penalized by having to continue to pay at a relatively high level. In addition, they will be paying interest (albeit at concessional rates) in local currency. In total, some countries might be paying more than they currently are. Critics charge that smaller economies with hard currency cash-flow problems could be adversely affected. Treasury counters that several factors will be taken into account in developing new payment schemes. Treasury also notes that the reduction in the principal amount to be repaid (officially regularizing the payments countries are now making) is a significant benefit in terms of halting the continued amassing of interest upon interest and principal officially outstanding, therefore encouraging new investment and strengthening local economies.

Scope of Debt Reduction. Some suggest that the Administration should broaden the scope of its debt reduction initiative beyond funds for environment and natural resource programs, and should include debt for development, and other similar measures, as contained in the Food Agricultural Conservation and Trade Act of 1990 (S. 2830). A "debt-for-health and protection swap" provision was included in S. 2830. (See **Legislation** for details.) The chairman of the House Committee on Agriculture was especially concerned that any debt reduction proposal be broadened to include agricultural, development and health initiatives.

Those in favor of concentrating available funds on environmental programs argue that it will ease pressures on these countries to farm or log marginal lands and to deplete their renewable and natural resources for much needed hard currency. They further argue that new funding is needed to help these countries manage resources for long-term profits, as well as to set aside tropical forests and other natural areas for conservation and research purposes. Reports of disappearing winter habitat for migratory songbirds, concerns about global warming and loss of biological diversity, and the impact of rapid resource development on these countries' long-term economic stability are all reasons cited for U.S. concern over the state of the environment in Central and South America.

Others argue that many Latin American countries would be better served by directing aid to health, education, and economic development programs. They view expanding the scope of the debt reduction program as a means to provide greater flexibility to the Administration in dealing with each country. Because each country has different needs for environmental reforms, and some may have more pressing needs in other areas, this flexibility would allow the United States to tailor a debt reduction program to the needs of each country.

Linkage to Economic Reforms. Some observers are concerned that linking debt reduction to economic reform will delay or block the achievement of important U.S. interests, such as preservation of the environment. Currently, only a few

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countries -- Venezuela, Costa Rica, Chile, Jamaica, and Mexico -- appear to be able to meet the strict conditions discussed by the Bush Administration (see Appendix, Table 2.) Some organizations argue that these economic reform conditions are too restrictive and that it would take some countries too long to meet them. Nevertheless, some view the linkage necessary, arguing that official debt reduction is one of the few concrete incentives that the United States has to encourage economic reform and restructuring in Latin America.

Investment Funding: New Appropriations and Conditionality. The $500 million contribution to the IDB for an "investment sector" program and the creation of a multilateral fund to be administered by the IDB may be problematic for the IDB and controversial in Congress for several reasons. Because the IDB has no such category as "investment" sector lending, the IDB probably would have to seek new authority from its board of directors to authorize a new type of program. (In addition, the relationship which the Administration's proposed IDB "investment sector" program would have to the recently established Inter-American Investment Corporation, set up to stimulate investment in Latin America, is unclear.) If new aid were granted, Congress may wish to put new conditions on it. Some observers note that congressional conditions may be resented by Latin American countries as an imposition, and create political difficulties for the bank. In addition, Congress has recently approved substantial funding for the seventh replenishment of the Inter-American Development Bank; some Members might consider new funding as an unnecessary embellishment in times of fiscal austerity. Also, whether Europe and Japan are willing to contribute to the fund is unclear.

Long-run Issues

The more difficult issues may arise in the longer run, when the United States moves forward on establishing new trade arrangements with Latin America. On the one hand, in announcing the initiative President Bush pointed out the advantages that liberalizing trade can bring. Freer trade can stimulate growth that will lead to greater demand for all goods and more investment, open new export markets for the United States and Latin America, and decrease the economic vulnerability of the Latin American countries and Caribbean countries and their need for U.S. aid.

On the other hand, greater trade will imply readjustment costs, both in the United States and elsewhere, some of which could harm certain U.S. interests. Some readjustments may already occur under the current GATT Uruguay Round, which could have implications for U.S. farmers. Freer trade with the region could hurt some of the most vulnerable U.S. industries, such as footwear and textiles. Labor may be alarmed that the United States may lose more manufacturing jobs to lower-wage Latin American and Caribbean countries with greater trade integration.

LEGISLATION

H.R. 5855 (Fascell)

Provides for the implementation of the foreign assistance provisions of the Enterprise for the Americas Initiative. Provides authority for the President to reduce the amount owed to the United States from concessional loans under the Foreign

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Assistance Act of 1961 or predecessor foreign economic assistance legislation, and to determine if countries are eligible under the criteria set up by the act. Principal repayments of the reduced debt obligations shall be paid in U.S. dollars to the U.S. Government; interest on the new obligations shall be at a concessional rate. Provides that for those countries that enter into an Environmental Framework Agreement with the United States, the interest of the reduced obligations will be paint in local currency and used for environmental programs established under the terms of the legislation. If the country has not entered into an environmental framework agreement, interest shall be repaid in U.S. dollars to a U.S. Government account.

States that eligible Latin American and Caribbean countries must have received approval for or be making significant progress toward arrangements with the International Monetary Fund and, as appropriate, the World Bank or the International Development Association, have in place major investment reforms or be making significant progress toward an open investment regime; and, if appropriate, have agreed with its commercial bank lenders on a satisfactory financing program. States that the authority of the section may be exercised only to such extent as approved in advance in appropriations acts.

Establishes in the Department of the Treasury an "Enterprise for the Americas Facility" to administer debt reduction operations for eligible countries. Authorizes the Secretary of State to enter into "Environmental Framework Agreements" with countries eligible for benefits under the Facility concerning the operation and use of an Environmental Fund for that country, which would receive payments in local currencies for the country's new obligations' interest payments. Monies disbursed by the Fund would be administered by an administering body established under the laws of the eligible country, consisting of one or more individuals nominated by the U.S. Government, one or more individuals nominated by the beneficiary country government, and a majority of individuals representing a broad range of environmental nongovernmental organizations of the beneficiary country, local community development nongovernmental organizations, and scientific academic organizations or institutions. The administering body would receive proposals for grant assistance and make grants under the priorities set forth in the Environmental Framework Agreement, and be responsible for their management and oversight.

Also establishes an Environment of the Americas Board, composed of 9 members appointed by the President, to advise the Secretary of State on negotiations of the Environmental Framework Agreements.

Committee consideration and mark-up session held Oct. 18, 1990. Reported by Committee on Foreign Affairs (H.Rept. 101-917) Oct. 22, and passed House by voice vote the same day. Received in Senate and referred to Committee on Foreign Relations Oct. 23, 1990. (The provisions of this bill were also included in H.R. 5892 (Crockett), A bill to provide for the implementation of the foreign assistance provisions of the Enterprise for the Americas Initiative and to promote Caribbean Regional Development. H.R. 5892 passed House on Oct. 22, and was referred to Senate.)

S. 2830 (Leahy)

Food, Agriculture, Conservation and Trade Act of 1990 (The Farm Bill). Section 1512 amends the Agriculture Development and Trade Act of 1954 to allow the

reduction of P.L. 480 sales credit debt owed to the U.S. Government by Latin American and Caribbean countries. Establishes an "Enterprise for the Americas Facility" within the Department of Treasury. States its purpose is to promote debt reduction, investment reform, conservation, and sustainable use of the environment (Section 602). States that debt may be reduced only as provided for in appropriation acts.

Provides that to be eligible for debt reduction, Latin American and Caribbean countries must comply with three conditions: 1) have in effect, or be making progress toward, an IMF standby arrangement or, as appropriate, structural or sectoral adjustment loans from the IBRD or IDA; 2) have put into place major investment reforms in conjunction with the IDB or otherwise be supporting an open investment regime; and 3) if appropriate, made agreements with commercial bank lenders regarding debt or debt service reduction.

Principal payments on reduced obligations will be deposited into Commodity Credit Corporation (CCC) accounts. Interest payments, charged at a concessional rate, will be paid into an Environmental Fund established under an "Environmental Framework Agreement" between the President and the country. For countries that have not established such an agreement, interest payments will be deposited into CCC accounts.

Monies disbursed from the Environmental Fund will be administered by a body composed of representatives appointed by the President and the eligible country, and representatives from environmental and local community development NGOs. It appears that the majority of the body is to be made up of local representatives from NGOs, and scientific or academic bodies. Funds will be used for agricultural activities, community initiatives that promote conservation and environmentally sustainable activities, and other activities as outlined in the International Development and Finance Act of 1989 (P.L. 101-240). Grants from the fund may be made to local nongovernmental environmental, conservation, development, educational, and indigenous peoples organizations, and other appropriate local or regional entities, or in exceptional circumstances, the government of the eligible country.

Also gives the Secretary of Agriculture the authority to provide grants for "debt-for-health-and protection swaps." Grants would be provided to foreign NGOs (including academic institutions) to purchase a country's discounted commercial debt. The debt would then be cancelled in exchange for the country's voluntary agreement to issue bonds or otherwise fund projects that will reduce the presence of animal and plant pests and diseases.

S. 2830, as reported from conference, passed House Oct. 23, and passed Senate Oct. 25, 1990.

APPENDIX

Table 1. Total Debt Outstanding from Latin America to the U.S. Government*
(millions of dollars - as of Dec. 31, 1989)

Country	Concessional Loans AID	Concessional Loans P.L. 480	Market Rate Loans ExIm	Market Rate Loans CCC	TOTAL
South America					
Argentina	50.4	0.0	409.3	0.0	459.7
Bolivia	330.2	139.0	32.8	0.0	502.0
Brazil	998.6	48.3	1,060.8	155.1	2,262.8
Chile	328.0	51.7	15.2	85.6	480.5
Colombia	525.6	3.5	548.8	0.0	1,077.9
Ecuador	131.1	19.0	29.2	0.0	179.3
Guyana	60.8	26.2	2.5	0.0	89.5
Mexico	24.0	0.0	1,212.8	444.5	1,681.3
Paraguay	35.5	2.0	0.0	0.0	37.5
Peru	336.9	206.2	54.0	94.9	692.0
Uruguay	40.1	3.0	10.2	0.0	53.3
Venezuela	4.1	0.0	34.5	0.0	38.6
SUBTOTAL	2,865.3	498.9	3,410.10	780.1	7,554.4
Central America					
Belize	26.6	0.0	0.0	0.0	26.6
Costa Rica	340.0	125.0	21.8	0.0	486.8
El Salvador	303.3	329.3	0.0	0.0	632.6
Guatemala	198.6	83.8	0.2	0.0	282.6
Honduras	328.2	94.6	3.0	0.0	425.8
Nicaragua	222.4	17.5	12.2	0.0	252.1
Panama	192.7	0.0	5.9	1.6	200.2
SUBTOTAL	1,611.8	650.2	43.1	1.6	2,306.7
Caribbean Islands					
Anguilla	2.1	0.0	0.0	0.0	2.1
Antigua & Barbuda	19.9	0.0	0.8	0.0	20.7
Bahamas	0.1	0.0	0.0	0.0	0.1
Barbados	7.6	0.0	0.0	0.0	7.6
Dominican Rep.	338.2	209.5	84.7	119.4	751.8
Haiti	18.3	107.2	8.6	0.0	134.1
Jamaica	442.5	269.1	47.3	54.4	813.3
St. Kitts & Nevis	8.3	0.0	0.0	0.0	8.3
St. Vincent	1.1	0.0	0.0	0.0	1.1
Trinidad & Tobago	0.0	0.0	108.6	0.0	108.6
SUBTOTAL	838.1	585.8	250.0	173.8	1,847.7
TOTAL	5,315.2	1,734.9	3,703.2	955.5	11,708.8

Source: Department of the Treasury.

WASHINGTON TIMES, December 11, 1990

A new openness in Argentina

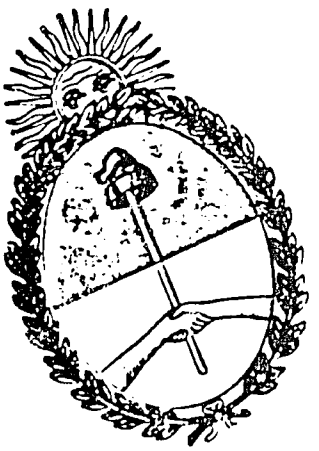
BUENOS AIRES, Argentina

Gauchos and their horses thundered past President Bush here at the elegant Rural Society, and the lean and wiry men of the pampas doffed their caps to the first American president to visit this proverbially anti-American country in 30 years.

Champagne flowed like Niagara Falls at the dinner. Tango dancers pounded the stage, and Mr. Bush and Argentine President Carlos Saul Menem both looked as happy as two Cinderellas incongruously transported to the ball of balls.

At one point, I looked about the huge hall Wednesday, where a sumptuous barbecue was being served to 400 Argentine and American guests, and wondered whether Texas, with its jealous cowboys, would ever forgive "Texan" George Bush this gaucho extravaganza.

But looking at Mr. Bush himself, I found not the slightest ambivalence at such a potentially contradictory allegiance. Not only did the president win Buenos Aires with his natural charm, respect for things Argentine and commitment to a "new relationship," he clearly was deep into building the world he envisions.



Take those parts of the past that Mr. Bush came here to help the smart, ambitious Mr. Menem erase. Argentina's economy is even today the largest state-run economy outside the Soviet bloc. It has had the highest inflation rate in the world; it has tottered until now on the brink of becoming one of the world's poorest nations, and 42 percent of the population of Buenos Aires lives in poverty.

Until now, too, these two large nations of the hemisphere have studiously avoided each other. Argentina, which gave the words "ego" and "pride" new meaning in the world, viewed the United States with hostility and resentment and withdrew from it into paranoid isolation.

Perhaps the degree of the transformation here — political, yes, but even more psychological — was shown during the Bush-Menem press conference Wednesday when an aggressive Argentine journalist demanded of Mr. Bush: "Argentina just sent frigates to the Gulf to help the U.S. What are you doing to help Argentina?"

"I don't believe Argentina sent frigates to the Gulf to help the U.S.," Mr. Bush said in a no-nonsense voice. "I think she did it to help herself. They're not trying to do us a favor, they're doing what is right."

"We did it for peace and dignity ... for the countries aggressed upon," Mr. Menem immediately responded. "We do not expect any type of compensation — and we would certainly not accept any."

Then the Argentine president, who has begun a profound turnaround of the Argentine economy in the last two years from statist to free market, added important words.

"This shows," he said, "that Argentina has returned to the Western world as a vocation, not as any favor. Argentina is returning to the world as a matter of conviction."

The mental change from the old arrogance toward the outside world (and particularly toward the United States, which Argentina saw as its primary rival) has clearly taken place. It opens the way for the first really positive and friendly relations between the two hemispheric heavies since the 1920s.

"We are seeing a fundamental change in our relations with the U.S.," says Elvio Baldinelli, the former minister of trade. "The U.S. in the past was not a great associate of Argentina's, but it will be in the future." But then he sounded the warning: "We will come out of this only on the level of the poorer countries of Europe," he added, but soon "this continent will be a continent with open [economic] policies."

This is where the potential shadows close in on the "democratization ... democratization ... democratization" that is Mr. Bush's prime message down here and that is winning him so many plaudits — now.

Despite all the talk here about new realities and about an end to "magic solutions," the fact is that it is going to be hard for Argentina economically even to arrive at that level of the "poorer nations." The news from a country such as Brazil, which has been trying these same economic changes, is not good. In short, there is no assurance that democracy will "work" in transforming these societies economically. The next stage after that could be frightening indeed.

Georgie Anne Geyer is a nationally syndicated columnist.

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FOREIGN POLICY

ROCHELLE L. STANFIELD

RHETORICAL ROSES

Stodgy middle age has descended upon the U.S. relationship with South America, substituting a correct, almost gentle, politeness for the fire and ice of previous times.

A mature partnership is sure to be more satisfying over the long term, but right now, as South America experiments with democracy and flirts with a market economy, it needs a robust young hero to rescue the region from its dire international debt crisis, to proffer new trade deals and leap in with investment capital. Uncle Sam, however, is too preoccupied with the Persian Gulf, too tired from dealing with domestic hassles, and—most important—too broke to be a swashbuckler.

"Latin Americans don't expect a great deal from the United States any more" and are "really trying to pursue their own agenda."

The question is: Can a democratic South America hang on and make do until the immediate danger is over?

The United States has returned its attentions to South America after more than a decade of neglect during which the U.S. hemispheric focus was on Central America. In June, President Bush proposed a grand, three-pronged Enterprise for the Americas Initiative to expand trade, ease the debt burden and stimulate investment. He followed up early this month with a five-day swing through Brazil, Uruguay, Argentina, Chile and Venezuela. Bush brought rhetorical roses but little substance. And his eye kept wandering to the Middle East, on which the attention of the senior advisers and members of the press corps who accompanied him remained during the trip.

"The President spent a whole week but did not advance the initiative beyond the grand vision of six months ago," said Peter Hakim, staff director of the Washington-based Inter-American Dialogue of the Aspen Institute. "I consider that trip a missed opportunity."

The South Americans received Bush with grave courtesy but little enthusiasm. They did not throw stones—as they did at then-Vice President Richard M. Nixon when he toured Venezuela in 1958—nor did they idolize him as they did President Kennedy a few years later.

"The Latin Americans don't expect a great deal from the United States any more," said Riordan Roett, director of Latin American studies at the Johns Hopkins School of Advanced International Studies in Washington. "The new political leaders in South America are really trying to pursue their own agenda, which doesn't conflict with the United States but isn't written by the United States, either, which I think is a very positive development."

The South Americans are trying to dig themselves out of the political-economic hole they fell into in the 1970s and 1980s. They all now have democratically elected governments, and several have experienced a peaceful transition from one civilian government to another. An attempted coup in Argentina, while Bush was in Brazil, was half-hearted. If anything, the ease with which it was put down and the contemptuous attitude toward the insurgents on the part of Argentinians and leaders of other South American countries reinforced the democratic fervor throughout the region.

Similarly, the concept of economic reform seems as firmly entrenched, if not as successful, as that of democracy. Efforts are under way to pare down government, privatize nationalized concerns and open up the economies to outside investment. One problem is that investors have not materialized.

The Enterprise for the Americas Initiative would set up a multilateral fund in the Inter-American Development Bank to promote policies that encourage investment. Specialists call it a nice gesture, but "it's not really going to change the flows [of capital]," said Stuart K. Tucker, a fellow at the Overseas Development Council, a Washington think tank.

As important as investment is trade. Argentina, Brazil, Paraguay and Uruguay have begun discussions toward setting up a free-trade zone by 1994. The idea is that these countries would develop a framework to bring to the United States, to negotiate a five-country deal. Colombia, Bolivia and Peru are also moving to expand trade among themselves.

Bush has set a goal of a hemispheric free-trade area, but the realization of that vision is a very long way off, especially with the apparent failure of the four-year Uruguay Round of the General Agreement on Tariffs and Trade. Prior to his South America trip, Bush went to Mexico to reaffirm progress on a proposed U.S.-Mexico agreement that would complete a North American free-trade zone. Any deals with South America would come after a U.S.-Mexico agreement, still years off. Chile would probably be next in line, because it has the most liberal economy on the continent. Yet Chile's finance minister, Alejandro Foxley, complains that the United States is moving too slowly in the trade area.

The biggest issue of all is debt. The five countries that Bush visited owe a total international debt of $250 billion, most of it to commercial banks. When asked during his trip about debt reduction, Bush brushed off the question.

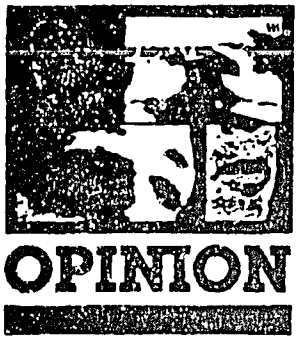
Of the five countries, only Venezuela has even a preliminary agreement under the so-called Brady Plan (named for Treasury Secretary Nicholas F. Brady) to reduce its debt to the banks. The enterprise initiative covers only official, government-to-government debt. Some specialists have criticized its provisions as more restrictive than those of the Brady Plan.

As a consequence of these enormous debt burdens, poor world trade markets and economic reforms that often throw large numbers of people out of work, social programs in these countries have gone down the drain. "We're looking at a Latin America that is becoming more impoverished, more malnourished and less educated," Roett said. "Clearly, that is in nobody's interest." There isn't much the United States can do about it right now, however, except cheer and clap—which is what Bush did on his five-country trip.

"In 1991, we'll probably get more of the muddling through we've seen in the last couple of years," Roett continued. "But that just means we're postponing what is going to have to be an inevitable reckoning." ■

THE CHRISTIAN SCIENCE MONITOR

December 3, 1990



Bush's trip south will give financially strapped governments an opportunity to assess the US commitment to expanded trade, debt reduction, and greater investment in the region

Latin America's Needs

By Peter Hakim

AT every stop on President Bush's South American itinerary this week, economic issues will dominate the agenda. Political leaders in Brazil, Uruguay, Argentina, Chile, and Venezuela will want to hear the president reconfirm the commitments he undertook this past June when he launched the Enterprise for the Americas Initiative – a wide-ranging proposal to strengthen US economic ties with Latin America and to work toward a free-trade zone in the hemisphere.

But the Latin Americans will also want to know what steps the United States is prepared to take to achieve these goals and what is expected of them. The president and his advisers ought to provide a clear response.

All of the countries the president will visit, except Chile, are locked in a protracted economic depression. Living standards are declining; poverty is spreading; triple-digit and higher inflation persists; and investment remains abysmally low. Latin America's leaders, however, are not looking for foreign aid, nor do they expect any significant revival of bank lending. They know that the only realistic path to economic recovery is through expanded exports, foreign investment, and the return of flight capital.

They also know that unimpeded access to the vast United States market is crucial for attracting foreign investors and building a dynamic export sector. The United States is already South America's principal market. Some 30 percent of South America's trade today is with the US. Increased sales to US buyers accounted for 75 percent of South America's export growth in the 1980s.

Latin Americans do not want to limit their trade to the US, but they are worried – rightly or wrongly – about the possibility of Europe and Asia forming restrictive trading blocs that might shut out their products. They are also concerned that the US will become more protectionist or form its own trading bloc with Mexico and Canada – in either case blunting their export drives. That is why South America's nations want trade agreements with Washington that will assure their access to US markets.

The benefits would not all go in one direction. Although US exporters send only 13 percent of their products to Latin America, annual sales total $50 billion – somewhat more than our exports to Japan. And economic recovery in Latin America would lead to some $10 billion to $20 billion a year in additional purchases from US exporters.

Moreover, trade currently accounts for only 15 percent of economic activity in Latin America. If the region sustains its economic reform efforts, that figure could increase sharply, with a corresponding expansion of imports from the United States. A vibrant export sector in Latin America, moreover, would provide opportunities for US investors – and expanding trade and investment would facilitate loan repayment to US banks.

SOUTH American governments do not expect to achieve special trade arrangements with the US overnight. They recognize Washington's first priority is a trade agreement with Mexico, which is already tied closely to the US economy. What they will expect from President Bush are clear signals that the US will be ready to move forward once the Mexican negotiations are concluded. The president's visit itself is one such signal. There are four other steps Washington should take:

First, the US should move quickly to implement the nontrade provisions of the Enterprise for Americas Initiative, including proposals for reducing US bilateral debts and establishing an investment promotion fund. Although neither will do much to help South American countries, action on them would provide reassurance of Washington's active commitment to the initiative.

Second, although formal trade negotiations with South American countries are not likely to begin before 1992 (the earliest a US-Mexican agreement could be concluded), systematic consultations among the US and the countries of Latin America should be initiated soon, preferably on a multilateral basis. Such consultations should focus on how the subsequent negotiations would be organized, on what each country should do to prepare for them, and what issues are likely to emerge as stumbling blocks to agreement.

Third, the US should continue to encourage Latin American countries to reach their own trade arrangements. Such arrangements are crucial in building toward a genuine hemispheric free-trade zone that would go beyond bilateral trade deals between the US and individual Latin American countries. The US has signed bilateral "framework agreements" specifying key issues for trade negotiations with a number of countries. There is expectation that a framework agreement involving the United States, Argentina, Brazil, Uruguay, and Paraguay will be announced during President Bush's trip.

Finally, the US should face up to the fact that the Brady plan for reducing Latin America's commercial debts is faltering and needs revision. Argentina and Brazil, South America's largest debtors, are, for example, still unable to qualify for debt relief. The sooner a strategy is devised for extending debt reduction to these and other countries, the faster they will recover and become stronger trading partners for the United States.

No one in Latin America expects the US to solve the region's economic problems. What Latin Americans want are expanded opportunities to compete for sales and investment capital in US markets and a workable strategy for dealing with their debt burdens. President Bush and his advisers should be responsive on both counts – for the benefit of the US as well as Latin America.

Peter Hakim is the staff director of the Inter-American Dialogue, which will be releasing its sixth comprehensive report on US-Latin American relations later this week.

THE WHITE HOUSE

Office of the Press Secretary
(Monterrey, Nuevo Leon, Mexico)

For Immediate Release November 27, 1990

REMARKS BY THE PRESIDENT
AT MEXICAN-AMERICAN BUSINESSMEN MEETING

Casino Monterrey
Monterrey, Nuevo Leon
Mexico

11:59 A.M. (L)

THE PRESIDENT: Thank you, my friends. Thank you, Mr. Minister Jaime Serra, for that kind introduction, and to all of you for that warm reception. Mr. Sada, I enjoyed your remarks, sir, and thank you for your comments about Texas. I expect Bob Mosbacher would respond also in this way, or our Secretary of State Jim Baker, and quite a few others in our administration.

But I am just delighted to be here. And really in Monterrey, I have felt the warmth of the friendship that has grown between our countries. I like to feel it's always been there. But I can tell you at the outset of these brief remarks, I don't ever remember a time when Mexican and U.S. relations were better. They are superb, and I'm going to keep working my heart out to make them even better still. (Applause.)

I want to salute the business people from Mexico and again express my appreciation to the business leaders from the United States that are with us today. We had a very important breakfast. This meeting, I'm told, has gotten into a lot of technical questions, and if we do have time for questions afterward and you ask me about flower duties or something of that nature, I will pass the question off to our able Ambassador Carla Hills or our able Secretary Bob Mosbacher.

But, you know, preparing for this trip I noted that 47 years ago, 1943, the last American President to visit Monterrey, Franklin D. Roosevelt, told of his hopes that one day every Mexican and American president would feel at "liberty to visit each other just as neighbors visit each other" -- just as -- and he went on -- just as "neighbors talk things over and get to know one another." Today, that ideal of a special relationship between the United States and Mexico is no longer a dream, it is real. It's as real as the spirit and drive, the compassion and the courage of this great President of yours, President Salinas, and of the Mexican people themselves.

Bernal Diaz, a great 16th century writer, once wrote of Mexico that "never in the world would there be discovered other lands such as these." The Mexico of 1990 lives up to that early vision. Yours is a land of beauty, the boundless energy of a creative people. It's a land of optimism and a land of infinite opportunity. You're a nation proud of yesterday and hopeful for the future, and it's a future that the United States wants to participate in. We want to share in that future.

It's easy to see why Mexico is so strong -- and why the relationship between our two nations has never been better, never been more important. Today, more people than ever before are establishing between us stronger social, cultural and economic ties.

Today, our governments are working closely to win this

MORE

war on drugs -- a war that takes a terrible toll on the lifeblood of both Mexico and the United States. Our law enforcement officials have been meeting regularly with their counterparts in Mexico and working very closely together. Their efforts are beginning to pay off as we see more illegal drugs seized than ever before.

We also see more and more universities on both sides of the border developing exchange programs as we work to encourage intellectual achievement and better understanding between our peoples. And we're working together on a host of common endeavors to protect our environment.

But it is difficult to imagine any theme more vital than the one that I'm told you have been discussing here this morning -- how the private sector can create and expand the economic resources that sustain our relationship as a whole.

I can tell you that I am convinced that the most important step that we can take together as two nations and as two peoples with drive and determination is the conclusion of this free trade agreement between the United States and Mexico.

You know that agreement is important because free trade means more jobs and productivity for both Mexicans and Americans. You understand the economic importance of the United States; and America, too, realizes the importance of Mexico. Consider that Mexico is now America's third-largest trading partner -- $52 billion in trade in 1989, and this year's number I understand will be even higher. Since every billion dollars of exports creates roughly 25,000 jobs, more cooperation means more prosperity for more people.

I know there's no blueprint, no "one-size-fits-all" approach to progress and reform. Each nation must decide how best to achieve economic growth. But it was President Salinas who said in his recent State of the Union address, "Mexico doesn't want to be a third world nation. It wants to be a first world nation."

He understands that prosperity in this hemisphere depends on trade, not aid. Already, your automotive, electronic, tourism and other industries have shown world-class productive capability, and when you grow, we grow. A Mexico that wants to get out and compete has selling power, but it also has buying power. And that's a good Mexico -- that's good for Mexico, good for America.

Negotiating this free trade agreement is not going to be easy. You're going to hear criticism -- we all will -- just as we did when we negotiated our Free Trade Agreement with our neighbors to the north, with Canada. But we should remember what trade liberalization can and already has done.

In 1988, Mexico entered the GATT -- and our bilateral trade with Mexico soared to over $50 billion -- up $17 billion from the year before the GATT entry. Virtually everyone favors free trade and fair trade, but not everyone has the vision to make it a reality. I believe that we do; I believe that Mexico and the United States do -- and I ask you not only to help make it happen, but to make it succeed.

Both our peoples can then look to a future of peace and prosperity. A proud future for two nations sharing not just common borders, not just common ideals, but a friendship that will last for generations.

I can't tell you what a joy it was yesterday to be in President Salinas' home with our family and his family. It was more than symbolic because of the hospitality was just exceptional. But I think it sent a signal -- I hope it did send a signal that we are true friends, north and south, Mexico and the United States of America. We have so much in common.

I want to thank you all for your kindness. I want to thank you for participating in this important forum. I want to thank you on my wife's behalf for this exceptional hospitality on this truly wonderful visit. And I want to express my thanks once again to President Salinas, to Minister Jaime Serra, and God bless the great nation of Mexico. Thank you all very, very much. (Applause.)

END 12:08 P.M. (L)

Salinas banks on free trade

By Bruce Babbitt

By acknowledging that Mexico's economic destiny lies with a North American free trade area, Carlos Salinas de Gortari has taken the final bold step to cement his nation's economic revolution.

The President has invested an enormous amount of political capital in his proposal for a free trade agreement with the United States. If he succeeds, the Mexican economic reforms will be consolidated beyond repeal, whomever his successor may be. But if he falls short, the opposition will inevitably turn the next presidential campaign into a referendum arguing against liberal economic reform and for a return to traditional Mexican economic nationalism.

If free trade is to become a reality, the agreement will have to be reached this coming year — in 1991. Mr. Salinas is by law a one-term president; his term ends in 1994 and he will become a lame duck in 1993.

On the US side, President George Bush faces a reelection campaign in 1992. And in a campaign year, any American president, no matter how committed to free trade, must defer to protectionist interests such as southern textile companies and the northern steel industry.

That means the year of decision when both presidents will be free to act is 1991. And Mr. Salinas' worst fear is that the United States simply won't be ready. Free trade may be his top priority, but President Bush is preoccupied with Saddam Hussein, the budget gridlock, and an American economy slipping into recession, an event which always calls forth prophets of protectionism.

If the free trade movement is to succeed, it cannot wait for the US President and the Congress to get organized. The process will need a strong grass-roots push from the press, the business community, friends of Mexico, and free traders. The threshold question is to spell out what is meant by free trade. The traditional definition, which formed the basis for the US-Canada Free Trade Agreement, has three parts encompassing the free movement of capital, labor, and goods.

The year of decision when both presidents will be free to act is 1991. And Mr. Salinas' worst fear is that the United States simply won't be ready.

Given the political and economic disparities between the United States and Mexico, it probably isn't realistic to expect that a true, triple-sector free trade agreement can be worked out in the available time. The most problematical sector is labor. There is little chance that the United States will agree to open its border to the unrestricted entry of Mexican labor, however desirable that may be considering that the American work force is aging rapidly at the very time that Mexico has a surplus of eager young workers. The 10-year debate that preceded the Simpson-Rodino immigration bill demonstrated that an unlikely combination of organized labor, zero-population growth advocates, and the Klu Klux Klan has the power to keep the door closed.

The Mexican government, which has in recent years gained a much more sophisticated understanding of American politics, appreciates this reality. It is therefore prepared at the outset to set aside virtually all the labor and immigration issues.

The situation is reversed with capital, where it is the US side that wants free movement and the Mexican side that invokes political and cultural arguments for moving slowly.

Mexico has already liberalized foreign investment rules to an extent scarcely imaginable even a year or two ago. But this progress has only accelerated the demand for more. The Japanese in particular have taken a tough and critical stance, demanding to know why Mexico should discriminate against foreign capital at all. (please turn to page 4

Bruce Babbitt is former governor of Arizona

(continued from page 1) In effect, the Japanese, themselves hardly a model of investment transparency, are demanding the non-discriminatory standard that they have become accustomed to from investing in the United States. Double standards aside, the Japanese, as the new foreign investment powerhouse, have become the most effective advocates for opening Mexico wider to direct foreign investment.

There are still many areas where Mexico can liberalize foreign investment regulation. The Foreign Investment Law still retains a xenophobic tone, and the Mexican Foreign Investment Commission is still a bureaucratic jungle lush with permit requirements and arbitrary administrators.

The one provision of the investment law that is probably not open to chang in the near-term is Article 4 which provides for government monopolies in oil, electricity, railroads, and several other industries. Yet even here, the Salinas government has shown considerable flexibility as evidenced by the sale of copper mines in Sonora, the coming sale of the telephone company, Telmex, and the narrowed definition of the Pemex monopoly in the petrochemical industry.

In the new post-Marxist world, it is the investors who call the shots, but capital is short and new investment opportunities are opening up in Eastern Europe, Asia, and elsewhere. Like it or not, Mexico will be judged by a competitive, international standard for direct foreign investment. Mexico is still not there, but we can expect that a free trade agreement will provide the necessary impetus.

In the third area of goods, services, and intellectual property, both countries will have to make big concessions. The Salinas government has already abolished most import licensing and brought the average tariff rate down to 11 percent. And it appears ready to go all the way to zero.

In the end, a workable agreement will consist of a tradeoff in which Mexico reluctantly opens to US investment and the United States grudgingly abandons its protectionist barriers in areas where Mexico has most to gain.

That in turn will put the negotiating ball in the Washington court, putting the US commitment to the test. Will a US Congress that has just voted to freeze footwear imports and to strengthen textile quotas be willing to make exceptions for a potentially large volume of Mexican imports? What about steel quotas and winter vegetables? And even on the Mexican side there will be some problem areas such as the complex system of export incentives and domestic protection given to the Mexican automotive industry.

In the end, a workable agreement will consist of a tradeoff in which Mexico reluctantly opens to US investment and the United States grudgingly abandons its protectionist barriers in areas where Mexico has most to gain. The result for Mexico will be an infusion of US capital and technology putting low-cost Mexican labor to work for the benefit of both Mexican and US consumers.

The Japanese, not party to the agreement, will nonetheless be big winners as they invest in Mexico to gain indirect access to US markets. The US will gain investment opportunities and a vast, Mexican market of nearly 100 million people eager for US goods. And that is to say nothing of the benefits of a new and more stable political relationship between the US and Mexico. ●

LOS ANGELES TIMES, November 23, 1990

PERSPECTIVE ON FREE TRADE

A Hand for Mexico, a Slap for Us

It's not true that U.S. workers will reap secondary benefits. Mexican workers won't be helped much, either.

By RICHARD ROTHSTEIN

A U.S.-Mexico free-trade agreement would confirm present trends—opening Mexico's economy to U.S. investment and the relocation of U.S. manufacturing to Mexico. Already, half a million workers in Mexican *maquiladora* plants make products for export to the States. Mexican rules restricting foreign (i.e., U.S.) ownership of factories have been nearly abolished. U.S. automobile firms now operate more technologically sophisticated plants in Mexico than they do at home. Much of California's furniture industry has relocated to Tijuana. Japanese and Korean consumer electronic firms have gained easier access to U.S. markets by establishing low-wage (but high-quality) factories in Mexico.

Meanwhile, and partly as a consequence, the U.S. manufacturing sector shrank from 23% of domestic employment in 1979 to 18% last year. This employment loss can only grow with free trade. So why does the Administration pursue an agreement?

Advocates offer two rationales, neither of which stands much scrutiny. First, they claim that free trade would open Mexico's market to American sales, creating economic growth at home. They speak of "80 million consumers" in Mexico, warning that without free trade, Japanese or Europeans, not Americans, could capture this enormous market. But low-wage markets are no bonanza. Mexican wages average $1 an hour and have been declining. "Consumers" earning only $1 an hour don't consume very much beyond the basic necessities.

Expanded free trade will probably further depress Mexicans' purchasing power because it will restrain traditional government industrial-protection policies and foster *maquilarization* of wages throughout the economy. It is no accident that wages in Mexico's *maquila* export sector (as low as 60 cents an hour) are substantially below wages in firms serving Mexico's domestic market.

Free-trade proponents claim that 80% of every peso paid to *maquila* workers is spent either in U.S. border communities or on U.S products. Thus, they argue, U.S. manufacturing in Mexico benefits us as well. This makes little sense. When a $10-an-hour job in Detroit is replaced by a 60-cents-an-hour job in Tijuana, it is ludicrous to suggest that U.S. workers benefit because 48 cents is then spent in San Diego.

Free-trade supporters also argue that moving basic manufacturing to Mexico supports higher-paying jobs at home. "Every time you put a plant in Mexico, it creates new jobs in the United States because we are the suppliers, the transporters and the managers of the plants in Mexico," said Commerce Secretary Robert A. Mosbacher Sr. in Los Angeles last month.

The Mattel Corp. recently announced that it would expand its toy assembly in Mexico, employing several thousand more Mexican workers. This, it claimed, would benefit California because the assembly operation would depend on skilled injection-molding jobs here.

This argument is contradicted by two decades of experience. Almost invariably, manufacturers claim that only basic assembly will relocate. Yet just as invariably, once Mexican basic manufacturing is running smoothly, higher-skilled jobs follow. Why shouldn't they? Mexican workers are no less skilled than their American counterparts (and robotization is more advanced in some Mexican manufacturing). Mexican universities and technical schools graduate increasing numbers of managers, engineers and skilled workers. And there are substantial inventory, transportation and quality savings gained by locating supply and design operations close to assembly plants they support.

The *maquila* sector now hosts high-tech firms as well as assembly plants. Westinghouse, for example, makes the F-16's guidance systems in Chihuahua. When Mexico's border industrialization zone was established 20 years ago, its main activity was sewing garments. Today, 39% of all *maquila* plants make electronics; apparel represents only 9%.

In truth, we are pushing a free-trade agreement more for political than economic reasons. The Bush Administration is more responsive to manufacturers seeking Mexico's low wages than to their U.S. workers facing layoff. It is more open to financing ventures that seek Third World manufacturing profits than to competing claims of a starved infrastructure and technological advance at home. The Administration also is responsive to retailers who expect low-cost imports to generate higher profits. While that's true in the short run, declines in U.S. purchasing power resulting from the loss of high-wage manufacturing could spell doom for mass retailers. It is ominous that the average hourly wage in the United States has declined almost 10% since 1980, due in part to replacement of high-wage manufacturing by service and retail employment. Farsighted retailers can take no comfort from this statistic, whatever temporary benefit they gain from cheap imports.

The Bush Administration, characteristically more interested in foreign than domestic policy, sees an opportunity to bolster Mexico's President Carlos Salinas de Gortari, who has staked considerable prestige on the quest for free trade, hoping it will stimulate U.S. investment in Mexico and remove temptations that U.S. investors might feel to send excess capital to developing markets in Eastern Europe. However, both Bush and Salinas would be well advised to pay more attention to the benefits of higher wages in both nations, and less attention to short-term profits gained from competitive impoverishment.

Richard Rothstein is a Los Angeles-based research associate of the Economic Policy Institute in Washington.

WASHINGTON POST, November 30, 1990

M. Delal Baer

Mexican Elections: Shadow Over the Summit

U.S. protectionists will try to use noneconomic arguments to derail a free-trade agreement.

The concord surrounding this week's summit between President Bush and Mexican President Carlos Salinas is unprecedented in 65 years of post-revolutionary Mexican history. The crown jewel of the summit is the promotion of a U.S.-Mexico free-trade agreement (FTA).

A U.S.-Mexico FTA would be the logical culmination of Mexico's economic strategy based on private investment and trade liberalization. For Mexico, an FTA will guarantee market access and attract investors. For the United States, an FTA will open up Mexico's market of 80 million people and enhance the competitiveness of our products vis-à-vis Japan and the European Community.

There is but one shadow cast over what would otherwise be a flawless summit. Politics are the Achilles heel of bilateral amity. President Salinas presides over a political system in which a single party has dominated the electoral scene for 65 years. Salinas has made guaranteeing the irreversibility of economic reform a precondition to democracy. He is mindful of the lessons of Eastern Europe, where wholesale dismantling of political institutions has complicated economic reform. He is also aware of the experience of Chile and South Korea, where economic reforms implemented under strict political control have survived transitions to democracy.

Salinas is neither a brutal autocrat nor revolutionary democrat. Rather, he is a gradualist in democratic questions. There is, however, such a thing as being too gradual. Widespread irregularities in the Nov. 11 local State of Mexico elections suggest serious backsliding. The government claims to have won 116 out of 121 municipalities by unbelievable margins. Ironically, the ruling Institutional Revolutionary Party (PRI) had worked hard, nominated good candidates and would have won most municipalities in a fairly managed process. President Salinas has reached a turning point in the Mexico state elections. Slow-motion democratization may have become a greater threat to Salinas' economic project than radical political reform.

President Salinas is not solely responsible for this descent into deadlock. Cuauhtemoc Cardenas, leader of the opposition Democratic Revolutionary Party, has refused to engage in the kind of negotiations that could lead to a pacted transition to democracy. Rather, he has preferred to label the PRI unreformable. He is betting on a welling up of public wrath that might destroy his political adversaries, scarcely an attitude of democratic tolerance.

The greatest victim of an electoral standoff could be Salinas' most precious project, the FTA. Free-trade opponents in the United States, realizing that they have already lost the economic argument, will try to use noneconomic arguments to derail an agreement and cloak their own protectionist motivations. They may attempt to link a FTA with Mexican electoral purity. Advocates of a FTA point out that a free-trade agreement is not an act of charity nor is it a reward to Mexico for good behavior. Rather, an FTA is in the economic interest of the United States and should be pursued for that reason alone.

Bush is fighting a rising tide of protection and recession at home. Clearly, he has made a negotiation and congressional passage of a free-trade agreement with Mexico one of the top priorities of his administration. Unsavory Mexican elections will only provide FTA opponents with new ammunition.

The State of Mexico election should serve as a wake-up call for President Salinas. There is time to recoup from this setback. Mexico will hold important midterm elections for seven governorships, the entire Chamber of Deputies and half of all Senate seats in the spring. There may be a silver lining in this dark cloud—the lessons of the State of Mexico election can still be learned before it is too late.

The writer is director and senior fellow of Mexico Project at the Center for Strategic and International Studies

The Partnership for Democracy and Development in Central America

November 20, 1990

The U.S. Department of State

On November 20, the U.S. hosted a meeting to explore and discuss Secretary Baker's initiative for a Partnership for Democracy and Development (PDD) in Central America. The Partnership is intended to expand exchange of information on programs in Central America, with a view to avoiding duplication, improving coordination, identifying gaps, and achieving a synergy making the whole greater than the sum of its parts. It will not substitute for ongoing programs or duplicate economic policy or debt discussions held in other fora. The PDD might be associated with the creation of a regional consultative group for Central America. It would assure continuing high level focus on Central America. The Partnership builds on the Esquipulas Process and is also responsive to the Economic Action Plan for Central America (PAECA), approved by the Central American Presidents last June at Antigua, Guatemala. We wish to keep structures, mechanisms, and bureacratic aspects of PDD to a minimum. Ford Cooper, a senior foreign service officer has been named U.S. Special Coordinator for the PDD.

At the November 20 meeting, the six Central American countries (including Panama) which were represented at the ministerial or vice-ministerial level; 21 of the OECD countries; Mexico, Venezuela, Colombia and six international entities (including the IDB--represented by its President Enrique Iglesias--and the IBRD) made positive statements noting the timeliness of an initiative to strengthen and deepen both political and economic development in the region.

Our sense of the meeting is that participants wish to pursue the PDD idea. A/S Aronson asked delegates to take home for consideration by their governments, suggestions to:

- o Aim for a more formal PDD organizational meeting next February at the Assistant Secretary level. Subject to further consultations, such a meeting might be held in Washington. We would expect that other countries would host future meetings.

- o Name a fairly senior official to coordinate PDD activities and serve as a point of contact with other member governments.

- o Consider whether a regional consultative group (not to replace existing country-specific groups) could play a useful role, bearing in mind that it should not take the place of existing country-specific consultative groups.

- o The structures, mechanisms and bureaucratic aspects of the PDD should be kept to a minimum; but there might be a need for a steering group with Central American, Latin American, Japanese, European, Canadian, and U.S. participation.

-- We propose to follow up on the November 20 meeting in order to develop a consensus on holding a more formal PDD organizational meeting perhaps by next February at the Assistant Secretary level.

-- The U.S. has offered to host this next meeting in Washington; but would anticipate that subsequent meetings be hosted by other countries.

-- Concluding the November 20 meeting, Assistant Secretary stated the PDD could demonstrate that no one is walking away from Central America. The PDD will work to help Central Americans escape a lost decade. It will enable the Central Americans to seek a future with peace, opportunity and dignity.

Central America and Panama: Major Issues for Congress

by Nina Serafino November 16, 1990

SUMMARY

During the past decade, the United States has become deeply involved in the affairs of the countries on the Central American isthmus. In July 1979, the leftist Sandinista National Liberation Front (FSLN) took power in Nicaragua. Attempting to forestall similar revolutions elsewhere in the region, particularly in El Salvador, the United States dramatically increased its activity and presence in Central America. Efforts to reshape political systems, most of which were in the hands of the military, professionalize the local militaries, and stimulate economic growth and development were accompanied by a buildup of the U.S. military presence and massive U.S. aid. Beginning in mid-1987, the United States became involved in supporting a democratic transition in Panama. For policymakers this implied the ouster of Panama's *de facto* military ruler, General Manuel Antonio Noriega. U.S. policymakers were concerned by Noriega's control of the political system and his alleged involvement in drug trafficking, particularly in light of U.S. interests in Panama, especially the Panama Canal.

In 1990, the United States faced several decisions in Central America, most importantly in El Salvador, Panama, and Nicaragua. Concerning El Salvador, debate over the desirability of U.S. aid to the military was reinvigorated in late 1989 when human rights abuse and military conflict escalated sharply toward the year's end, symbolized by the bombing of a union headquarters, by the killing of six prominent Jesuit priests, and by a massive, country-wide offensive by the Salvadoran guerrillas. In Panama, the Dec. 20, 1989, U.S. military action ousting General Noriega raised questions concerning the duration of a U.S. military presence in Panama and the appropriate level and nature of U.S. assistance. The Feb. 25, 1990, victory of the opposition United Nicaraguan Opposition (UNO) coalition in Nicaragua resolved the U.S. dilemma concerning policy toward that country and support of the anti-Sandinista contras, but raised questions concerning the amount and timing of U.S. aid to the new Chamorro government.

During the legislative session, Congress provided significant amounts of assistance for Panama and Nicaragua while it strongly conditioned military assistance to El Salvador. In February 1990, Congress lifted restrictions on aid and trade benefits for Panama and authorized around $51 million in urgent assistance to help support the new government (P.L. 101-243). In May, Congress provided $420 million in ESF assistance for Panama and $300 million in ESF assistance for Nicaragua in FY1990 supplemental appropriations legislation (P.L. 101-302). Toward the end of the legislative session, in FY1991 foreign aid appropriations legislation (P.L. 101-513), Congress strongly conditioned military assistance to El Salvador on the behavior of both the Salvadoran government and the leftist guerrillas of the FMLN.

Congress took into account in 1987 when it halted military aid to the contras (although non-lethal aid continued) and encouraged them to negotiate with the Sandinista government. (These negotiations reached no conclusion.) In the first of the follow-up accords, signed in February 1989, Nicaragua promised to hold fair elections under international observation by Feb. 25, 1990, in exchange for a pledge by the presidents of the other Central American countries to design a plan for demobilizing the contras. This was an important factor in the formulation of the March 1989 bipartisan accord signed by President Bush and leaders of both parties in Congress, which provided continued non-lethal aid to the contras through Feb. 28, 1990, but focused U.S. attention on the Nicaraguan electoral process.

The effects of the most recent accord, signed in December 1989, are as yet uncertain. This provides for further efforts towards demobilization of the contras, and specifically supports Nicaragua's efforts to have all aid to the contras -- a reference to U.S. aid -- channeled through international agencies. The most dramatic points of the December accord concern El Salvador. There, it called for an end to violent activities by the FMLN, a resumption of the dialogue between the government and the FMLN, which had taken place sporadically since 1984, and the demobilization of the FMLN.

Development of the Situation in Panama.

Until Panama's political crisis erupted in mid-1987, Panama had largely faded from the news since the late 1970s when the Panama Canal Treaties were ratified and when Congress passed implementing legislation for the creation of the Panama Canal Commission (PCC), the new U.S. agency responsible for managing the Canal until the year 2000. In the first half of the 1980s, U.S. legislative activity regarding Panama was largely limited to annual authorization and appropriation measures for the PCC. In that period, however, there were significant political developments in Panama that laid the foundation for the political crisis that began in mid-1987.

In 1981, the Panamanian political landscape changed abruptly when General Omar Torrijos, Panama's populist military ruler since 1968, died in a plane crash. Torrijos had already began a process of political liberalization that was to culminate with the direct election of a civilian president in 1984. However, by 1983, Colonel Manuel Noriega, who had long served as Torrijos' intelligence chief, assumed control of the National Guard and engineered the establishment of the Panama Defense Forces, which substantially broadened the powers of Panama's military.

Noriega's behind-the-scenes control of Panama's civilian political system was demonstrated in 1984 when a Noriega-backed presidential candidate, Nicolas Barletta, won elections that were widely perceived to be fraudulent. Barletta himself was forced from office in 1985 because of his call for an investigation into the brutal murder of an opposition leader. During this period it is reported that Noriega aided U.S. efforts to supply the contras in Nicaragua . In June 1986, allegations arose in the press and congressional hearings that Noriega was involved in numerous illegal activities, including drug trafficking, in addition to his manipulation of Panama's political system. Congressional hearings in 1986 also focussed on these allegations. In early 1987, before Panama's political crisis erupted, the U.S. Senate voted to disapprove a presidential certification that Panama was fully cooperating with the United States in anti-drug measures. By June 1987, allegations against Noriega by

a high-ranking Panamanian military official sparked riots and prompted the formation of a broad opposition coalition to challenge Noriega's political control.

Major Issues For Congress

El Salvador

Issue. In 1990, Cogress considered the Administration's FY1991 request for $375.4 million in economic and military aid to assist the Cristiani government in its struggle with the leftist guerrillas of the Farabundo Marti National Liberation Front (FMLN). At issue was whether to approve the Administration's request or to withhold substantial portions of the military aid as pressure on the Salvadoran military to punish members guilty of human rights violations and to encourage a negotiated settlement of the war. The major action by Congress was passage of a foreign aid appropriation bill (H.R. 5114, P.L. 101-513) that limited FY1991 military assistance for El Salvador to $85 million and withheld 50% of the assistance to encourage a negotiated settlement. (See **Legislation** for more detail.)

Background. U.S. support for El Salvador seemed to be producing desired socio-economic reforms and improvements in the human rights situation in the early years following the election of Christian Democrat Jose Napoleon Duarte in 1984. By the end of his term the party was tarnished with an image of corruption and ineffectiveness and lost control of the legislature and the presidency to the rightist Nationalist Republican Alliance (ARENA) party in 1988 and 1989. The June 1, 1989, inauguration of ARENA's Alfredo Cristiani ended nearly a decade of U.S.-supported centrist governments in which the Christian Democratic Party was a key ally. By late 1989, the country seemed to be experiencing increasing polarization and violence -- symbolized particularly by the FMLN guerrilla offensive in November-December 1989 -- and the brutal killing of six Jesuit priests on Nov. 16, 1989, by elements of the Salvadoran military. Although military activity continued in 1990, the level of violence decreased and regular U.N.-mediated peace talks between the government and the guerrillas began in April 1990.

Options. In considering aid to El Salvador, Congress had three basic options. The first option was to continue aid to El Salvador roughly at present levels, and under current conditions. Proponents of this approach argued that any reductions in aid might weaken the democratically elected Cristiani, who is perceived as a moderate struggling with a radical rightist faction for control of his party and trying to control human rights abuse while fighting an externally aided, communist-led insurgency. They argued that significant cuts in U.S. aid might lead to a guerrilla victory that would have disastrous consequences for the United States. The second option was to withhold a portion of the aid and to condition the aid on prosecution of those responsible for the killing of the six Jesuit priests and on good faith efforts to achieve a negotiated settlement. Proponents of this approach argued that leverage had to be exerted to insure improvement in human rights and to encourage a realistic political settlement of a conflict that could not be won militarily. The third option was to terminate aid to El Salvador on grounds that government involvement with human rights abuse and repression was so great that the United States should withdraw and not be associated with the regime.

Panama

Issues. In 1990, in light of the U.S. military intervention and the establishment of a new Panamanian government in December 1989, Congress faced such issues as economic support for the new government, and the adequacy of measures taken by the new government to prevent money laundering. An additional issue is the role of the U.S. military in Panama.

Background. The U.S. military intervention in Panama culminated almost two years of strong U.S. pressure against the *de facto* political rule of General Noriega. Since June 1987, when Noriega's rule was challenged by a broad opposition coalition, the objective of U.S. policy toward Panama was support for civilian democratic rule. For policymakers, this meant the ouster of Noriega from power. His rule was considered problematic because of his manipulation of the political system, and his alleged involvement in drug-trafficking (he was indicted on drug-related charges in February 1988 by two U.S. Federal courts). For U.S. policymakers, these problems loomed even larger when considering U.S. interests in Panama, including the Panama Canal and the safety of U.S. citizens in Panama.

Noriega demonstrated his control over Panama when he ousted Panama's civilian president in 1988, and overtly stole Panama's national elections in May 1989. The regime nullified those elections when it became evident that the opposition had won, reportedly by a 3-1 margin. Up until that time, U.S. policy largely consisted of the nonrecognition of the regime, and a range of severe economic sanctions. After the election nullification, President Bush announced a policy emphasizing continued support for regional diplomacy through the Organization of American States (OAS). Despite three months of efforts, the OAS was unable to bring about a peaceful transfer of power in Panama. Instead the regime appointed a new provisional government made up of Noriega's associates.

The situation deteriorated beginning in early October 1989 when a coup attempt by PDF rebels was crushed by troops loyal to Noriega. Following the coup attempt, the regime enacted a series of repressive emergency laws designed to crack down on any opposition. In mid-December 1989, a new Noriega-controlled legislative body designated Noriega as head of government and declared Panama to be in a state of war with the United States. Soon after, the regime's intensified harassment against U.S. soldiers led to the killing of a U.S. Marine on Dec. 16, 1989.

In response to these events, on Dec. 20, 1989, President Bush ordered U.S. forces into combat in Panama with four objectives: to safeguard the lives of some 35,000 Americans; to defend democracy; to apprehend Noriega and bring him to trial in the United States; and to protect the integrity of the Panama Canal Treaties. According to President Bush, all four objectives had been achieved by Jan. 3, 1990, the last being Noriega's arrest and arrival in the United States. News reports indicated that the Panamanian people welcomed the U.S intervention, even though it was condemned in resolutions passed by the United Nations and the Organization of American States. Most Members of Congress responded favorably to the action, although some opposed it.

Regarding U.S assistance to the new government, on Jan. 25, 1990, President Bush announced an economic recovery program for Panama worth up to $1 billion In the immediate future, AID would provide $42 million in assistance for housing, public works, small business rehabilitation, and technical assistance. In addition, the economic recovery program would include a package worth up to $500 million in loans, guarantees, and programs to stimulate market access and private investment. In February 1990, Congress approved legislation (P.L. 101-243) for the $42 million and lifted legislative restrictions, thereby restoring Panama's eligibility for the U.S. aid and trade benefits. In May, Congress appropriated an additional $420 million in economic assistance for Panama (P.L. 101-302). (See **Legislation**.)

Regarding the issue of money laundering, some Members of Congress warned that future aid to Panama could be jeopardized if the new government does not move quickly enough to either enforce existing laws or make changes to Panama's banking system to prevent laundering. On Feb. 7, 1990, in passing urgent assistance legislation (P.L. 101-243), Congress required a Presidential report by Apr. 15, 1990, on specific actions taken by the Endara government to halt money laundering. In appropriating $420 million in economic assistance (P.L. 101-302), Congress did not condition the assistance, but in a conference report strongly urged that no more than 80% of the aid be provided unless Panama undertook certain anti-money laundering efforts.

Regarding the U.S. military in Panama, an important issue is its role in assisting the new Panamanian Public Force, created to replace the old PDF. Although all U.S forces sent for the intervention have returned to the United States, an estimated 10,000 troops are still stationed in Panama to fulfill the U.S. responsibility of defending the Canal. In addition, since the military intervention, U.S. military police have participated in joint patrols with the Panamanians to assist them in carrying out their police duties. U.S. officials indicated that the troops would continue patrolling and would only return to their bases once the new Public Force was fully operational. Because of the substantial progress of the Public Force, U.S. officials announced in late October 1990 that all U.S. troops will have returned to their bases by Nov 28, 1990.

Nicaragua

Issue. On Apr. 25, 1990, Nicaragua's new president, Violeta Barrios de Chamorro, was inaugurated. This event heralded the start of a new era of U.S.-Nicaraguan relations, as it removed the Sandinista government with which the United States has had hostile relations and brought to power a coalition that the United States supports. Nevertheless, U.S. policymakers differed on the timing of proposed assistance to the new government, and the appropriate U.S. role in the demobilization of the "contras," the anti-Sandinista rebels who have received $322 million in direct U.S. aid since 1981. These issues were largely resolved with the passage of the Dire Emergency Supplemental Appropriations Act for FY1990 (H.R. 4404, P.L. 101-302), and the completion of contra demobilization in June 1990.

Background. On Feb. 25, 1990, Nicaragua's voters turned out of office the Sandinista government, which has ruled the country for 10 years, choosing instead the newly formed United Nicaraguan Opposition (UNO) coalition. A coalition of 14 parties, spanning the political spectrum from conservative to communist, the UNO

won the presidential race by a 14-point majority, 55% to 41%. By a similar nation-wide margin, the UNO also gained a majority of representatives to the legislative National Assembly, and won the municipal elections in most of the country's major cities, including the capital.

Soon after the elections, the UNO began separate negotiations with the contras and with the Sandinista National Liberation Front (FSLN) to resolve conflictive issues, particularly contra demobilization and the Sandinista presence in military and police forces. On Mar. 23, 1990, the UNO signed the "Toncontin" agreement with the contras. This provided that the contras would move into enclaves in Nicaragua supervised by international agencies established under the Central American peace process, with those remaining in Honduras to be disarmed by April 20. On March 27, the UNO signed an agreement with the FSLN on several issues. Most importantly, the pact represented a pledge by the military to obey civilian control and a pledge by the UNO to respect the military's hierarchy, command structure, and promotion list. Although these two accords set common goals, as political compromises they are in some respects vague and subject to interpretation and do not necessarily satisfy all relevant parties. Thus, the government faced difficulties with both the FSLN and the contras when she was inaugurated on April 25.

The Bush Administration has taken a number of steps to assist the future UNO government. On March 13, President Bush lifted the trade embargo against Nicaragua, and said he would send Nicaragua $21 million in food and humanitarian aid. He also sought by April 6 congressional approval for $300 million in emergency FY1990 supplemental appropriations for Nicaragua. This sum included $128 million to meet immediate economic needs; $75 million for other economic, social, and political programs; $50 million to help clear Nicaragua's $234 million arrearages with international financial institutions (IFIs); and $15 million for the repatriation of Nicaraguan refugees. The President also requested congressional approval of $32 million for demobilization and resettlement of contras and their families. Administration officials stated that the money would assist contras' return to civilian lives after they have disarmed. The funds were approved with the passage of H.R. 4404; which was signed into law May 25, 1990 (P.L. 101-302). In addition, the Administration requested $200 million in ESF assistance for FY1991. Although Congress did not specifically earmark the $200 million for Nicaragua in action on the foreign aid bill (H.R. 5114, P.L. 101-513), it did note in a conference report (H.Rept. 101-968) that it expects the Administration to provide as close as possible to its assistance request.

LEGISLATION

P.L. 101-243, H.R. 3952

PANAMA: To authorize certain assistance and trade benefits. Authorizes $42 million in economic assistance ($10 million in housing guarantees and $32 million in economic assistance, with up to $1.2 million for judicial and police training under the Administration of Justice Program). Allows the use of previously obligated military assistance funds for Panama (estimated at $9.3 million) to be used for the procurement of law enforcement equipment with not more than $500,000 for lethal equipment. Restores Panama's eligibility for aid and trade benefits by waiving the

Brooke-Alexander amendment, which bars aid to governments that are in arrears on payments on U.S. government debts, and by waiving application of the drug sanctions in the Foreign Assistance Act and the Narcotics Control Act. Introduced Feb. 6, 1990; ordered reported the same day by Committee on Foreign Affairs. Passed House (voice vote) and Senate (voice vote) Feb. 7; signed into law Feb. 14, 1990.

P.L. 101-302, H.R. 4404

Dire Emergency Supplemental Appropriations for FY1990. PANAMA: Chapter III provides $420 million in Economic Support Funds (ESF) until Sept. 30, 1991, for assistance to Panama, of which $15 million can be used for debt-for-nature swaps. Allows for training and assistance to help create a professional civilian police force with not more than $5 million for the procurement of non-lethal law enforcement equipment. NICARAGUA: Provides $300 million in ESF until the same date, of which $30 million is to support the voluntary demobilization, repatriation, and resettlement of members of the Nicaraguan resistance ("contras") and their families. States that contra aid is to be channeled through the International Commission of Support and Verification (CIAV) except under certain conditions. Up to $10 million of the Nicaragua and Panama funding may pay for administrative expenses of the Agency for International Development (AID). Reported to House by Committee on Appropriations Mar. 27, 1990. Passed House (amended) 362-59, Apr. 5, 1990. Received in Senate Apr. 5, 1990, and referred to Committee on Appropriations. Reported by Senate Appropriations Committee. Conference report included new monitoring provisions calling for periodic reports from the Agency for International Development and the General Accounting Office on funds for Panama and Nicaragua. Passed Senate (amended) by voice vote May 1. Both chambers approved the conference report May 24. Signed into law May 25, 1990.

P.L. 101-513, H.R. 5114

Foreign Operations, Export Financing and Related Programs Appropriations Act, FY1991. EL SALVADOR: Limits FY1991 military assistance to $85 million, withholds 50% of the assistance to create incentives for both parties to achieve a negotiated settlement, and withholds $5 million of the military aid until the Salvadoran government prosecutes and obtain verdicts for four separate human rights cases involving 31 killings. The withheld aid is be restored if the President determines that the FMLN has failed to negotiate in good faith or has rejected an active role in the negotiations for the U.N. Secretary General; has rejected a plan for the settlement of the conflict; is receiving significant shipments of lethal arms from abroad; is carrying out sustained military activities that jeopardize the government; or is engaging in violence against civilian targets. All assistance is to be terminated, however, if the government has failed to negotiate in good faith or has rejected an active role for the U.S Secretary General; has rejected a plan for the settlement of the conflict; has failed to prosecute those responsible for killing the Jesuit priests; has failed to control acts of violence against civilians by military or security forces; or has failed to actively seek and encourage a law enforcement service from outside El Salvador to accompany and monitor investigators of the Jesuit murders. In addition, all military assistance is to be terminated if the elected government has been overthrown by military coup or decree. NICARAGUA: Specifies that no aid is to be provided to any member of the Nicaraguan Resistance who has not disarmed and is not abiding by the terms of the various cease-fire and disarmament agreements. Although the legislation does not specifically earmark $200 million in

ESF assistance requested by the Administration, in a conference report Congress noted that it expects the Administration to provide as close as possible to the $200 million. Reported to House by Committee on Appropriations (H.Rept. 101-533). Passed House (308-117) June 27, 1990; received in the Senate July 10. Reported to Senate by Committee on Appropriations Oct. 10, 1990 (S.Rept. 101-519). Passed Senate, amended, (76-23) Oct. 24, 1990. Conference report (H.Rept 101-968) filed in House Oct. 27, 1990. House Agreed (188-162) to conference report Oct. 27, 1990. Senate agreed to conference report by unanimous consent Oct. 27, 1990. Signed into law Nov. 5, 1990.

H.R. 4636 (Fascell)

Supplemental Assistance for Emerging Democracies Act of 1990. PANAMA: Authorizes $470 million in supplemental FY1990 aid for Panama. NICARAGUA: Authorizes $340 million in supplemental FY1990 aid. EL SALVADOR: As reported by Committee, limits FY1991 military aid up to $85 million, and would withhold half of unexpended FY1990 military assistance and half of FY1991 military aid to promote a negotiated settlement. Reported to House by Committee on Foreign Affairs (H.Rept. 101-470) May 1, 1990. Amendments adopted May 22, of which three specifically applied to Central America, including the Moakley-Murtha amendment, approved 250-163, to clarify and strengthen the bill's conditions on withholding aid for El Salvador. The same day, the House disapproved the bill, 171-244.

S. 2364 (Pell)

Emergency Supplemental Assistance for Panama, Nicaragua, and Sub-Saharan Africa Act of FY1990. PANAMA: Authorizes $470 million for supplemental appropriations for FY1990. Provides $170 million for the private sector; $125 million for public investment; $130 million to pay arrearages to IFIs; and $45 million to strengthen public administration, including civilian law enforcement programs. Has provisions on Panamanian cooperation on U.S. narcotics policy. NICARAGUA: Provides $300 million for FY1990: $128 million for immediate economic assistance to the government and private sector; $50 million to assist Nicaragua pay its arrearages to IFIs; and $75 million to assist its long-term economic growth and development needs. Also provides $30 million for the voluntary demobilization, repatriation, and resettlement of disarmed contras and their families, to be channeled through the CIAV in coordination with the Nicaraguan government except under certain conditions; $2 million for the ONUCA's expenses, and $15 million for the repatriation and resettlement in Nicaragua of Nicaraguan refugees and other displaced Nicaraguans. Contains provisions on trade with Nicaragua. BOTH: Provides $10 million of the funds can be used for AID administrative expenses; and contains certain environmental restrictions. Reported to Senate by Committee on Foreign Relations Mar. 29, 1990. Passed Senate (amended) by voice vote Apr. 5, 1990. On May 24, the House adopted a Fascell amendment substituting the text of H.R. 4636 as amended by the House on May 22, excluding an amendment on Panama and all language on El Salvador. On the same day, the House passed the bill as amended and the Speaker appointed conferees. On June 5, the Senate received a message on House action; House requested a conference.

One Year Later: Update on Andean Drug Strategy

Melvyn Levitsky, Assistant Secretary for International Narcotics Matters (INM)

Address before the Task Force on International Narcotics Control, House Foreign Affairs Committee, Washington, DC, October 10, 1990

On behalf of my colleagues who have joined me today, let me express our appreciation for the opportunity to appear before the House task force to review with you the status of the Andean strategy, the Cartagena summit, and compliance on various legal requirements. We believe that congressional understanding and support for the counter-narcotics effort is essential to the effort and a component in its success.

Let me start by reviewing where we stand in implementing the Andean strategy in Colombia, Bolivia, and Peru. Following a general summary, I would like to review highlights of country programs, bring you up to date on developments since the Cartagena summit, and conclude with brief remarks on certain compliance issues.

The administration announced the Andean initiative a year ago. There has been progress in some areas and less in others, but we are convinced that we have the right approach. We have developed an integrated program that combines economic assistance and military and law enforcement efforts in a phased plan that takes into consideration the range of complexities inherent in dealing with the drug issue. We are moving ahead, but we still have a long way to go.

As we begin the second fiscal year of this effort, we need to look at where we have come from and where we are going. As called for in the President's strategy, decisions on resources for FY [fiscal year] 1991 will be based upon the results of such a review. This evaluation is still underway, but we are happy to share with the Congress our preliminary views.

We have come a long way in the past year. We have taken the idea of an integrated counter-narcotics strategy and brought together all of the involved executive branch agencies to develop plans with the three Andean governments aimed at implementing efforts to dismantle the drug trafficking organizations.

Assistant Secretary Melvyn Levitsky

There have been notable achievements in many areas. New, democratically elected governments in each of the three Andean nations have repeatedly voiced their commitments to the counter-narcotics struggle, and they have each taken steps, in cooperation with the United States, to meet the challenge. Together, we have worked to use intelligence better to focus our efforts on higher-level targets, moving away from a primary focus on eradication programs and low-level interdiction efforts. We have supported the internal programs of the three states to improve the operational capabilities of their law enforcement and military forces engaged in the drug war. These programs have resulted in increased seizures and pressure on the trafficking organizations. We have involved our own military to enhance detection and monitoring in the approaches to the United States, forcing the traffickers to disperse their activities. We have seen increased seizures, arrests, confiscation of assets, and signs of disarray within the trafficking organizations.

We have helped to improve counter-narcotics cooperation with the police in all three countries. We have assisted the armed forces in Colombia to assume a more vigorous role, as have elements in the Bolivian air force and navy, which have produced some of the most dramatic seizures in recent years. There are encouraging signs that our air interdiction efforts have hampered the easy movement of drugs by air directly to the United States. We have not, however, limited our efforts to interdiction.

We also have looked to economic assistance programs. Scheduled to begin this year, they are designed to provide a mix of activities to assist the Andean governments and people. These include macroeconomic efforts and more focused efforts to give those people involved in coca production a viable economic alternative. Of course, the question remains as to whether and how the Congress will authorize and appropriate narcotics-related economics assistance and whether overall economic assistance funds will be earmarked in such a way as to reduce the amount available to our counter-narcotics programs.

Several areas, however, pose problems in implementing an effective narcotics control program in the Andean region. We are continuing our efforts to have a positive influence in these areas, keeping in mind that we are working on an issue that ultimately affects fragile social, economic and political institutions of sovereign countries.

- We are working with law enforcement agencies to increase substantially the pace of laboratory destruction and cocaine seizures. Our goal in this area is to improve performance of host country interdiction operations to a point that eliminates cocaine traffic destined for the US and European markets.

• We are developing new international mechanisms to address money laundering and the flow of precursor and essential chemicals.

• We are seeking better programs to use seized assets for counter-narcotics purposes. We are establishing projects to overcome institutional weaknesses in the legal and judicial systems that enable traffickers to regain these assets.

• We are striving to develop cooperative programs to deal with allegations of violations of human rights and corruption. Our counter-narcotics projects include provisions for end use monitoring of equipment.

We knew at the outset, however, that our effort to address these problems in all their complexity was not going to be easy or over quickly. We knew it was going to require a multi-year effort and sustained cooperation between all elements of the US government.

As we move into the second year of the Andean implementation plan, we are building on the FY 1990 plan, which involved strengthening of political will, military and law enforcement effectiveness, and the targeting of trafficking organizations. Working in close coordination with our missions in Colombia, Bolivia, and Peru, we are developing sub-plans to address specific problem areas such as judicial reform, public diplomacy, air strategy, ground strategy, riverine strategy, coca containment, control of precursor and essential chemicals, the targeting of drug kingpins, money laundering, and economic support.

The intent of this effort, based on a continuing assessment of the performance of the Andean states, is to carry forward the progress we have made and address the shortcomings we have noted. Knowing that we must sustain a vigorous program, we are determined to pursue those efforts that have produced results, reassess those that have not, and seek new approaches that will enhance our chances of success.

I would like to turn now to a review of some of the specifics of our efforts in each of the Andean states, noting progress and difficulties.

The major successes of the President's Andean strategy to date can be credited to the heroic efforts of Colombia, which deserves the lion's share of the credit. At the same time, the Bolivian government has collaborated in bilateral and multilateral efforts to combat cocaine trafficking and has pursued economic policies to put the country back on a sound footing. The newly inaugurated Fujimori administration in Peru is working to overcome the disruptive policies and practices of the past administration, seeking to lay important groundwork for a comprehensive economic and political strategy to address not only the narcotics problem but the whole range of social and political difficulties that plague Peru.

Colombia

We estimate that Colombian trafficking organizations control some 80% of the cocaine processing industry in the Andes.

Colombia's progress in attacking these organizations exceeds what we anticipated a year ago despite unrelenting pressure from drug traffickers and insurgent groups. The government of Colombia has acted forcefully to protect itself and preserve its democratic institutions. US assistance has helped to sustain Colombia's operational efforts and to focus them on key targets.

Colombian determination to target the leadership of the drug cartels and their infrastructure, particularly cocaine processing labs and air transportation nodes, has resulted in serious disruption of the operations of the drug trafficking organizations. Both the police and the military played active roles in counter-narcotics activities in 1990, including one combined army and air force operation against a distribution center called La Petrolera, which seized 19 tons of cocaine. Extraditions to the United States continued, reaching 22 people for the period of August 1989 to August 1990. Disrupting these trafficker operations has a "trickle down" effect of lowered demand for coca base and coca paste, thereby influencing coca leaf prices in Peru and Bolivia.

While Colombian forces have inflicted significant damage on the Medellin cartel, the Cali cartel as well as emerging new cartels have not yet been targeted as aggressively. In addition, the widespread violence continues in Medellin, and the environment of threat and intimidation aimed at civilian leaders, judges, and the law enforcement establishment continues to make life dangerous for all citizens.

We are seeking to address this problem through the programs outlined in our FY 1990 and FY 1991 submissions. Our FY 1990 counter-narcotic assistance to Colombia included the following:

• $20 million in INM-funded programs to support the Colombian National Police as the lead anti-narcotic force, especially to sustain its field presence and air operations;

• $71 million in FMF [foreign military financing] programs to provide equipment, services and training for the Colombian armed forces counter-narcotics efforts (and $500,000 in IMET [international military and educational training]);

• $1 million in FMF earmarked funds for weapons and ammunition for the Colombian National Police;

• $995,700 in FMF earmarked funds for the defensive arming of aircraft already in the inventory of the Colombian government;

• Currently estimated $3.7 million of economic assistance, which includes ESF [economic support fund] and development assistance.

A drawdown of $65 million worth of military equipment, services, and training delivered last fall provided vital resources which have enabled the Colombian government to move aggressively against drug traffickers and their assets. In addition, a drawdown of $20 million worth of military equipment, services and training being delivered this fall for counter-narcotics purposes provides Colombia with resources to sustain momentum against trafficker organizations.

Bolivia

We believe that the Bolivians have felt constrained by a perceived dependence on the "coca economy" and have been careful to avoid measures that might provoke civil violence or destabilize fragile democratic institutions.

In the first half of 1990, there was an increasing convergence between the counter-narcotics policy approaches of the Paz Zamora government and those of the United States. The Bolivian congress ratified the 1988 United Nations

Convention Against Illicit Trafficking in Narcotics Drugs and Psychotropic Substances. The Bolivians also have signed Cartagena side agreements with the United States on essential chemicals, public awareness and control of weapons.

Helped by low coca leaf prices, the coca eradication program attained record rates, although prices began edging higher during the middle of the year. By July 1990, the voluntary coca eradication program surpassed the annual target of 5,000 hectares specified in the Bolivian coca control law of 1988. Bolivia is pursuing a goal of eradicating 7,500 hectares by the end of 1990 to make up for a shortfall in the 1989 eradication program. The current 1990 pace of seizures of cocaine products and arrests in Bolivia should exceed the statistics for 1988 and 1989.

The Bolivian air force counter-narcotics task force operated 12 US government-owned helicopters for more than 10,000 hours without accidents. The navy counter-narcotics Riverine Task Force improved its performance dramatically, spending the majority of its time in the first half of 1990 on operations away from its base. Among its significant successes was the recent destruction of the largest cocaine HCL production laboratory found in Bolivia. Virtually all officers and more than 60% of the patrolmen assigned to the National Police Rural Mobile Patrol Force (UMOPAR) are now graduates of the US government-supported Chimore training center, which also provided paramilitary rural counter-narcotics training for personnel from several other Latin American countries. These successes, however, have not been unmitigated.

While it is our intention to work with the Bolivians to engage the full range of their capabilities in the drug war, Bolivian army involvement has not been clearly delineated. We now have assurances from the highest levels of the Bolivian government that the army will participate in the expanded Bolivian armed forces counter-narcotics program as cited in Annex III of the bilateral agreement on cooperation against narcotics trafficking, but the exact degree and nature of that cooperation remains unclear. It is important to note, however, that we are not forcing a military option on the Bolivians. Their air force and navy already cooperate, and the degree of military support to the overall effort is a Bolivian decision. We have made clear, though, and the Bolivians have accepted, the notion of performance-based programs.

Our FY 1990 counter-narcotics assistance program to Bolivia included the following elements:

- $15.7 million of INM-funded programs designed to strengthen law enforcement and interdiction capabilities and disrupt trafficking infrastructure;
- $39.1 million in FMF funds to support the role of the armed forces in the war against drugs (and $500,000 in IMET);
- $1 million in earmarked FMF funds for weapons and ammunition for UMOPAR;
- A drawdown of $7.8 million worth of Department of Defense equipment, services, and related training;
- $40.5 million currently estimated in economic assistance.

Peru

Peru presents the most difficult situation because of the complexity of its problems and the newness of the Fujimori administration. Counter-narcotics performance was limited during the final months of the Garcia administration. The Fujimori administration has publicly committed itself to fight narcotics traffickers and insurgents, and to adhere to international human rights standards. But as a new government with a wide range of serious internal problems, it has moved slowly and sometimes uncertainly towards developing a comprehensive strategy. There is, however, significant support within the government and in the public to develop a workable counter-narcotics program in cooperation with the United States. We are continuing negotiations with the new government on integrated counter-narcotics programs.

Santa Lucia, the base of interdiction operations in the Upper Huallaga Valley, is near completion. Security and logistical arrangements are in place. The airstrip is long enough to land a C-130 transport aircraft, providing an air bridge between Santa Lucia and Lima. Hangar and maintenance facilities are also near completion.

Police cooperation at Santa Lucia has continued to be strong in the first weeks of the Fujimori administration. In August, the national police at Santa Lucia destroyed 14 cocaine-base labs, one stash house, and four chemical storage sites, and arrested 74 people. A record number of square meters of seed beds were eradicated in August, bringing the total since the program began to an equivalent of 7,365 hectares in potential mature coca plants.

Despite additional airlift, new tactics, and improved intelligence, police interdiction results have only been moderately successful. The lack of military support and cooperation for counter-narcotics operations in the Upper Huallaga Valley continues to be a serious drawback to law enforcement operations.

The first phase of aerial herbicide testing is complete, and all scientific tests on the treated soil and water indicate that "Spike" is a safe and effective coca herbicide.

Peru has signed several side agreements as part of its Cartagena summit commitments, including agreements regarding essential chemicals, public awareness, and tax information exchanges. Peru also has exchanged diplomatic notes with the United States on the current bilateral extradition treaty, which remains in force. But problems remain.

The Fujimori administration, still working to define its overall priorities and the essential elements of its programs, declined to participate in the FY 1990 FMF program to provide $35.9 million in military assistance for counter-narcotics programs. President Fujimori has said that he wants to pursue a more comprehensive approach integrating his economic concerns, rather than focus in this first agreement solely on military cooperation.

The Fujimori administration, though committed to improving Peru's performance, has not yet taken action to establish firm human rights monitoring and corruption controls.

Our FY 1990 counter-narcotics program included the following:

- $19 million in INM-funded programs to support law enforcement projects;
- $1 million in FMF earmarked funds for weapons and ammunition for the Peruvian National Police;

• $4.3 million currently estimated in economic support.

Cartagena Update

In summary, we should review the past year in light of the Cartagena summit and the commitments made there by the four countries.

The Declaration of Cartagena, signed on February 15, 1990, commits the governments of Colombia, Bolivia, Peru, and the United States to a comprehensive multilateral effort to fight drug trafficking. At Cartagena, the United States and the Andean countries reaffirmed their will to attack all facets of the illegal drug trade: production, transportation, and consumption. The role of the United States is to limit domestic demand for drugs and assist other countries to reduce the supply of illegal drugs, develop alternative sources of income for coca growers, and enhance interdiction capabilities. The role of the Andean governments is to disrupt trafficking of illegal drug products, prevent the diversion of essential chemicals, and discourage illicit coca cultivation.

To assist the Andean countries in working toward this common goal, the United States agreed to cooperate on economic, military, law enforcement, diplomatic and public awareness initiatives.

To assist the United States, the Andean countries agreed to adopt sound economic and investment policies, as well as pursue legislation and regulations to foster private investment.

In addition to the agreements previously mentioned, several bilateral side agreements have been concluded:

• Colombia has signed a bilateral agreement on asset sharing.

• Bolivia has signed bilateral agreements on tax information exchange, essential chemicals, public awareness, and weapons control.

• Peru has signed bilateral agreements on tax information exchange, essential chemicals, and public awareness and has exchanged notes on extradition.

To follow up on the progress of these agreements, the parties agreed at the summit to hold a high-level follow-up meeting within a timely period after the Cartagena meeting. We fully expect a follow-on meeting will reflect the overall progress in implementing this important strategy to eliminate the threat of drugs facing us all.

The record of Cartagena, however, is mixed. Our major area of progress has been in Colombia, where the government has not only been vigorous in its efforts but reasonably successful. But the cartels in Colombia represent more centralized targets and by declaring open warfare on the country they made a counterattack possible practically and politically. Colombia, too, is stronger economically and has a better grip on democratic processes. The leadership in Colombia is more confident of its institutional base and is therefore in a better position to respond. The situations in Bolivia and Peru are more problematic.

The economic and political environment in both Bolivia and Peru is not as strong as in Colombia. Years of mismanagement and civil upheaval in Peru, the collapse of significant international markets for Bolivia's major exports plus hyperinflation, and a history of fragile democracy in both countries mean that they have less flexibility to respond to the range of challenges presented by drug trafficking. This range of problems is one reason why the President's strategy focuses on broader political, economic, and law enforcement programs rather than on the narrower problem of drug eradication or interdiction.

No one is deceived, however, that success in such an undertaking will be easy or straightforward. Nor should anyone believe that we can establish arbitrary, obligatory standards that pay no heed to the realities of dealing in the international environment or the domestic politics of this or other countries. Cartagena is not a report card that establishes immutable pass-fail demands.

More than anything else, Cartagena represents a statement of intent, a hope for the cooperation that is essential if we are to succeed in what must be a joint undertaking; but it will be nothing but words on paper if we are unwilling collectively to live up to its promise. The President's strategy, which formed the basis of our request to Congress, represents a serious effort by the United States to live up to its obligations. ■

UN Security Council Resolution on Israel

Resolution 673 (October 24, 1990)

The Security Council,

Reaffirming the obligations of Member States under the United Nations Charter,

Reaffirming also its resolution 672 (1990),

Having been briefed by the Secretary-General on 19 October 1990,

Expressing alarm at the rejection of Security Council resolution 672 (1990) by the Israeli Government, and its refusal to accept the mission of the Secretary-General,

Taking into consideration the statement of the Secretary-General relative to the purpose of the mission he is sending to the region and conveyed to the Council by the President on 12 October 1990,

Gravely concerned at the continued deterioration of the situation in the occupied territories,

1. *Deplores* the refusal of the Israeli Government to receive the mission of the Secretary-General to the region;

2. *Urges* the Israeli Government to reconsider its decision and insists that it comply fully with resolution 672 (1990) and to permit the mission of the Secretary-General to proceed in keeping with its purpose;

3. *Requests* the Secretary-General to submit to the Council the report requested in resolution 672 (1990);

4. *Affirms* its determination to give full and expeditious consideration to the report.

VOTE: Unanimous (15-0). ■

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HEMISFILE

Perspectives on Political and Economic Trends in the Americas

Volume I Number 6 November 1990

Gearing up for an oil change

By Edward L. Morse

The oil producing countries of Latin America appear to be on the verge of revolutionary change.

Not only is the doubling of oil prices since Iraq's Aug. 2 invasion of Kuwait a precursor of what is almost inevitably going to take place later on in the 1990s, the price hike also comes at a time when structural changes have begun to erode the resource nationalism that has long-dominated the Latin American approach to oil.

Today over 50 percent of the world's oil is produced by countries that do not permit foreign companies to play any role whatsoever in their sectors. We are now, however, witnessing a major (please turn to page 2)

DAVID DIAZ

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(continued from page one) reversal of the resource nationalism that has characterized the past 20 years. To a large degree this stems from major changes in the Soviet Union. But Venezuela is also in the vanguard of this movement. Its impacts elsewhere in the hemisphere are bound to be enormous.

Venezuela's Petróleos de Venezuela (PdV) is now the fourth-largest oil company in the world, behind Saudi Arabia's state-owned Aramco, Royal Dutch Shell, and Exxon. Mexico's Pemex ranks 12th and Brazil's Petrobras 25th. In the 1980s PdV took the lead, along with Kuwait's KPC and Saudi Aramco, in integrating itself downstream by forming joint ventures in refining and marketing in Europe and the United States. Last year it ranked sixth in the world among companies in terms of overall refining capacity and frequently had to buy oil in the market to serve its international refining needs.

As a major oil entity, PdV and its subsidiary companies can hold their own in terms of technology and human resources with any company in the world. But the company lacks the capital required to expand its production capacity and to undertake the full program of capital investment it seeks in refining and petrochemicals. As a result, it is already taking steps to open up its domestic oil sector to foreign investments again. Legal changes that look sure to be enacted soon will make it feasible for foreign oil firms to come back to Venezuela — a political sea-change made possible only by the change in psychological and political attitudes engendered by the international strength of PdV.

In Mexico, too, the government is indicating that foreign companies may have a role to play. In its case, the move is being propelled by severe capital shortages, rising domestic consumption, and the prospects of declining domestic oil production. Already Mexico's 1.3 million barrel a day export surplus is likely to dwindle to 500,000 b/d by 1995. The only way to reverse this is by harnessing foreign capital and technology. A recent study indicates domestic drilling costs in the country are five-times those in the United States. As a result, Pemex has announced it will likely be signing service contracts with foreign drilling companies in the near future.

Mexico is still far from reversing its well-entrenched resource nationalism. But it is moving in that direction. Rumors are that a $1.5 billion US loan could provide a wedge for the re-entry of US firms, which would be paid on a royalty type of arrangement for their services. And it is only a short step from "pure service" to "risk service" contracts — the cover by which Ecuador and other Latin American countries permit equity type of investments in the oil sector.

To be sure, a high price environment and a reversal of resource nationalism do not exactly work hand in hand. And in some countries any move away from resource nationalism is hard to imagine. But with a reopening of the Soviet Union, of Iran, Iraq, Algeria, and perhaps even Kuwait and Saudi Arabia to foreign upstream investments, competition for capital will push Latin America in the same direction. And it's no secret that the oil establishments in both Mexico and Venezuela want to be on the same bandwagon. Indeed, in many ways Caracas is leading the way. The same pressures exist throughout the region.

Whatever the short-term consequences of the current crisis, one thing is certain: some day it will come to an end. And once oil from Iraq and Iran — some 5 million to 5.5 million barrels a day — again begins to reach the market, oil prices will tumble. That's because high prices today are slowing down demand and overall global economic growth and because some of those countries that have boosted output will be reluctant to lose their recently acquired market shares.

Given the overall lack of investment in new oil production facilities worldwide, however, and the growth in demand (which ha been increasing about 1 million barrels a day a year ir the last half-decade), an eventual supply crunch is likely to follow. The upshot is bound to be high prices later on in the 1990s. And the effec of this future rise in prices, like the current one, will vary dramatically from country to country. (please turn to page 12

Latin American oil flow

Exporters

Country	Net exports (barrels per day)	Estimated incremental annual income per $1/bbl increase in oil prices ($ millions per year)	Estimated incremental 4Q 1990 income ($ millions)
Colombia	330,000	66	330
Ecuador	200,000	73	365
Mexico	1,300,00	474	2,370
Trinidad & Tobago	180,000	36	180
Venezuela	2,180,000	766	3,830

Importers

Country	Net imports (barrels per day)	Estimated incremental cost per $1/bbl increase in prices ($ millions per year)	Estimated incremental 4Q 1990 costs ($ millions)
Brazil	510,000	186.2	931.0
Costa Rica	20,000	7.3	36.5
El Salvador	15,000	5.5	27.5
Guatemala	20,000	7.3	36.5
Honduras	16,000	5.8	29.0
Nicaragua	14,000	5.1	25.5
Panama	21,000	7.7	38.5

Source OLADE

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(continued from page 3) The 26 Caribbean and Latin American member-nations of OLADE — the Latin American Energy Organization — play a significant but uneven role in the international petroleum industry. Combined they contain about 11.5 percent of the world's 1 trillion plus barrels of oil reserves, they produce about 10.6 percent (6.6 million barrels a day) of total output. With combined consumption of 5 million barrels a day, the region is a net exporter.

Five countries had combined exports of 3.5 million barrels a day last year — Colombia, Ecuador, Mexico, Trinidad and Tobago, and Venezuela. Two of those, Ecuador and Venezuela, are members of the Organization of Petroleum Exporting Countries. Since the crisis began, Mexico has raised production and exports by about 135,000 b/d and Venezuela has put in place a program to boost volume another 500,000 b/d by the end of the year. About half of the region's 1.2 million barrels a day of oil imports go to Brazil. The economies of the Central American isthmus are also highly dependent on outside supplies, while most of the remaining countries are self-sufficient and therefore largely sheltered from global oil shocks.

For the region's five exporters, the increase in the average price of oil has been an unexpected, if short-term boom. If current prices are to be sustained, the resulting income gain for the five exporters for the last quarter of 1990 will be more than $7 billion divided as follows: Colombia, $330 million; Ecuador, $365 million; Mexico, $2.37 billion; Trinidad and Tobago, $180 million; and Venezuela, $3.83 billion.

For the oil importers, mainly Brazil and the countries of Central America and the Caribbean, the surprising price rise is a short-term economic jolt. Brazil was particularly hard-hit, with nearly all of its 510,000 barrels a day of average imports coming from the Middle East, 40 percent from Iraq and Kuwait.

Brasilia's problems were double barrelled — coping with the price escalation and replacing lost supplies. Assuming that average oil prices are $20 a barrel higher in the fourth quarter than in the second, Brazil's import bill will increase by close to $1 billion for the period Oct. 1 to Dec. 31. On the supply side, the country was benefitting from its efforts — begun before Aug. 2 —to have Iran replace Iraq as its principal supplier. And, ironically, in the aftermath of government measures adopted last spring, it also benefitted from plunging consumption, which fell 40 percent from its peak of 1.13 million barrels a day by last June and is still only gradually recovering.

Brazil moved quickly to make up for lost supplies. It now imports 200,000 b/d from both Iran and Saudi Arabia and 50,000 b/d from neighboring Venezuela. That's a boost of 100,000 barrels a day from Iran, and 50,000 from both Saudi Arabia and Venezuela.

Meanwhile the country's domestic production has been faring well. In September domestic output reached a record-high of 680,000 b/d, up 30,000 b/d from August and 60,000 b/d over last year's average. Even here, however, output could slide because of labor problems.

In Central America the economic consequences of the current crisis are lower than for Brazil in absolute terms, but considerably higher in relative terms. The region's combined average imports account for only 105,000 b/d. But oil represents a considerably higher proportion of overall imports for most of them. Combined, the Central American countries will be hit by an extra $200 million in costs if oil prices stay at present levels through 1990.

In a major effort of hemispheric cooperation, Latin America's two largest exporters, Venezuela and Mexico, have further eased soft credit terms originally provided under the decade-old San José Accord. The new terms should help the Central American and Caribbean countries to withstand the costs of higher oil prices in the short run.

Mexico and Venezuela's new initiative is also based on their long-term economic interests in the petroleum sector. It not only protects their market share, in addition, the two countries are looking to convert a significant amount of the growing indebtedness of the San José aid recipients into equity in projects that use goods and services from the two countries. High on their lists are oil refining and marketing facilities which will help increase the international scope of their state-owned oil companies.

In short, if the revolution now unfolding in the oil sector takes hold, its impact on the Latin American countries will be profound. ◆

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Cuba: An Anachronism in Today's World

Michael G. Kozak, Deputy Assistant Secretary for Inter-American Affairs

Address before the Cuban-American National Foundation, Washington, DC, October 11, 1990

Thank you for the opportunity to come here today to discuss US policy toward Cuba. Over the years, the Cuban-American National Foundation has shown firm support for many of our policies on Cuba and been a source of great assistance in humanitarian efforts to help Cuban immigrants. It is a pleasure to be with you.

In August 1989, I spoke to the Subcommittee on Western Hemisphere Affairs of the House Foreign Affairs Committee about US policy toward Cuba. Looking over that statement in preparation for speaking with you today, I had to marvel at how much the communist world has changed since then—and at how much Cuba has remained the same. While Eastern Europe and the Soviet Union have embarked on the path toward democratic freedom and market economy, President Fidel Castro has frozen Cuba in a time warp choked with 30 years of stale rhetoric and outmoded centralized control that, as each day passes, bring greater hardship to the Cuban people.

Cuba's Time Warp and US Policy

Developments in the socialist world have provided Castro with an opening for change. Yet, while other socialist nations move unequivocally toward democracy, the government of Cuba defies the times, forbidding any review of the country's single-party system. On the contrary, Castro has implemented the first phase of "the special period in peacetime." Instead of moving Cuba forward with the rest of the world, Castro has announced that Cuba is moving backward, toward a pre-industrial economy where beasts of burden and bicycles will replace 20th-century machines and modes of transportation—all in the name of preserving the purity of the revolution.

In the name of that revolution, the government of Cuba has, for three decades, systematically deprived its people of basic political rights and economic freedoms, supported armed insurgencies abroad, and been the Soviet Union's major client state in the Western Hemisphere. These are the issues that separate Cuba from the United States. Where the American system fosters individual achievement, the Cuban structure stifles personal development, flattening the individual into a cog in the machinery of an increasingly discredited ideology. In the past year, Castro has not only closed Cuba off from the climate of international reform. He has, at the same time, increased repression at home and continued to support the efforts of Marxist guerrillas to overthrow the freely elected government of El Salvador in defiance of the regionally accepted peace process.

Recently, I have heard rumors that US policy toward Cuba is under review: that we are hardening our line toward Cuba by targeting it in international forums or that we are softening our policy through moves to normalize relations.

Neither is the case. US policy objectives toward Cuba have been constant for the nearly 30 years that Cuba has pursued policies inimical to American values and to US interests. The objectives of our policy are internal democratic reform, an end to human rights abuses, and an end to support for insurgency abroad. The tools of this policy are well known to you all:

- The absence of normal diplomatic relations;
- Diplomatic isolation in international organizations and from normal bilateral ties with other countries;
- The comprehensive economic embargo, which aims to deny Cuba the means to carry out policies inimical to the United States; and
- The broadcast of unbiased news and information to the Cuban people.

US policy toward Cuba is the result of an unacceptable pattern of behavior by the Cuban government at home and abroad. The United States cannot have friendly relations with a government that abuses its own people, that resists reforms to improve the life of its citizens and supports insurgencies abroad. US policy toward Cuba has been and will remain constant until Cuba takes steps to remove the impediments to improved relations. These impediments are major and worthy of review.

Cuban Support for Subversion Abroad

Cuba's continued support of the FMLN [Farabundo Marti National Liberation Front] insurgency in El Salvador not only attempts to subvert a democratically elected government but also clashes with the policies of Cuba's regional neighbors, the authors of the peace process now in train. Why does Cuba continue to support the FMLN? Why does Cuba jeopardize the best chance we have had in a decade for peace in Central America? Why won't the Cubans use their influence to support progress in the negotiations? The only answer seems to be that Cuba is not willing to apply in Central America the lesson of the Namibian accords in Southern Africa, where Cuba's ongoing troop withdrawal from Angola is making a contribution to regional peace and stability. Instead, in this, our shared hemisphere, Cuba has persisted in disrupting the hopes of thousands for peace and democracy in Central America.

Human Rights Abuses and Political Repression in Cuba

Cuba continues to be one of the worst violators of human rights in our hemisphere. Since the revolution in 1959, Cubans have been denied the most basic democratic rights and guarantees for fair political and judicial processes. They are subjected to surveillance by block committees,

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denied legal due process, and prevented from travel abroad. Many have been subjected to arbitrary arrest and imprisonment.

In recent months, the Cuban government has intensified its crackdown on dissent after a resolution passed by the UN Human Rights Commission on Cuba offered it an incentive to correct its abusive practices. Instead, in response to that resolution—which four East European nations supported—Castro replied: "Do not even dream that we are going to comply." Castro later articulated his concept of human rights: "Revolutionaries have complete freedom of expression, while counterrevolutionaries have no freedom of expression at all. That is the rule."

Indeed, last July, a Cuban court meted out the stiffest sentences against human rights activists in nearly a decade. Seven members of the small Democratic Unity Movement were condemned to up to 7 years in prison for rebellion after they talked to foreign reporters. Just last week, eight activists were sentenced to up to 6 years in prison for "subversive propaganda" or "illegal associations." The leaders of four of Cuba's five principal human rights groups remain in detention; some without being charged. The longest-serving political prisoner in the world, Mario Chanes de Armas, is still detained after more than 29 years.

Castro's denial of basic human and political freedom to Cuban citizens remains a major obstacle to the improvement of relations. We share the goal of all who seek the establishment of democracy in Cuba through a pluralistic process.

Cuba's Military Ties With the Soviet Union

Over the years, Soviet security assistance has given Cuba one of the largest and best equipped military establishments in the Western Hemisphere. In the past, Soviet military assistance to Cuba has hovered around $1.5 billion annually. It has enabled Cuba to project its power and influence in this hemisphere and elsewhere in a manner inimical to US interests and those of other peaceful nations.

In turn, the Soviet Union has traditionally received important strategic benefits from its military ties to Cuba. Soviet aircraft and naval vessels use Cuban facilities. The Soviets' largest single intelligence gathering installation outside the USSR is located in Cuba.

Although the overall Soviet-Cuban relationship is evolving, Soviet military support to Cuba remains a source of serious concern for the United States. We would like to see Soviet military assistance to Cuba eliminated.

Changes in the Soviet Union may bring this about, but, so far, this has not occurred. Yet as Moscow moves forward with its own reforms, the ideological gap between Cuba and its longtime ally will grow. Castro has reacted harshly to the prospect of losing Soviet support, trying to minimize its importance. In his last July Rebellion Day speech, he rejected the lessons of the reforms in the Soviet Union. "If the USSR crumbled," he said, "if the USSR disappeared, we would continue building socialism in our country. Socialism is not . . . a temporary game. It is not and cannot be a transitory decision."

Moscow has stated publicly its intention to put its trade relations with Cuba on a hard currency basis. The present Soviet economic relationship with Cuba allows Castro to prolong his corrupt system and to inflict greater suffering on the Cuban people. The United States would like to see Soviet aid and subsidized trade arrangements with Cuba evolve into an economic relationship more in consonance with general trade practices around the world—based on world market prices in hard currency. The Soviets have said that this is their intention. We hope that is so.

Conclusion

There is no sign that the Cuban government would consider the changes that could improve life inside Cuba and lead to better relations with the United States. On the contrary, Castro has taken the path of defiance, forcing the Cuban people to endure more hardship, deprivation, and repression. In Castro's words, "we shall not resign for any reason or circumstances whatsoever . . . from the path that we have chosen." His new, preferred motto is "socialism or death."

The economic landscape in Cuba today paints a grim picture of what the consequences may be. Last week, Castro launched the austerity program known as the "special period in peacetime," with strict rationing of food, fuel, and consumer goods. Castro told the people they will have to make their own clothes. He plans to relocate more than 30,000 workers and students to rural areas, where they will till the farms with their hands. Shortages in basic commodities, deteriorating public services, long lines, and empty shelves define the daily disintegration of the lives of the Cuban people as they try to survive under a regime whose legitimacy erodes day by day.

Castro has claimed that the US embargo is responsible for the economic destruction we now are watching in Cuba. That is simply not the case. Castro has ruled Cuba for 30 years. He and his policies are responsible for what has happened—no one else. He should cease evoking the specter of US plots and an imagined military threat "from the north" to justify his repressive regime. The government of Cuba must answer for the consequences of its policies on the Cuban people.

The United States looks forward to the day when a democratic Cuba will flourish. Our policies seek to promote change in Cuba that will allow all Cubans to participate freely in the decisions that govern their lives. We know you share this goal.

The Battle for Turf in Cuba May Split the Island

The Americas

By Arturo Villar

The news hit Miami like a fireball: Cuban Vice President Carlos Rafael Rodriguez said in a Radio Havana interview that the Cuban government had begun negotiations with prominent exiles who are seeking to end Fidel Castro's rule through peaceful means. The largest Spanish-language daily in the Cuban-exile capital headlined it in a full-page, one-inch banner. The airwaves sizzled with speculation, accusations and even triumphal claims before it was discovered that Mr. Rodriguez had misspoken.

Only four months ago, few in Miami would have credited Radio Havana or believed such an improbable statement from the old-line Marxist Cuban vice president. But in June, Gustavo Arcos Bergnes, president of the Havana-based Cuban Committee for Human Rights, publicly called for three-way negotiations to look for a peaceful solution to Cuba's growing economic and political problems. He invited the government, the exile community and the island's dissidents to begin talks that would lead to a reconciliation of their 30-year violent confrontation.

Mr. Arcos's credentials are irreproachable: anti-Batista insurgent; Mr. Castro's comrade in arms in the Moncada barracks attack in Santiago de Cuba on July 26, 1953; chief representative of the Sierra Maestra guerrillas in Latin America during the insurrection; the revolution's first ambassador to Belgium, and, finally, a twice-imprisoned dissident of the Castro regime who refuses to leave Cuba.

Nevertheless, Armando Valladares, another high-visibility Cuban with his own claim to moral authority, responded to Mr. Arcos's exhortation with a vicious attack on his motives, calling the invitation for negotiations an act of "treason." Mr. Valladares spent 20 years in Mr. Castro's prisons, wrote a devastating book on his experiences when allowed to leave Cuba, and then became U.S. ambassador to the U.N. Human Rights Commission in Geneva. He is closely allied with the Cuban American National Foundation, a powerful lobbying group of Miami-based Cuban businessmen who have effectively pressured Congress and the White House to maintain a hard line toward Mr. Castro and his revolution.

For years, observers of the Cuban-American community have wondered if the foundation truly represented the attitude of the nearly one million Cubans living in the U.S. toward Mr. Castro and his revolution. No one doubted that Cuban exiles were anti-Communists and wished to get Mr. Castro out of the government. But the belligerent and intransigent policies of the foundation seemed to clash with the desire of hundreds of thousands of Cuban-Americans to return to Cuba for weeklong family visits, which were allowed in 1979.

Mr. Arcos's position became a rallying point for those who differed from the vociferous and, until then dominant, hard-line segment of the Cuban exile community. Soon a new political party—*Union Liberal Cubana*—was formed, and a coalition with the International Christian and Social Democratic parties was established to explore the possibility of negotiating with the Cuban government to organize democratic elections on the island.

The old and new political groups are vying for the attention of the exile community, Washington, Moscow, the Latin American capitals and even the new governments in Eastern Europe. And all have one thing in common: the elimination of Mr. Castro from power. The question that divides them is tactical: how best to obtain their goal. And, more specifically, what price should the Cuban people pay to gain control of their destiny?

There is no way of knowing whether changes in Cuba will be peaceful or violent. And if the past is prologue, it is quite possible that the Cuban people will add another violent chapter to their history. What is certain is that the transition to post-Castro Cuba, which so many glibly and gleefully anticipate, will be suffered only by those in the line of fire—namely, by those Cubans who now live on the island.

The dissidents in Cuba and the newly formed coalition in exile coincide in looking for a peaceful solution. They look at the example of Eastern Europe and say that, to avoid violence, they are willing to pay the price of protracted negotiations and a slow transition to a free market.

Some in this alliance want the U.S. to do nothing different in its relations with Cuba. Others, particularly the Cuban Commission for Human Rights and National Reconciliation, are asking for a lifting of the U.S. embargo on Cuba to clear the way for a truly Cuban solution to the crisis. Their central argument is that Mr. Castro keeps using U.S. hostility as an excuse for denying true change within the system and that the U.S. could help open up political space on the island by declaring peace on the "revolution."

The traditional hard-line groups are adamantly against any negotiations with Mr. Castro or any relaxation of U.S. hostility toward the Cuban revolution. The Cuban American National Foundation claims it can raise billions of dollars in private capital for investment in Cuba and says it is negotiating with the Soviet Union and East European governments to forgive the Cuban debt if a newly formed post-Castro government pledges to lead the country to a free-market system immediately. These groups oppose any residual Castro influence in a new Cuba, citing Nicaragua as an example of evolutionary change that offers no real humanitarian solutions.

All of these arguments are perfectly sensible, but they discount the most important element in any discussion of post-Castro Cuba: What of the Cubans living on the island? None of the warring exile groups have a way of knowing how strongly Cubans in Cuba feel for or against these various "solutions." In practice, their only gauge is the testimony of the few journalists who have used their limited stays in Cuba to wander throughout the island and try to fathom the feelings of a populace that lives in constant fear and under relentless vigilance.

These observers report that Cubans are uncertain of their future, skeptical of the intentions of their leaders and confused about the causes for the demise of communism in Eastern Europe. But they also report that many claim to be afraid of Miami Cubans and their plans for a possible return. Sebastian Arcos—brother of Gustavo and vice president of the Cuban Committee on Human Rights—recently pleaded with the exile community to tone down the attacks on the system, stating that "people in Cuba, especially the young, want change, but internally, because they are afraid of the Americans and the Cubans in Miami."

Most journalists report a seemingly common trait among Cubans on the island today: a desire to understand how and why the U.S.S.R. is going from a totalitarian to a democratic form of government and a fascination with *perestroika* and *glasnost*. All of the anti-Castro groups are hoping that Moscow will pressure Mr. Castro to open up internally or signal its support for a change at the top in Cuba. And after all, perhaps it was no coincidence that it was Vice President Rodriguez—long considered to be Moscow's man in Havana—who gave the rare interview to Radio Havana and whose misstatement led to the recent speculation in the exile community.

Mr. Villar is publisher of VISTA, the Hispanic Magazine.

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