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WASHINGTON ECONOMIC WATCH

A Digest of Development Policy Information

A Project of the Overseas Development Council

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WASHINGTON
ECONOMIC
WATCH

A Digest of Development Policy Information

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January 22, 1993

Dear Readers:

Welcome to the first edition of the 1993 series of Washington Economic Watch. We are pleased to announce that funding has been reinstated and quarterly production will resume in 1993. As in previous issues, WEW covers the important economic policy debates in Washington. This inaugural edition provides insight on issues of concern to developing countries, as monitored during the pre-election and transition period in autumn of 1992.

Herein you will find statements made by senior U.S. government officials, summaries of U.S. congressional hearings, press commentary, and excerpts from policy research and analysis published by Washington 'think tanks' and multilateral financial institutions. The material is organized according to six functional categories; within each are subject groupings, with policy statements generally appearing first and commentary and analysis following. Also included is a bibliographic listing of participating institutions. Please direct requests for publications to the respective organizations.

ODC has experienced a few administrative changes as well. Dawn Murphy recently joined ODC as the new WEW Coordinator to whom all future correspondence should be directed.

We look forward to an exciting year with the new administration in place and hope that this issue proves to be an informative resource for your institution.

Sincerely,

Christine Contee

Christine E. Contee
Director of Public Affairs
& Fellow

ODC

A Project of the Overseas Development Council

John W. Sewell, President

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212-759-0900

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202-546-5788

Johns Hopkins Foreign Policy Institute
1619 Massachusetts Ave. NW
Washington, DC 20036
202-633-5771

Middle East Institute
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Washington, DC 20036
202-785-1141

Middle East Report
1500 Massachusetts Ave. NW
Suite 119
Washington, DC 20005
202-223-3677

National Bureau of Economic Research
1050 Massachusetts Ave.
Cambridge, Mass. 02138
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National Planning Association
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Washington, DC 20036
202-265-7685

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Alexandria, VA 22314
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Population Council
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Washington, DC 20036
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Population Reference Bureau
777 14th St. NW
Washington, DC 20005
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Rand Corporation
1700 Main St.
Santa Monica, CA 90406-2138
213-393-0411

Refugee Policy Group
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Washington, DC 20036
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Resources for the Future
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Washington, DC 20036
202-328-5000

SRI International
333 Ravenswood Ave.
Menlo Park, CA 94025
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The Washington Institute
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Washington, DC 20036
202-293-7440

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Woodrow Wilson International Center for Scholars
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World Resources Institute
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Washington, DC 20006
202-638-6300

Worldwatch Institute
1776 Massachusetts Ave. NW
Washington, DC 20036
202-452-1999

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Congressional Budget Office
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Fourth Floor
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Department of Commerce
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Department of Defense
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Washington, DC 20585

Department of Justice
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Washington, DC 20530

Department of State
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Department of the Treasury
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Washington, DC 20220

Drug Enforcement Agency
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Washington, DC 20240

Environmental Protection Agency
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Washington, DC 20460

Export-Import Bank of the United States
811 Vermont Ave., NW
Washington, DC 20571

Federal Deposit Insurance Corporation
550 Seventeenth St., NW
Washington, DC 20429

Federal Reserve System
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Washington, DC 20551

Federal Trade Commission
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General Accounting Office
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Washington DC 20503

Office of National Drug Control Policy
Executive Office of the President
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Office of Public Affairs
Executive Office of the President
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Washington, DC 20500

Office of Technological Assessment
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Washington, DC 20003

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International Monetary Fund
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Washington, DC 20431

Organization of American States
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Washington, DC 20036

Organization for Economic Cooperation and Development
20001 L St. NW Suite 700
Washington, DC 20036-4095
785-6323

The World Bank
1818 H St. NW
Washington, DC 20433

4. Journals

Africa Report
833 United Nations Plaza
New York, NY 10017

Congressional Quarterly
1414 22nd St. NW
Washington, DC 20037

Foreign Policy
2400 N St. NW
Washington, DC 20037-1196

International Economy
1050 Connecticutt Ave. NW
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Latin Finance
2121 Ponce de Leon Blvd.
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National Journal
1730 M St. NW
Suite 1100
Washington, DC 20036

TRADE AND COMMODITIES

TRADE

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NAFTA: 'The Beginning of a New Era'

The United States, Mexico, and Canada announced Aug. 12 that negotiations for a North American Free Trade Agreement (NAFTA) have been completed. President Bush described the agreement as "the beginning of a new era on our continent, on the North American continent." NAFTA must still be approved by the House and Senate, which are expected to consider it in early- to mid-1993. A Fact Sheet, prepared by the White House, follows, together with remarks by the President and Secretary of Commerce Barbara Hackman Franklin.

White House Fact Sheet on NAFTA

The President announced Aug. 12 that the United States, Mexico, and Canada have completed negotiation of a North American Free Trade Agreement (NAFTA). The NAFTA will phase out barriers to trade in goods and services in North America, eliminate barriers to investment, and strengthen the protection of intellectual property rights. As tariffs and other trade barriers are eliminated, the NAFTA will create a massive open market—over 360 million people and over $6 trillion in annual output.

Background

With sharp increases in global trade and investment flows, U.S. economic growth and job creation have become closely tied to our ability to compete internationally. Since 1986, U.S. exports have increased by almost 90 percent, reflecting our success in opening foreign markets and the competitiveness of American industry. In 1991, the United States exported over $422 billion of industrial and agricultural products, and over $164 billion in services, making the United States the world's largest exporter—ahead of Germany and Japan. More than 7.5 million U.S. jobs are tied to merchandise exports, up from 5.0 million in 1986. Of these jobs, 2.1 million are supported by exports to Canada and Mexico.

For many years, Mexico used high tariffs and licensing restrictions in an effort to encourage industrial development and import substitution. Under President Salinas and his predecessor, President de la Madrid, the Mexican government has opened its market and implemented sweeping economic reforms. In 1986, Mexico joined the General Agreement on Tariffs and Trade (GATT) and began reducing its tariffs and trade barriers.

As a result, bilateral trade has increased dramatically. From 1986-91, U.S. exports to Mexico increased from $12.4 billion to $33.3 billion, twice as fast as U.S. exports to the rest of the world. U.S. agricultural exports rose 173 percent to $3 billion; consumer goods tripled to $3.4 billion; and exports of capital goods surged to $11.3 billion from $5 billion. U.S. exports to Mexico now support more than 600,000 American jobs, while exports to Canada support 1.5 million.

Economic reforms have also been good for Mexico. Its inflation rate has dropped from over 100 percent in 1986 to under 20 percent in 1991, and its economy has grown at an average annual rate of 3.1 percent over the last four years, after stagnating during the 1980s.

In June 1990, Presidents Bush and Salinas endorsed the idea of a comprehensive U.S.-Mexico free trade agreement and directed their trade ministers to begin preparatory work. Canada joined the talks in February 1991, leading to the three-way negotiation known as NAFTA. Formal negotiations began in June 1991 after Congress extended through May 1993 the "fast track" procedures originally enacted in the Trade Act of 1974, authorizing the Administration to submit the agreement with implementing legislation for an up-or-down vote.

The President's trade strategy, which is a key part of his overall economic growth plan, is designed to create new markets for American products and provide new opportunities for American companies and workers.

The NAFTA Agreement

The NAFTA will create a free trade area (FTA) comprising the United States, Canada, and Mexico. Consistent with GATT rules, all tariffs will be eliminated within the FTA over a transition period. The NAFTA involves an ambitious effort to eliminate barriers to agricultural, manufacturing, and services trade, to remove investment restrictions, and to protect effectively intellectual property rights. In addition, the NAFTA marks the first time in the history of U.S. trade policy that environmental concerns have been directly addressed in a comprehensive trade agreement. Highlights of the NAFTA include:

★ **Tariff Elimination.** Approximately 65 percent of U.S. industrial and agricultural exports to Mexico will be eligible for duty-free treatment either immediately or within five years. Mexico's tariffs currently average 10 percent, which is two-and-a-half times the average U.S. tariff.

★ **Reduction of Motor Vehicle and Parts Tariffs.** U.S. autos and light trucks will enjoy greater access to Mexico, which has the fastest growing major auto market in the world. With NAFTA, Mexican tariffs on vehicles and light trucks will immediately be cut in half. Within five years, duties on three-quarters of U.S. parts exports to Mexico will be eliminated, and Mexican "trade balancing" and "local content requirements" will be phased out over 10 years.

★ **Auto Rule of Origin.** Only vehicles with substantial North American parts and labor content will benefit from tariff cuts under NAFTA's strict rule of origin. NAFTA will require that autos contain 62.5 percent North American content, considerably more than the 50 percent required by the U.S.-Canada Free Trade Agreement. NAFTA contains tracing requirements so that individual parts can be identified to

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determine the North American content of major components and sub-assemblies, *e.g.*, engines. This strict rule of origin is important in ensuring that the benefits of the NAFTA flow to firms that produce in North America.

★ **Expanded Telecommunications Trade.** NAFTA opens Mexico's $6 billion market for telecommunications equipment and services. It gives U.S. providers of voice mail or packet-switched services nondiscriminatory access to the Mexican public telephone network and eliminates all investment restrictions by July 1995.

★ **Reduced Textiles and Apparel Barriers.** Barriers to trade on $250 million (over 20 percent) of U.S. exports of textiles and apparel to Mexico will be eliminated immediately, with another $700 million freed from restrictions within six years. All North American trade restrictions will be eliminated within 10 years and tough rules of origin will ensure that benefits of trade liberalization accrue to North American producers.

★ **Increased Trade in Agriculture.** Mexico imported $3 billion worth of U.S. agricultural goods last year, making it our third-largest market. NAFTA will immediately eliminate Mexican import licenses, which covered 25 percent of U.S. agricultural exports last year, and will phase out remaining Mexican tariffs within 10-15 years.

★ **Expanded Trade in Financial Services.** Mexico's closed financial services markets will be opened and U.S. banks and securities firms will be allowed to establish wholly-owned subsidiaries. Transitional restrictions will be phased out by Jan. 1, 2000.

★ **New Opportunities in Insurance.** U.S. firms will gain major new opportunities in the Mexican market; firms with existing joint ventures will be permitted to obtain 100 percent ownership by 1996 and new entrants to the market can obtain a majority stake in Mexican firms by 1998. By the year 2000, all equity and market share restrictions will be eliminated, opening up completely what is now a $3.5 billion market.

★ **Increased Investment.** Mexican "domestic content" rules will be eliminated, permitting additional sourcing of U.S. inputs and, for the first time, U.S. firms operating in Mexico will receive the same treatment as Mexican-owned firms. Mexico has agreed to drop export performance requirements, which presently force companies to export as a condition of being allowed to invest.

★ **Land Transportation.** More than 90 percent of U.S. trade with Mexico is shipped by land, but U.S. truckers currently are denied the right to carry cargo or set up subsidiaries in Mexico, forcing them to "hand off" trailers to Mexican drivers and return home empty. NAFTA will permit U.S. trucking companies to carry international cargo to the Mexican states contiguous to the United States by 1995, and gives them cross-border access to all of Mexico by the end of 1999. U.S. railroads will be able to provide their services in Mexico, and U.S. companies can invest in and operate land-side port services. The combination of truck, rail, and port breakthroughs will help create an efficient, intermodal North American transport system.

★ **Protection of Intellectual Property Rights.** NAFTA will provide a higher level of protection for intellectual property rights than any other bilateral or multilateral agreement. U.S. high-technology, entertainment, and consumer goods producers that rely heavily on protection for their patents, copyrights, and trademarks will realize substantial gains under NAFTA. The agreement will also limit compulsory licensing, resolving an important concern with Canada.

Statement by Secretary of Commerce Barbara Hackman Franklin

The negotiators from the United States, Canada and Mexico should be congratulated for reaching this historic agreement that creates the largest free trade area in the world. I am particularly proud of the people at the Department of Commerce and the significant contributions they have made toward turning President Bush's vision of the NAFTA into reality.

President Bush's steadfast pursuit of free and open markets for American products and services has achieved an economic grand slam on par with his much-heralded arms accords with the former Soviet republics. In one bold stroke, we are creating an unprecedented economic force and unleashing the continent's abundant man-made and natural resources—from labor and technology to capital and energy. Through the NAFTA, we have taken our first step into the North America of the 21st Century: a continent stronger and more dynamic than any on earth.

Once the NAFTA is fully implemented, Americans will benefit tremendously from increased economic growth, lower prices, better access to expanding export markets, greater long-term competitiveness of U.S. industry, and hundreds of thousands of new American jobs. Already, 624,000 U.S. jobs are supported by merchandise exports to Mexico. (More than 1.5 million U.S. jobs are supported by exports to Canada.) An independent, nonpartisan study projects that another 300,000 U.S. jobs will be created through the NAFTA. And export-related jobs are good jobs—paying 17 percent more than the average American wage.

For Americans, Canadians and Mexicans, the NAFTA is a win-win situation. Canada and Mexico are already the United States' two largest markets for manufactured goods. And Mexico is the fastest growing major market for U.S. goods and services. The NAFTA will ensure even greater market growth and prosperity.

American workers and businesses will benefit from several key results of the NAFTA:

- Immediate elimination of tariffs on about half of U.S. exports to Mexico; this will expand opportunities for U.S. exports of such high-tech goods as computers, semiconductors, and medical and telecommunication equipment;
- Opening of the $146 billion Mexican services market to U.S. service firms, including banking, securities, insurance, and transportation;
- Opening of the rapidly growing Mexican auto market while providing North American producers with a transition period to adjust to full competition.

As the rhetoric heats up around the NAFTA—and it certainly will—we must keep in mind that this is an agreement worth fighting for. In the words of President Bush, "We're fighting for our children's futures."

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The objective of NAFTA is to open markets. It is not designed to crate a closed regional trading bloc, and does not erect new barriers to non-participants. The NAFTA is fully consistent with GATT criteria for free trade agreements, and with U.S. support for strengthening the multilateral trading system in the Uruguay Round.

Economic Studies

At the request of the Office of the U.S. Trade Representative, the U.S. International Trade Commission surveyed and evaluated the various economic analyses of NAFTA. In May of this year, the USITC reported that:

> [T]here is a surprising degree of unanimity in the results regarding the aggregate effects of NAFTA. All three countries are expected to gain from a NAFTA.

These independent studies found that NAFTA would increase U.S. growth, jobs, and wages. They found that NAFTA would increase U.S. real gross domestic product by up to 0.5 percent per year once it is fully implemented. They projected aggregate U.S. employment increases ranging from under 0.1 percent to 2.5 percent. The studies further project aggregate increases in U.S. real wages of between 0.1 percent to 0.3 percent.

U.S. exports to Mexico currently support over 600,000 American jobs. The Institute for International Economics recently estimated that this figure will rise to over 1 million U.S. jobs by 1995 under the North American Free Trade Agreement.

Environment, Labor, and Adjustment Issues

In a May 1, 1991, letter to the Congress, the President described actions that the Administration would implement to address concerns regarding the impact of free trade on the environment, labor rights, as well as worker adjustment programs.

- **Environment.** The Administration has moved forward with a comprehensive bilateral environmental agenda to allay concerns that free trade could undermine U.S. environmental and food safety regulations or lead to environmental degradation on the U.S.-Mexico border. During the last year, substantial progress has been made. Highlights include the following:
  - —*Standards.* The NAFTA allows the United States to maintain its stringent environmental, health, and safety standards. It allows states and localities to enact tougher standards based on sound science. It encourages "upward harmonization" of national standards and regulations, and prohibits the lowering of standards to attract investment.
  - —*Integrated Border Plan.* In February 1992, EPA and its Mexican counterpart (SEDUSOL) completed a comprehensive plan for addressing air, soil, water, and hazardous waste problems in the border area. Agreement has been reached on measures to implement the first stage of the plan covering the period from 1992-94.
  - —*Border Infrastructure.* The President has proposed a 70 percent increase in the budget for border environmental projects to $241 million for FY 1993, including $75 million for the "colonias" (unincorporated communities on the U.S. side of the border that often lack effective sanitation services and running water) and over $120 million for border wastewater treatment plants.
  - —*Border Plan/FY 1993 Appropriations.* To date, in the FY 1993 Appropriations process, the House of Representatives has refused to fund the $50 million EPA request for the colonias and cut the Administration's $65 million request for a Tijuana-San Diego sewage treatment plant to $32 million. For its part, the Senate failed to fund $120 million of the requested funds for border wastewater treatment. The President has called upon Congress to reverse these cuts.
  - —*Environmental Conference.* On Sept. 17, 1992, EPA Administrator Reilly will host a trilateral meeting with the Canadian and Mexican environmental ministers in Washington, D.C. to discuss environmental aspects of NAFTA.
- **Worker Rights.** Mexico has a comprehensive labor law that provides workers with extensive legal rights. The economic benefits of the NAFTA will provide Mexico with resources to move forward with vigorous enforcement initiatives launched by the Salinas Administration.
  - —*Labor Cooperation.* The U.S. Department of Labor has negotiated a five-year Memorandum of Understanding (MOU) to strengthen bilateral cooperation with respect to occupational health and safety standards, child labor, labor statistics, worker rights, labor-management relations, and workplace training. Several joint MOU initiatives are now under way.
- **Safeguards.** President Bush committed that NAFTA would contain measures to ease the transition for import-sensitive U.S. industries. For our sensitive sectors, tariffs will be phased out in 10 years, with particularly sensitive sectors having a transition of up to 15 years. In addition, NAFTA contains "safeguard" procedures that will allow the United States to reimpose tariffs in the event of injurious import surges.
- **Worker Adjustment.** Dislocations in the United States are likely to be minimal, since U.S. trade barriers are already quite low. Nonetheless, during the fast track debate, the President promised that dislocated U.S. workers will receive timely, comprehensive, and effective services and retraining—whether through improvement or expansion of an existing program or creation of a new program. The Administration has already begun consulting with the relevant Congressional committee regarding adjustment services for displaced workers.

Next Steps

The timing of Congressional consideration is governed by the fast track procedures, which require the President to notify the Congress of his intent to enter into the agreement at least 90 days before it is signed. Although the Aug. 12 announcement reflects the completion of negotiations, the draft text probably will not be finished until September, since further legal drafting and review are required to implement the understanding reached by the negotiators.

After the agreement is signed, legislation must be prepared to implement it, including any necessary changes to U.S. law.

Under the fast track, the North American Free Trade Agreement will not go into effect until the Congress has approved the implementing legislation on an up-or-down vote. The approval process must occur within a specified time—90 "session" days of Congress.

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REMARKS BY THE PRESIDENT ON THE NORTH AMERICAN FREE TRADE AGREEMENT

August 12, 1992

Today marks the beginning of a new era on our continent, on the North American continent. This morning the United States, Mexico and Canada are announcing the completion of negotiations for a North American Free Trade Agreement, NAFTA.

First, I want to express my deep appreciation to Ambassador Carla Hills, our United States Trade Representative; to Secretary Serra of Mexico; and to Minister Wilson of Canada for this outstanding achievement. And also standing next to me is Carla Hill's Deputy, my able friend, Julius Katz, who had a very instrumental role in all these negotiations.

This historic trade agreement will further open markets in Mexico, Canada and the United States. And it will create jobs and generate economic growth in all three countries. Increased trade with North America will help our nation prepare for the challenges and opportunities of the next century. The Cold War is over. The principal challenge now facing the United States is to compete in a rapidly changing, expanding global marketplace.

This agreement will level the North American playing field, allowing American companies to increase sales from Alaska to the Yucatan. By sweeping aside barriers, NAFTA will make our companies more competitive everywhere in the world. We've seen this happen with the U.S.-Canada Free Trade Agreement. And we'll see it even more with the NAFTA.

Open markets in Mexico and Canada mean more American jobs. Our nation is the world's leading exporter, well ahead of Japan and Germany. And today over seven million Americans are hard at work making products that will be sold around the world. Export-related jobs pay 17 percent more than the average U.S. wage. These jobs are the kind that our nation needs to grow and prosper; the kind that showcase American talent and technology. More than 600,000 Americans are now employed making products and selling them to Mexico—our fastest growing export market. We sold over $33 billion worth of goods to Mexico last year, and are projected to sell $44 billion this year.

In the last five years, as President Salinas has dismantled many longstanding Mexican trade and investment restrictions, our exports to Mexico have nearly tripled. In the last five years, let me repeat that, our exports to Mexico have nearly tripled. And that's one-quarter of a million new American jobs.

This agreement helps us lock in these gains and build on them. Last year the Congress endorsed moving forward with NAFTA by extending the fast track procedures for Congressional consideration and implementation of trade agreements. The rapid completion of the NAFTA talks shows how much can be accomplished when the Executive Branch and the Congress work together to do what is best for our nation. And I'll work closely with the Congress for rapid implementation.

At the time fast track was extended I outlined steps that we would take to address environmental and labor concerns. We've taken every promised step and we are meeting or beating every commitment that I outlined. This is the first time a trade agreement has included stringent provisions to benefit the environment. The NAFTA maintains this nation's high environmental, health, and safety standards. In fact, it goes even further and encourages all three countries to seek the highest possible standards.

The Environmental Protection Agency and its Mexican counterpart have already developed a comprehensive integrated border plan to clean up air, water and hazardous waste along the Rio Grande. These problems are serious, but they will be solved by environmental cooperation, increased trade, and higher levels of economic growth—not protectionism.

Unfortunately, Congress has reduced the funding for our border plan in the appropriations process. And I asked the Congress to fully fund these important environmental initiatives. With NAFTA we're moving forward with our trade strategy. Trade is part of my long-term economic growth plan to create more opportunities for all Americans.

In a changing world, we must give our workers the education and skills they need to compete, and assistance and training to find good jobs. I've said many times, level the playing field and the American worker can outthink, outproduce and outwork anyone, anytime.

Today's historic agreement links our future with out past. Five centuries ago this very month, a man of courage and vision set sail from the Old World in search of new trade routes and opportunities. Chistropher Columbus was an entrepreneur, and the journey he started 500 years ago continues to pay off abundantly today. By moving forward with the NAFTA we will replenish that investment of opening up new horizons of opportunity and enterprise in the new world.

So this is a good day for America, a good day for North America. And once again, I want to express my appreciation to Ambassador Hills and her extraordinarily able team who have worked literally day and night for months to complete this negotiation phase of the agreement.

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SELECTED TOPICS

Conference Explores Issues, Obstacles, And Support for NAFTA Agreement

With negotiations for a North American Free Trade Agreement (NAFTA) entering their final stage, the Institute for International Economics and the Fraser Institute called a timely conference that

Hufbauer: a NAFTA posits a "win-win" scenario for both Mexico and the United States.

intended according to C. Fred Bergsten, Director of the Institute for International Economics (IIE), "to take stock of where the negotiations are headed, to try to make some inputs into the final round, and to pave the way for the ratification debate." The day-long seminar, held on June 22 in Washington, D.C., featured panels of Canadian, Mexican, and U.S. experts and others, who assessed the economic, political, labor, and environmental aspects of the negotiations and speculated on the prospects and possible pitfalls the agreement might face in these three countries.

Overview of the NAFTA

Drawing on their recently published study, *North American Free Trade: Issues and Recommendations*, Gary Clyde Hufbauer, a Visiting Fellow at IIE and Marcus Wallenberg Professor of International Financial Diplomacy at Georgetown University, and Jeffrey J. Schott, a Research Fellow at IIE, offered a broad examination of the NAFTA negotiations. Hufbauer, like many of the discussants, saw the NAFTA as a natural extension of Mexico's reform efforts. The NAFTA should be viewed, he said, "as an insurance policy and a capstone for all that has gone before and is going on simultaneously."

Citing the $9 billion trade surplus that the United States is projected to run with Mexico by 1995, Hufbauer posited a "win-win" scenario for both countries, estimating a net job gain in the United States of 130,000 jobs and a net gain in Mexico of 600,000 jobs. The NAFTA would also help Mexico close its income gap with the United States and Canada. If Mexico is able to raise its income by 2 percent a year, it will close that gap by 2030.

In the United States, however, the net job gain represents the creation of 240,000 new jobs but the loss of 110,000 existing jobs. Clearly, there would be dislocations, and Hufbauer chided the U.S. administration for not providing a few "helpful leaks" about adjustment assistance. (He suggested a $900 million fund earmarked for adjustment and available over five years.) Mexico, Hufbauer added, faces a "very sharp drop" in agricultural employment within the next decade—a decrease to 15 percent from 26 percent of the total work force. Such a transition is normally accompanied by an increase in land values, he said, so that the tax system "should be able to capture those land values and convert them into urban infrastructure."

Hufbauer hoped that the NAFTA negotiations would yield an improved version of the Canada-U.S. Free Trade Agreement (one that incorporated, for example, all its dispute settlement mechanisms). The NAFTA should, he argued, provide for the rapid removal of tariff barriers and include a safeguard mechanism that provides for a "super rapid liberalization" by the country enjoying the plus side of the swing if a huge and persistent swing occurs on a broad sectoral basis in favor of one partner.

Hufbauer felt that the U.S. administration was "well behind the curve" in failing to recognize that environmental issues posed the "greatest potential deal breaker." Environment, like labor, is essentially "a money question, and the United States has to get out its wallet," Hufbauer said. In addition to accepting current environmental standards, Hufbauer recommended that the United States put up "at least an extra $1 billion a year for environmental cleanup in the obvious border areas." He also suggested a two-stage agenda to deal with environmental dumping—the concern that polluting Mexican plants might cause plants in the

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United States, which are cleaner but more expensive to operate, to close down. The agenda would first require strict enforcement of existing standards and, by 1995, allow each country to put on notice those standards that it wanted the other to strengthen. This would trigger negotiations. If negotiations failed, a "green fee" (paid to the country that needed to elevate its standards) could be imposed.

Hufbauer cautioned that reports from the negotiations suggested there might be several troubling shortfalls in the potential agreement, principally in agriculture and financial services. Although agriculture offers potentially large gains, the reports suggested that "either agriculture is to be left off the table or the liberalization is to be so backloaded as to be politically not credible." He also expressed concern that the laudable privatization of Mexico's banking system may have contained "some understanding" that would shield the Mexican financial system from liberalization for a long time. This, he argued, would be intolerable for midsize companies and consumers, who would be prey to a price gouging system.

Jeffrey Schott, extending Hufbauer's analysis, called special attention to the "rules of origin" negotiations, particularly for textiles, automobiles, and computers, which he felt were headed in a dangerous and discriminatory direction. The legitimate solution to the question of how to prevent the transhipment of goods from low- to high-tariff countries was, he said, to harmonize tariffs. Focusing on rules of origin, he said, could distort trade and investment in the area and, perhaps more ominously, sponsor an emulation effect in other regions, particularly Europe.

Schott also expressed concern over the lack of attention being paid to the accession process. An accession clause would, he believed, offer the "opportunity to build a common regime and avoid a patchwork quilt of inconsistent and discriminatory trade arrangements." It would also provide a clear standard for admission to the NAFTA club.

Mexican Perspective

Rogelio Ramírez de la O, president of Ecanal, a private research company in Mexico City, and Luis Rubio, with the Centro de Investigación para el Desarrollo, an independent research institute in Mexico City, noted that Mexico is so deeply committed to an extensive program of economic reforms that in a sense it has already begun to capture some of the benefits of the free trade arrangement. Ramírez noted that trade liberalization has had its own price effect, and economic reform, which has led to import growth, has already raised expectations, growth, and capital inflows.

But Ramírez was troubled by the specter of U.S. protectionism as well as by preliminary evidence indicating that Mexico's manufacturing and labor-intensive industries have yet to respond to the stimulus of the economic reforms. Manufacturing industries in Mexico have recorded only 0.1 percent growth since 1987, and labor-intensive industries have recorded net losses in output and employment, he said.

Rubio framed his discussion of the political dimensions of the NAFTA within two broad questions: Why reforms? Why a NAFTA? The old stability in Mexico, he noted, was rooted in the cooperation of key political groups that Rubio identified as the winners of the revolution. An "extremely well developed system of patronage" provided the glue that held the system together, Rubio said, and the system worked as long as it delivered. But by the mid-1980s, it was clear, he said, that Mexico would have to change or face social and political upheaval.

A broad new coalition—which, according to Rubio, is huge and includes, among others, the middle classes, most of labor, and some in the peasant coalition—emerged as the reform process proceeded. Rubio credited current Mexican President Carlos Salinas de Gortari with transforming this new coalition into something much more coherent. The reforms have now acquired a dynamic of their own. "The best guarantee of reform," Rubio observed, "lies precisely in the expectation that the process of reform

Ramírez de la O: Mexico's manufacturing and labor-intensive industries have yet to respond to economic reform.

is genuine," and those expectations can be met only if the reform process is strengthened. "There is no way to go back," he added. "Everything has changed."

Why a NAFTA? Rubio argued that, from a purely economic perspective, a NAFTA would establish the rules of the game for Mexico and "avoid having antidumping rules invoked every time a Mexican exporter was successful." From a political perspective, however, perhaps the NAFTA's more important function

would be as an external guarantee for the reforms. The Salinas Government, Rubio noted, realized that at the heart of the reform process was the issue of confidence, and there could be no confidence without a sense of permanence about the reforms. A clearly defined relationship with the United States would solidify and formalize this confidence.

A recent poll, Rubio said, estimated that 84 percent of the Mexican population supported the NAFTA. Rubio believed NAFTA's popularity has at least as much to do with a continued commitment to these reforms as with the specifics of the agreement.

Waverman: Canada's limited trade with Mexico has dampened its support for a NAFTA.

Canadian Perspective

Gilbert Winham, Professor of Economics at Dalhousie University, confessed that he could "just weep" when he heard of 84 percent support for the NAFTA. It is the opposite in Canada.

There is scant natural enthusiasm for the NAFTA in Canada, observed Leonard Waverman, Professor of Economics and Director of the Center for International Studies at the University of Toronto, because Canada's trade with Mexico has traditionally been very limited. While 80 percent of Canada's exports, and 70 percent of Mexico's, go to the United States, Canada's trade with Mexico has amounted to less than $3 billion annually—a fraction of its yearly $200 billion trade with the United States. Until this year Canadian-Mexican trade had, in fact, been declining.

Canada remained unconvinced of the potential for increased trade with Mexico and approached a NAFTA somewhat anxiously, Waverman noted, because "increased competition with Mexico in the U.S. market plus the upset of increased Mexican sales in the Canadian market" might pose risks for Canada. In truth, Waverman added, the United States and Mexico were free to sign a bilateral agreement, and the real question was whether Canada would remain outside the NAFTA to protect its market from Mexican exports. He maintained that Canada should take an intelligent but defensive approach—agreeing to participate in a NAFTA with an eye on the larger Latin American market.

Most at risk from the heightened competitiveness a NAFTA might generate, Waverman felt, was Canada's auto market. But he also speculated that Canada's energy sector, which has received little mention in Canada's discussion of the NAFTA negotiations, might also face increased competition. In other areas, however, such as forestry and food, Waverman indicated that there were few areas of direct competition.

Winham noted that any discussion of a NAFTA in Canada of necessity resurrected the issue of Canada's Free Trade Agreement with the United States. That agreement, the product of a Canadian initiative, is now opposed by 70 percent of the population, according to a recent poll. Waverman believed that the NAFTA could be promoted to the Canadian public as an opportunity for Canada to rewrite the Canada-U.S. Free Trade Agreement to its advantage. He thought it impossible in Canada to sell NAFTA on its own merits.

Winham cited a poll that suggested most Canadians would support an agreement that served as a stepping stone to a larger hemispheric trade arrangement. He felt Canadians could be convinced to see the longer-term benefits of participating in a multiparty agreement that would eventually lead to a broad regional arrangement.

But Winham and Waverman agreed that selling the NAFTA in Canada would not be easy, and the timing, Winham added, is "going really quite badly for Canada." The country is unlikely to implement the NAFTA until the United States does, and that is not likely to take place until early 1993. If the NAFTA and the Canada-U.S. Free Trade Agreement remain unpopular in Canada, the Mulroney Government, he speculated, may choose not to implement the NAFTA until after the next Canadian elections.

U.S. Perspective

In terms of popular support for the NAFTA, the United States is somewhere in between Mexico and Canada, noted I. M. Destler, a Visiting Fellow at the Institute for International Economics and Professor at the University of Maryland's School of Public Affairs. The 1991 vote on the extension of fast-track legislation was the latest indication, he said, "that when the chips are down [the U.S.] Congress will continue to support generally liberal trade initiatives. Executive officials, particularly the U.S. trade representative, retain substantial leeway and leadership capability within the United States if they are politically

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adroit and if they remain sensitive to international and major industry concerns."

The length of the negotiations, however, has all but scuttled the original timetable for the NAFTA, which will require implementing legislation in the United States. Barring extraordinary action, Destler said, this implementing legislation now will not be introduced until the next legislative session in early 1993. The election in the intervening months may inject additional uncertainties into the process. It will certainly bring a sizable number of new members to Congress, "increasing," Destler observed, "at least at the margin, the uncertainty about how Congress will respond."

Environmental Concerns

While participants cautioned that the labor dislocations occasioned by a NAFTA would be both real, and in certain regions and sectors, significant, most discussants believed the environment would be the most contentious issue. Peter Emerson, a Senior Economist with the Environmental Defense Fund, noted that environmentalists tended to be both wary of the secrecy that surrounded these negotiations and fearful of an agreement that might reduce a national government's right to legislate in the environmental area. More specifically, they were concerned about the creation of a pollution haven in the border free trade area, and they doubted that Mexico had the technological resources to implement the necessary environmental standards.

Both Lawrence Summers, Vice President, Development Economics, and Chief Economist of the World Bank, and Dwight Lee, Professor of Economics at the University of Georgia, argued that the environmentalists were right to raise the issue but wrong to assume that free trade and a better environment were antagonistic rather than allied goals.

"It is with some trepidation that I return to the topic of the environment," Summers noted wryly. Raising environmental concerns in the context of a free trade agreement is both appropriate and likely to be constructive, he said, but "there is little doubt that the environment in the United States and Mexico will be better with a NAFTA than without one."

Environmentalists fear that increased growth will bring increased air and water pollution, but overwhelming evidence contradicts this link between growth and pollution, Summers said. "Economic growth past a minimum standard of living well below that of Mexico today is associated with improvements rather than reductions in environmental performance. The [World Bank's] *World Development Report* found a clear level of improvement after $1,000 in per capita income. Growth creates both the way and the will to improve the environment. A more prosperous Mexico will be more able and more willing to enforce its environmental regulations." More economic openness, he added, is also associated with production closer to state of the art technology, which tends to be cleaner.

A more legitimate concern, Summers felt, was effective regulation. "As we move to one world, as trade barriers come down, the pressure for some common regulatory environment becomes much stronger." He urged that common minimum standards be adopted and noted existing Mexican standards are close to U.S. standards.

The issue, Summers argued, is enforcing existing laws. "What better way to bind the enforcement of those laws," he asked, "than to have them treated as an international obligation with a clear commitment to a major party that is in a position to impose sanctions? A free trade agreement between the United States and Mexico combined with a Mexican commitment to enforce current environmental obligations would very strongly be in both countries' interests."

Lee underscored Summers' arguments by noting that free trade increases the efficiency with which resources are employed. "Does anyone seriously doubt that more competition in recent decades would have been good for the environment in Eastern Europe?" Wealthier is healthier, Lee concluded. "As countries become wealthier, they demand, and can afford, a healthier environment."

Summers: the environment in the United States and Mexico will be better with a NAFTA than without one.

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NAFTA and Jobs

By Ingrid A. Mohn
Office of Mexico
U.S. Department of Commerce

For over 50 years the United States has led the world in pursuit of the economic benefits that flow from freer trade. Each dollar earned by U.S. exporters has a powerful and beneficial impact on our citizens—especially in terms of job creation. The U.S. Department of Commerce estimates that each billion dollars of U.S. exports supports about 20,000 American jobs. The North American Free Trade Agreement establishes a history-making plan which will boost exports, and therefore help to make the U.S. economy and U.S. workers a competitive powerhouse in the 21st century.

Increasing U.S. Exports. The NAFTA will place the United States in the middle of a continental market of over 360 million consumers, with a combined annual output in excess of $6 trillion. Our NAFTA business partners—Canada and Mexico—are our first and third largest export markets, respectively. An agreement which will improve trade conditions in these huge markets is vital to overall U.S. prosperity, competitiveness, economic growth, and job creation.

Generating U.S. Jobs. U.S. exports to Canada and Mexico reached a record $118 billion in 1991, supporting over 2.1 million U.S. jobs.

According to the U.S. Trade Representative (USTR), U.S. jobs supported by exports to Mexico more than doubled in the past five years, to well over 600,000. To put that into perspective, that's about the same as the total number of jobs in the entire U.S. textile mill products industry.

Mexico is also our largest manufactured goods market, which means further removal of trade barriers in Mexico and means U.S. jobs dependent on exports will continue to grow—jobs in the production of machine tools and auto parts, textile fabrics, and medical equipment.

In fact, *manufactures exports supported 85 percent of the total U.S. jobs related to exports to Mexico.* About one-fifth of the manufacturing jobs supported by exports to Mexico are in high-technology industries.

Canada, our largest export market and trading partner, purchased $84 billion in U.S. merchandise exports in 1991, supporting some 1.7 million U.S. jobs. The removal of barriers under the provisions of the U.S.-Canada Free Trade Agreement (CFTA) resulted in increased U.S. exports of goods and services, even during recessionary periods in both countries. By improving and expanding on the CFTA, NAFTA will

further facilitate U.S. exports to our largest customer.

Higher Wages. Trade expansion under NAFTA not only means more jobs, but better paying jobs for American workers. A study of recent wage statistics reveals that export-related jobs pay 17 percent more than the average wage in the United States.

The policy implications are clear: exports are good for the United States and good for U.S. workers. Better paying jobs are created when foreign markets are open to exports of U.S. goods and services. International trade initiatives such as the NAFTA generate growth in exports and an increase in wages for American workers.

How Will the NAFTA Affect U.S. Jobs?

The overwhelming majority of economic studies have found that NAFTA will have a positive impact on U.S. employment. Studies by government (U.S. International Trade Commission), the private sector (KPMG Peat Marwick), and "think tanks" (Institute for International Economics—IIE, and the Brookings Institution), all conclude that a NAFTA will result in a net job increase in the United States, as well as Mexico and Canada.

The IIE, for example, found that with a NAFTA, one million workers in 1995 would owe their jobs to U.S. exports to Mexico. Some 175,000 of those would be net new jobs in higher paying sectors.

Nevertheless, there has been much speculation and fear about the potential for plant relocations and worker displacement after a NAFTA.

A key factor for the U.S. negotiators, therefore, was to ensure that nothing in the NAFTA would encourage U.S. plants to move, and that the transition to free trade would be sufficiently gradual that there would be no abrupt changes in employment as competitive market conditions change. The NAFTA features that have been negotiated ensure that the benefits of a NAFTA will far outweigh any costs.

Job turnover is a normal feature of any economy. According to the Bureau of Labor Statistics, a total of 115 million workers were employed in the United States in 1991, and 31 million of these had been with their current employer for only one year or less. Most of these 31 million are believed to be voluntary job-changers who took new jobs for better pay, working conditions, or location.

This annual mobility of the U.S. workforce dwarfs the number of low wage jobs that could be displaced over the NAFTA transition period of 15 years (the IIE study cites 150,000). Moreover, some of this adjustment will come through gradual changes in industries rather than abrupt job loss.

Most U.S. sectors have little to fear from Mexican imports, as most already enter duty-free, or are subject to very low duties. The average U.S. tariff on dutiable imports from Mexico is only 4 percent. There is much more to be gained in exports for U.S. workers and producers by dismantling Mexico's tariff and non-tariff barriers, which are 2.5 times higher than ours.

Rules of origin provide an incentive to use North American-made inputs. The rules of origin assure that the benefits of NAFTA accrue to the producers and workers of the three countries undertaking its obligations, and that neither Mexico nor Canada is used by non-member countries as an export platform to the United States.

The NAFTA does not encourage U.S. plants to move to Mexico. In fact it removes some Mexican requirements on U.S. plants that are already there to buy a certain percentage of Mexican components, or to export the majority of their products rather than selling them in the Mexican market. The NAFTA ensures that U.S. plants operating a subsidiary in Mexico enjoy a "level playing field" with Mexican companies and with other foreign companies located in our fastest growing market.

Mexican wages reflect Mexican productivity. Output per worker in the United States is five to six times that of Mexico. Since 1980, output per person employed in U.S. manufacturing has grown 2.5 times faster than in Mexico. For this reason, the United States is running a trade surplus.

Total production and marketing costs are key to plant location decisions, not wages alone. If wages were all that mattered in the manufacturing world, then the underdeveloped countries would be economic powerhouses. A productive and well-trained work force, developed infrastructure, a stable social and political environment, and easily accessible technology and capital are critical factors in the location decisions of companies. The United States provides all of these, which work to offset the advantage of low wages elsewhere.

Skilled labor is much more plentiful in the United States. Mexican technical schools and their graduates are too few to meet the demand. Reflecting the laws of supply and demand, studies by the University of Texas at El Paso show that Mexican engineers, technicians, supervisors, and managers in Ciudad Juarez earn salaries similar to or in excess of those of their American counterparts in El Paso. The idea that there is a large pool of skilled labor ready to accept low wages and, in the process, take skilled jobs away from Americans, is a myth.

Thus it is clear why virtually every single study of

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the potential impact of a NAFTA concludes that it is unrealistic to expect that a free trade agreement with Mexico will result in any sudden or dramatic movement of U.S. plants and jobs to Mexico. Moreover, the safeguards which have been built into NAFTA will assure an orderly transition to continental free trade.

What Effect Does Mexico's Maquiladora Industry Have on U.S. Employment?

Concerns have been raised regarding the effect of maquiladoras (offshore production in Mexico) on U.S. employment. Some argue that U.S. export statistics to Mexico—and related jobs figures—are exaggerated because they include some products which will ultimately be imported back into the United States.

It is simply not true that the United States just buys back from Mexico what we sell to it. Since 1986, U.S. export growth has outstripped import growth every year; over the entire period through 1992, exports to Mexico grew more than twice as fast as imports from Mexico. If bilateral trade consisted mainly of trading the same goods across the border, the growth rate of imports would be the same or exceed that of exports.

In terms of trade statistics, maquila trade represents a net import for the United States, since the raw materials and components we export to maquilas for processing are worth less than the finished product we import. Clearly, if maquiladora trade were not included in U.S. trade statistics, the U.S. trade surplus with Mexico would be even greater.

While it is true that some exports to maquilas return to the United States, these inputs nonetheless support U.S. jobs, just as any other U.S. output shipped directly to local U.S. markets or other countries.

What Adjustment Measures Does NAFTA Provide?

The President's Action Plan, released in May 1991, commits to a number of steps to minimize problems associated with changing economic conditions. Some of these steps have been taken in parallel processes to the negotiations. Others were more appropriately addressed directly in the NAFTA:

A long transition period for import sensitive sectors, during which tariffs and other barriers will be phased out in small increments, ensures orderly adjustment. Specifically U.S. negotiators obtained a special 15-year transition period for certain highly import-sensitive industries such as glassware and footwear, which extended beyond the ten-year time frame set for elimination of all remaining tariffs.

A safeguard mechanism allows us to respond effectively and quickly if there are injurious increases in imports as a result of tariff reductions agreed to in the NAFTA. This means that if an industry has serious trouble competing, even with the incremental phase-out of tariffs, then duties may be reimposed ("snapped back") temporarily to provide an interval for the industry to make changes necessary to adjust.

Exclusion of labor mobility from NAFTA precludes any free movement of labor across the borders. Because the NAFTA is a free trade agreement, and not a blueprint for a common market, it does not require any changes in U.S. immigration law. However, like the U.S.-Canada FTA, the NAFTA does contain provisions to facilitate temporary business travel allowing professionals to deliver cross-border services. This reduces the need for companies to move or set up operations outside of the United States to service the Mexican or Canadian markets.

How Can U.S. Industries Compete Against Mexican Goods?

It is generally not known that many U.S. industries considered to be highly sensitive to global competition are actually performing very well in the Mexican market. Their exports to Mexico are actually generating jobs.

Textiles and apparel, autos, and steel are frequently cited as being particularly vulnerable to Mexican competition. The following provides surprising information about the performance of these industries in today's highly protected Mexican market.

Textiles and Apparel. While many sectors in U.S. manufacturing and agriculture derive significant employment from merchandise exports to Mexico, they are led by jobs in the apparel and textile industries:

- Almost 40,000 U.S. jobs in textiles and apparel were supported by U.S. exports to Mexico in 1990.
- Jobs in these industries supported by exports to Mexico have multiplied eight-fold since 1983—from 5,000 to 40,000.
- Textile exports to Mexico have grown 230 percent over the past four years, exceeding $1 billion in 1991, and making Mexico our second largest textile market.

The NAFTA will phase out Mexico's high tariffs on textiles and apparel, which will improve export conditions for this U.S. industry even further.

Automotive Industry. Automotive trade is the largest component of U.S.-Mexico bilateral trade:

- Some 16,000 U.S. jobs were supported by exports of motor vehicle equipment and parts to Mexico in 1990—up from 3,000 in 1983.
- In 1991 automotive exports to Mexico were $5.7 billion, and imports $7.6 billion.
- Although industry imports from Mexico are higher than exports, *exports are growing more rapidly*—averaging 26 percent annually versus 18 percent for imports, in 1986-91.
- Mexican market liberalization in the auto parts sector has more than tripled U.S. parts exports—from $1.8 billion in 1986 to $5.4 billion in 1991.

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• For the first time since 1986, U.S. auto parts manufacturers had a trade surplus with Mexico in 1991. Exports surged from a $1.1 billion deficit in 1986 to a $5.3 million surplus in 1991.

• Automotive industry exports grew over the past several years despite Mexican trade barriers, such as high tariffs, strict limitations on auto imports, and local content requirements. The NAFTA removes these limits.

Mexico is projected to be the fastest growing market in the Western Hemisphere for automotive goods. Ending protection under the NAFTA of Mexico's automotive industry, and especially opening up the essentially one-way trade on vehicles, will create even greater export opportunities and jobs for U.S. firms.

Steel. The Mexican market is becoming more important to the U.S. steel industry:

• Some 7,000 U.S. jobs were supported in 1990 by exports to Mexico of primary iron and steel—more than double the number of jobs in 1983.

• Mexico was the second largest market for U.S. steel exports in the first half of 1992—Canada was the largest.

• U.S. steel exports to Mexico more than doubled over the past two years, reaching almost $800 million in 1991, while imports grew less than 5 percent, to about $235 million.

• High export growth took place in the face of a relatively high Mexican tariff of 8.2 percent versus a 4.7 percent U.S. tariff (trade-weighted averages).

With tariff reductions and improvements in government procurement opportunities, the U.S. steel industry should increase exports even more under the NAFTA.

Are Certain States With Import-Sensitive Industries at Particular Risk?

There is concern in some states, especially those dependent on "import-sensitive" industries, that more competition with Mexico will hurt their economies. In fact, 47 states have shown dramatic increases in their exports to Mexico over the 1987-91 period. The trade successes of some of these states may be surprising.

Pennsylvania, a traditional steel-producing state, has an impressive record:

• About 14,000 jobs in Pennsylvania are supported by exports to Mexico (1987-91).

• The leading Pennsylvania export to Mexico is primary metals—$154 million in 1991.

• Pennsylvania exports to Mexico grew 283 percent 1987-91—much higher than exports to the rest of the world, at 78 percent.

• The state ranked seventh in the nation in total dollar value of exports to Mexico, with almost $700 million in exports to Mexico in 1991.

• Mexico is Pennsylvania's third largest export market.

North Carolina, a large textile producer, is a very successful international trader:

• Exports from North Carolina to Mexico support about 6,500 jobs (1987-91).

• North Carolina's top three 1991 exports to Mexico are industrial machinery and computers at $78 million, chemicals at $53 million, and textile mill products at $38 million.

• North Carolina exports to Mexico grew 249 percent from 1987-91—much higher than its exports to the rest of the world, which grew 68 percent.

• The state is thirteenth in the nation by value of exports to Mexico—$331 million in 1991.

• Mexico's rank as a North Carolina export market moved from 15th to 7th over the past four years.

Michigan, dominated by the automotive industry, also is doing extremely well:

• Approximately 32,000 jobs in Michigan are supported by exports to Mexico (1987-91).

• Transportation equipment led Michigan's top exports to Mexico at $818 million.

• Michigan ranks third in the nation in the value of its exports to Mexico.

• Michigan exports to Mexico grew 51 percent—nearly double the growth rate of its exports to the rest of the world.

• Mexico is Michigan's second largest export market—after Canada.

Most States Have Greatly Increased Exports to Mexico. Virtually every state benefited from the rapid growth in U.S. exports to Mexico from 1987 to 1991, even with high Mexican tariffs. Every region of the country posted large increases in exports to Mexico over the same period. Thirty-one states doubled their exports, while 15 states tripled exports in those four years.

Growth in our trade with Mexico is not solely concentrated along the border. The industrial midwest states increased exports almost 90 percent over the past four years. In fact, the top ten states registering the greatest percentage growth in shipments to the Mexican market over the past four years were non-border states.

Further export growth boosted by NAFTA market openings will mean dollars and jobs for Pennsylvania, North Carolina, Michigan, and all the rest of the United States of America.

What about Labor Issues Apart from Job Creation and Market Access?

The NAFTA has created an historic opportunity for

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the governments of the United States and Mexico to build on their shared commitment to promote and improve the interests of working men and women in their countries. One of the President's Action Plan commitments was to sign a bilateral Memorandum of Understanding (MOU) between the U.S. and Mexican Departments of Labor on worker issues. The other was to ensure an effective, adequately funded adjustment program in case workers lose their jobs as a result of the NAFTA.

U.S.-Mexico Labor Memorandum of Understanding. The MOU was signed on May 3, 1991, calling for closer cooperation and joint action on a wide range of significant labor issues, including occupational safety and health, child labor, and labor statistics.

In addition, Mexican and U.S. officials have addressed additional concerns involving improvements in labor law and worker rights, as well as the problem of the so-called "informal sector."

A principal initial activity has been the development of comparative studies in safety and health, child labor, and labor law and worker rights as a necessary prerequisite to the identification of priorities for attention and improvement. Concrete activities are already under way in important areas such as safety and health.

Building on this effort, on Sept. 14, 1992, the United States and Mexico signed a bilateral agreement establishing a Consultative Commission on Labor Matters under the auspices of the 1991 MOU and the U.S.-Mexico Binational Commission. The Commission, cochaired by the U.S. and Mexican Secretaries of Labor, serves two purposes: to provide a forum for consultation on labor issues of interest or concern, and to manage and oversee new and ongoing cooperative labor activities. The Commission will meet at least once a year, but more frequent or emergency meetings may be held, as necessary.

In addition to the Consultative Commission, the United States and Mexican Secretaries of Labor agreed to two new fronts of bilateral cooperation focused on improving industrial hygiene and workplace safety.

Worker Adjustment Assistance. Although virtually all economic studies indicate that NAFTA will result in a net job gain, the President has nonetheless committed to funding a program for possible dislocations from low skill to high pay jobs resulting from trade liberalization under the NAFTA.

On Aug. 24, 1992, a new comprehensive worker adjustment program called Advanced Skills Through Education and Training (ASETS) was proposed. This proposal calls for funding at three times the level of current worker adjustment programs, which the new program would replace.

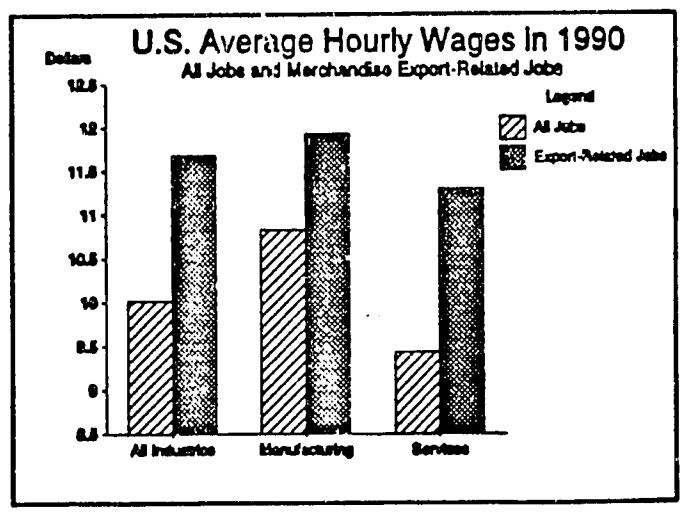
The President's ASETS proposal provides a general framework which will be expanded pending further discussions with Congress and others. A final proposal will be submitted in time to be considered concurrently with the NAFTA implementing legislation.

ASETS is designed to bring all programs under one umbrella and streamline job training services in every community. Its key elements include:

- Universal coverage, including workers whose jobs may be at risk, as well as those who have lost their jobs, which will help to avoid lay-offs and to ensure effective transition;
- Rapid response services and access to a wide range of support services and labor market information, which will ensure that intervention starts early, when it is most effective;
- Skill grants for retraining, which means that workers will be able to choose the most appropriate training programs and providers; and
- Income support payments, which will provide workers in training who have exhausted their unemployment insurance benefits with the financial assistance necessary to complete training. ASETS would be funded at $10 billion over the next five years, with $2 billion appropriated annually.
- Two-thirds of the total annual funding ($1.3 billion) would be allocated to the states, more than tripling resources available through current programs.
- One-third of the total annual funding ($670 million) would be retained by the Secretary of Labor for discretionary allocation for uses of national priority.
- At least $335 million and as much as $670 million per year would be available specifically for NAFTA-related dislocations.

Conclusion

Economic integration in North America has led to cooperation across the full range of labor issues. The future picture for the American worker under the NAFTA is one of increased competitiveness, more U.S. exports, and therefore more, and better-paying, jobs. The United States will continue to further open foreign markets in order to expand U.S. exports and keep Americans at work and prosperous.



Selling the Free-Trade Agreement

By RUDI DORNBUSCH & SANDRA MASUR

Selling free trade is always tough. In bad economic times it is even tougher. That it should be done with a low-wage country defies belief. That's the situation the United States faces with the North American free-trade agreement.

Unemployment in U.S. manufacturing has increased sharply, and it was rising even before the recession. Real wages have declined for a decade, and the notion that trade is good for you is about as appealing to the American people as eating brussel sprouts. Should the United States then, reject the free-trade agreement? Absolutely not. The case for it is too strong.

The trade pact improves U.S. living standards four ways:

• Firms obtain access to a wider market. Mexico is still highly protected, but it is already clear from the limited opening of the past few years that the demand for U.S. goods is very strong. Today, Mexico is already the United States' third largest trading partner and may this year surpass Japan as the second largest export market for U.S. manufactured goods. Beyond trade in merchandise, opening trade in services is a milestone achievement. Couple that with access to Canada, America's largest trading partner, and the gains are very real.

• Companies competing in world trade can rationalize production throughout North America without regard to barriers. Production can be placed where it makes the most sense (wage differentials are only one of many factors to consider) to create greater efficiencies.

• A large North American market without internal trade barriers will attract foreign producers. North America's import dependence is bound to come down, and that will boost jobs and wages.

• Consumers obtain access to lower-priced goods and have a wider range of choice. Everybody is a consumer, so everybody benefits.

None of this comes free. There are adjustments to be made, especially in industries like garments, glass and in some farm sectors.

There are fears that automobiles, too, might wander off to Mexico, but those fears are unfounded. Without the free-trade agreement, Mexican import restraints would continue to hold off an avalanche of U.S. cars; with the agreement, U.S. automakers can export freely from the United States to Mexico. That means jobs stay home. Remember that in Europe, Spain has not driven Germany into unemployment, nor will Mexico ruin Canada and the United States. Mexico will not steal jobs, good or bad. The United States is already wide open to Mexican products; nothing prevents U.S. companies from moving there now.

Buttressing these economic arguments is Mexico's commitment to modernization, privatization and reform. More has happened in the past two years under the pressure of the free-trade talks than in the preceding 100. With a 2,000-mile shared border, the United States has a national interest in Mexico's prosperity. The trade agreement locks in the reforms, keeps Mexico growing and puts it on a path to democracy.

A good free-trade agreement must meet five standards. With only a few exceptions, the North American treaty hits all the marks.

First, the agreement must ultimately lead to unrestricted trade for all goods, services and investment. Anything short of that endorses unwarranted protectionism. The trade pact substantially accomplishes this. Unfortunately, it falls short in two areas: Mexico's historic concern with its oil and Canada's preservation of the cultural exemption. But these are the only two exceptions, and the United States will keep pushing for further liberalization and to ensure these exceptions do not apply to future agreements.

Second, adequate transition arrangements to freer trade are essential. Again, the agreement is on target. It provides generous transition periods, in some cases as long as 15 years for sensitive sectors.

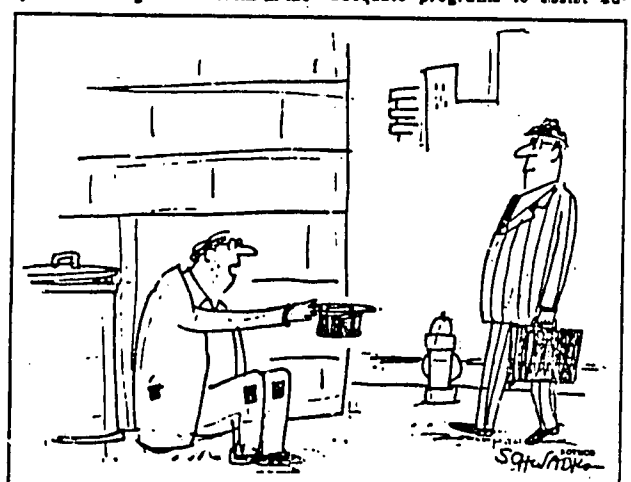
Third, a program of worker retraining and adjustment assistance is essential. In a soft labor market, adequate programs to assist adversely affected workers is a fair and necessary counterpart to the benefits accruing to the winners. President Bush has come forward with a plan. The issue is funding and that's where the fight will be, not whether the United States should have such programs.

Fourth, the agreement must be open so that Latin American countries like Brazil and Chile can join in the not-too-distant future. The agreement has an accession clause to make this possible. Europe is creating a broad economic zone, and the North American economies should not close their eyes to greater regional trade. In fact, that is the most plausible strategy to make headway in the world trade talks.

Fifth, all three countries must recognize that social dumping and environmental degradation are shortsighted. Again, the free-trade pact is a winner; it is the "greenest" trade agreement ever negotiated. Environmentalists, instead of carping, should declare a major victory. They have forced major changes in Mexico and ensured that never again will the environment be absent from the trade debate.

The North American free-trade agreement will have a rough time. Unions are dead set against it. Rep. Richard Gephardt wants to renegotiate, which is another way of saying "kill it." The key is Bill Clinton. Although an internationalist and, in principle, supportive of an open trading system, he has not yet endorsed the agreement.

The Bush administration's mistake was to let negotiations drag on and get caught in the election crossfire. Even so, a year from now we will have a North American free-trade agreement. The case is too compelling. Bill Clinton won't deep-six it and Congress won't take responsibility for voting it down.



"Please, sir! I just need enough for some Grey Poupon to go with my government surplus cheese."

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INTERNATIONAL
Economic
Insights
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The US-Asian Pillar: A New Initiative

by Robert Z. Lawrence

The United States, in its concentration on the North American Free Trade Agreement (NAFTA) and Western Hemisphere growth has ignored Asia. The author proposes a new initiative of negotiating approaches to correct this policy error. The aim would be closer trading links between a Japan-centered Asia and the United States in a form of deeper global economic integration.

The successful conclusion of the NAFTA negotiations and the problems in achieving a GATT agreement have reinforced the view that the world economy is in the process of disintegrating into three separate regional blocks: Europe, the Western Hemisphere and Asia-centered on Japan. The problem with this scenario, however, is that it would not serve the interests of the major global players—particularly the United States. An alternative direction would be toward two, partly overlapping arrangements; one centered on Europe and another on the United States that could sustain postwar progress toward increasing global integration.

The United States is, after all, a global trader, and the Western Hemisphere accounts for only one-third of its trade. Why would the United States follow a policy in which it gained access to Latin America while leaving Asia—the world's most dynamic region—to Japan?

The Bush Administration, preoccupied with the GATT and the NAFTA, increased the danger of this outcome by not giving Asia the attention it deserves. Its policies toward Asia have been inconsistent and hypocritical. On the one hand the United States negotiated the NAFTA and announced the regionally exclusive Enterprise for the America's Initiative. On the other, it opposed the proposals of President Mahatir of Malaysia for an Asian arrangement which would exclude the United States. The United States managed temporarily to keep Asian nations at bay by tepidly participating in the consultative Asian Pacific Economic Cooperation (APEC) group, but it is unlikely that APEC, in its current form, will satisfy either the United States or its Asian partners.

US policy is now at a crossroads. There is a growing recognition that as economies become increasing interdependent, it is necessary to move beyond simply removing border barriers, towards a deeper form of integration which deals with policies and practices which were once considered to be matters of purely domestic concern. The issues in the Uruguay Round (particularly about intellectual property rights and agricultural subsidies), EC92, the Structural Impediments Initiative (SII) between the United States and Japan, all reflect this growing awareness.

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But how should deeper integration be achieved? One approach for the United States would be to forego additional free trade agreements and return to the traditional approach of relying exclusively on multilateral initiatives at the GATT. But the GATT's membership is too diverse and its governance system too weak to provide a credible setting for agreements which aim at deep integration.

A second approach is to rely exclusively on bilateral and plurilateral initiatives. While this might achieve progress on a decentralized basic, it would lack the glue required to keep the system together by ensuring that such arrangements did not exclude outsiders. The most sensible strategy, therefore, is to use multilateral and plurilateral approaches in a complementary fashion. Willing participants would proceed with integration initiatives which moved beyond the GATT but at the same time the GATT's ability to police sub-global arrangements would be strengthened. The goal would be to increase the likelihood that these arrangements could eventually serve as the building blocks of a more integrated global economy.

As part of this third approach (as the Administration belatedly recognized in its recent campaign speeches) the United States should move beyond the geographical confines of the NAFTA. The United States should now invite all willing partners, regardless of their geographic location, to enter into arrangements which would integrate the markets for goods, services and investment. The aim would be to establish an open network of nations with arrangements which move beyond the GATT. Just as happened with Mexico—and is now taking place with Latin American nations—willing countries (or groups of countries) should be invited to conclude preparatory framework agreements which would lay out the goals and procedures for such arrangements.

Thinking about this approach leads to a key question—would such an invitation be extended to Japan? There is considerable evidence that despite its low tariffs and official policies of free trade and investment, foreign entry into Japan remains extremely difficult. Indeed, Japan is distinguished by its low share of manufactured imports, low degree of intra-industry trade, low share of sales by foreign firms and the high level of markups on foreign products which serve as the functional equivalent of high tariffs. The problems experienced by foreign firms and products relate to the *invisible barriers* presented by private sector practices such as *keiretsu*, and public policies such as the weak enforcement of anti-trust policies. That is why an agreement with Japan which dealt only with the formal border barriers and aimed at achieving nondiscrimination and national treatment would not be attractive to Americans. It would not be acceptable to deal only with the formal use of trade barriers while neglecting the informal barriers.

To participate in such negotiations, Japan would have to agree to deal with anti-trust policies, intellectual property rights, high-technology policies, product standards and certification, corporate governance and stockholder rights. Moreover, before negotiating the details of specific policies, it would be useful to discuss the ultimate objectives of such an agreement. One of the problems of the SII talks—the Super Impatient Initiative—is that it jumped right into the details

of the policy without laying out a big-screen vision. By contrast, the EC92 program began with agreement on the goals of a single open market and then laid out the steps necessary to achieve it. A key component of the initial framework agreement would be commitments from the United States and Japan to work toward genuinely open markets.

In this context, a critical distinction is made between practices that are different and those that are exclusionary. It is not necessary to stamp out all differences between Japan and the United States. Nations can have different institutions and arrangements and still achieve openness. Indeed differences can be a major source of trade gains. The major problems result from differences which severely inhibit foreign access. This is clear from the current discussion over EC subsidiarity which is attempting to resolve such fundamental questions as: what can be dealt with at the national level, what can be dealt with by mechanisms such as mutual recognition of national approaches which allow regulatory competition, and what requires harmonization, common standards or international regulation.

Even as it negotiated with Japan, the United States would continue to play a GATT leadership role and to simultaneously explore deeper integration with other nations in Asia and elsewhere. The preliminary discussions might be carried out separately—but ideally, several nations would simultaneously negotiate the core of this arrangement. Moreover, there would be an understanding that accession would subsequently be extended to others on a conditional basis. As more nations joined, others would feel increasing pressure to follow. Thus the formation of a US-centered network which included the most important Asian countries, could provide an important stimulus for progress in US–Japan relations.

Why would the United States leave Asia, the world's most dynamic region, to Japan?

There are some who argue that regional or other sub-global arrangements are bound to become protectionist and exclusive. After all, why should those inside the arrangement wish to see their preferences eroded? This overlooks the fact that those on the periphery of the agreement are drawn towards joining and those on the inside, with whom they have important relationships, inevitably seek their inclusion. It is also true that as integration deepens, those outside feel pressure to conform. For example, when there are twelve standards in Europe, those outside feel free to be different. But when there is just one standard, the pressures to conform (and participate in making the standard) grow. As the European experience has shown, deepening thus leads to broadening.

The aim would be to establish an open network of nations with arrangements that move beyond GATT.

The European arrangement which began with six countries and today has twelve will soon be expanding to include most EFTA countries. In addition, others from Eastern Europe and beyond are clamoring to join. Likewise, now that the NAFTA is concluded, the US-centered arrangement finds increasing numbers of applicants waiting in line. Indeed, if the response to this new proposed initiative was strong enough, with many countries indicating serious interest, the negotiations could serve as the core of a conditional arrangement for global integration which could become part of the GATT. ■

Dr. Lawrence is Albert L. Williams professor of international trade and investment of Harvard University.

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CLINTON • GORE ON TRADE

To win in global markets, America needs an economic growth plan that provides every person and every firm with the means to be more productive. We need a trade policy that puts people first by investing in ourselves. Bill Clinton and Al Gore's National Economic Strategy invests in the ongoing education of the American people, in the productive equipment that gives our workers the tools to compete, and in the economic infrastructure that binds our markets and our businesses together. It also recognizes that America needs companies that invest in the future, profit from change, and treat their workers as full partners.

When our workers and firms do their part to be competitive, we must have an Administration that does its part to ensure that we have open markets for their goods and services. We need a new trade and competitiveness program. A Clinton/Gore Administration will stand up for American workers by standing up to countries that don't play by the rules of free and fair trade. Given a chance, American farmers, workers and businesses can out-compete anybody.

THE CLINTON/GORE PLAN

We must organize to compete and win in the global economy. We need a national strategy that will reward work, expand opportunity and put people first: with more public and private investment; the world's best educated workforce; and competitive strategies in health care, energy and trade.

Promote world growth

To promote world growth policies in the post-Cold War era, we must be economically strong at home. President Bush's weak economic record has deprived him of the authority he needs to insist that Japan adopt expansionary policies to reduce its $100 billion trade surplus, and to ensure that Germany's high interest rates do not cripple growth throughout Europe. A Clinton/Gore Administration will hold all advanced countries accountable for doing their part to promote world trade, end unfair trade practices and open markets.

Support a strong "Super 301"

This is the provision of U.S. trade law that has helped pry open foreign markets. Our competitors must know that we won't stand for unfair trade practices that prevent our farmers, workers and businesses from selling products abroad and creating jobs at home. We have had plenty of empty promises on trade; what we need now are results.

North American Free Trade Agreement

Bill Clinton will support a free trade treaty with Mexico, but only if it has adequate protection for workers, health and the environment on both sides of the border. A Clinton/Gore Administration will support a free trade policy that puts people first. We must have strong transition strategies that ensure that workers benefit from a more open world trading system.

Paid for by the Clinton/Gore 92 Committee

General Agreements on Tariffs and Trade (GATT)
America needs leadership to break the logjam and get the Uruguay Round finished. President Bush's ill-fated trip to Japan and his poor performance at the G-7 summit demonstrate that our trade policies suffer from a lack of Presidential leadership. Bill Clinton and Al Gore will ensure that the Uruguay Round opens markets for agriculture, services and in particular manufacturing; protects our intellectual property; and takes a tough stand against unfair trade practices. The United States needs to continue to promote free trade that aims to raise -- not lower -- standards for health, safety, and the environment. No trade agreement should preclude the United States from enforcing non-discriminatory laws and regulations affecting health, worker safety and the environment. Bill Clinton and Al Gore will not allow the Uruguay round to alter U.S. laws and regulations through the back door.

Economic Security Council
A Clinton/Gore Administration will create an Economic Security Council, similar to the National Security Council, to coordinate American international economic policy.

MFN with China
The Bush Administration erred by extending Most Favored Nation trade status to the People's Republic of China before it achieved documented progress on human rights. We should not reward China with improved trade status when it has continued to trade goods made by prison labor and has failed to make sufficient progress on human rights since the Tiannamen Square massacre.

Reform the Office of the U.S. Trade Representative

Bill Clinton will issue an executive order banning trade negotiators from cashing in on their positions by serving as representatives of foreign corporations or governments. He will rededicate the Office of the Trade Representative to serving the country -- not selling out for lucrative lobbying paychecks from foreign competitors.

Create a civilian DARPA

Bill Clinton and Al Gore will create a civilian advanced technology agency modelled on the Defense Advanced Research Projects Agency (DARPA). America can no longer afford to get the Nobel Prizes while our competitors get the profits. A civilian technology agency will bring businesses and universities together to develop cutting-edge products and technologies, to move our ideas into the marketplace where they can create jobs for our people. The new agency will increase America's commercial R&D spending, and focus its efforts in crucial new technologies such as biotechnology, robotics, high speed computing, and environmental technology.

Incentives for manufacturing innovation

• Provide a targeted investment tax credit to encourage investment in the new plants and productive equipment that we need here at home to compete in the global economy.

• Make permanent the research and development tax credit to reward companies that invest in ground-breaking technologies.

• Help small businesses and entrepreneurs by offering a 50 percent tax exclusion to those who take risks by making long-term investments in new businesses.

Standing up for America's workers

• Require every employer to spend 1.5 percent of payroll for continued education and training, and make them provide the training to all workers, not just executives.

• Bring business, labor, and education leaders together to develop a national apprenticeship program that offers non-college bound students training in valuable skills.

• Provide all Americans with affordable, quality health care.

• Limit deductions for outrageous [illegible] pay. Companies will be allowed to deduct bonuses tied to profits for top executives only if other employees also receive bonuses.

• Restore the link between pay and performance by encouraging companies to provide for employee ownership and profit sharing for all employees, not just executives.

• End tax breaks for American companies that shut down their plants here and ship American jobs overseas.

THE RECORD

• From 1979 to 1991, there was a 142 percent increase in the number of Arkansas companies exporting products. Nearly 75 percent of those companies had less than 200 employees.

• Bill Clinton made numerous trade missions to Europe and Asia to negotiate expanded markets for Arkansas products.

• Senator Gore has insisted that other governments dismantle barriers which unfairly block access to their markets.

• Gore does not believe the long-term solution to our country's competitiveness problem is a blanket policy of protectionism. Senator Gore has fought to invest in the research and development of new technologies, to rebuild our crumbling infrastructure, to better educate our children, and to retrain our workers.

• Senator Gore introduced and steered into law the High Performance Computing Act of 1990, to create a national high-speed computer network linking schools, research centers, and universities to the nation's most powerful computers, and making those computers accessible to people who otherwise would not be able to take advantage of their power and speed. It was the result of more than a dozen years of work by Gore.

• Gore joined a number of his Senate colleagues in June 1991 to introduce a comprehensive package of legislation to strengthen our manufacturing base. They will help us establish a federal manufacturing policy to develop and commercialize critical technologies and sharpen our ability to turn inventions into affordable, usable products.

• Gore supported the fast-track process for the negotiation of a U.S. Mexico Free Trade Agreement, but final approval of NAFTA is dependent on its protection of American workers and support of enforceable environmental standards.

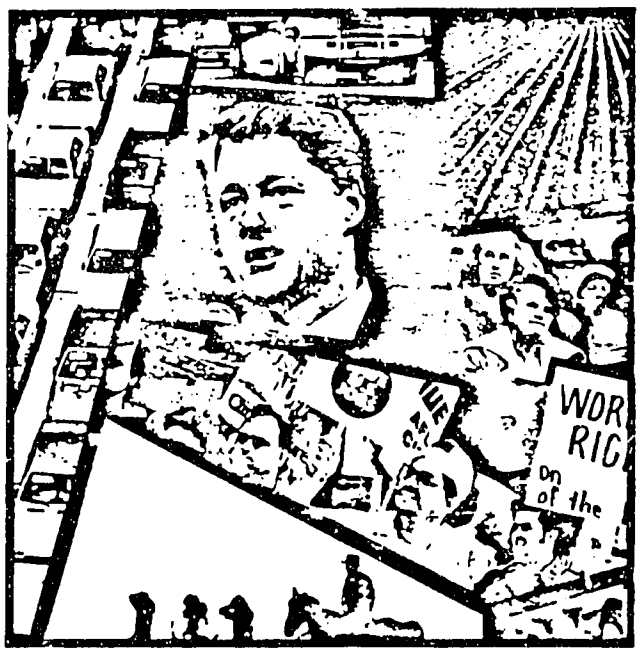
COVER STORY

Warning Bells on NAFTA Sound for Clinton

President-elect supported trade agreement in campaign, but labor, environmental groups want renegotiation

If the North American Free Trade Agreement (NAFTA) goes through Congress next year, newly elected Democrat Sherrod Brown wonders which of the six auto plants in and around his Ohio congressional district will be the first to close its doors and put hundreds of decently paid workers on the street. "The disaster, the catastrophe, brought on by NAFTA in this part of the country will be huge," Brown predicts.

Elected from a district heavily dependent on the auto and steel industries, Brown can find little solace in President-elect Bill Clinton's promise to create a government program for retraining workers whose jobs evaporate when the agreement to eliminate trade and investment barriers between the United States and Mexico becomes a reality.



PATI CHISHOLM

"We're training 55-year-old workers making $15 an hour for $7-an-hour jobs," he says. "That's not an answer."

NAFTA could be the most explosive economic issue Clinton will tackle in his first months in the White House. And as Brown's comments suggest, Clinton's toughest task may be answering the doubts among fellow Democrats, many of whom ran for election or re-election to Congress calling for drastic changes in the controversial trade agreement which, to their chagrin, Clinton endorsed in the last month of the presidential campaign.

Clinton's embrace of NAFTA was accompanied by a promise to go much further than President Bush in protecting U.S. jobs, worker rights, and the environment in side agreements. But on the central issue of whether the pact should be renegotiated, Clinton came down firmly opposed.

It may have been a smart move politically, but it transformed what was shaping up as a major headache for Bush's second term into a migraine for Clinton once he takes office. How Clinton handles NAFTA will be an important test of his ability to shift from campaigning to governing.

Someone Will Be Unhappy

If he accedes to congressional Democrats and those in organized labor who want to scrap the agreement, he will be breaking a campaign pledge. More important, he will risk damaging relations with Mexico.

Although Mexican President Carlos Salinas de Gortari says he is willing to listen to Clinton's concerns about jobs and the environment, he is opposed to reopening negotiations and would want concessions in return for doing so. It will also require some explaining to Canada, which is the third party to the agreement.

"It's easy to forget that it takes three to tango. He can't go back and unilaterally reopen the agreement," says Willard Workman, international vice president for the U.S. Chamber of Commerce. "Otherwise the whole thing comes unraveled."

But if Clinton does not reopen the negotiations, it may be difficult for him to mollify the anti-NAFTA bloc in Congress, which almost succeeded in killing the U.S.-Mexico talks in 1991. "Regardless of what [Clinton] does, we as Democratic members of Congress have got to stand up and fix this agreement," says Rep. Marcy Kaptur, D-Ohio. "It's impossible to meet that threshold without renegotiation." *(1991 Almanac, p. 118)*

Clinton may still decide to delay action on NAFTA next year, saving his political capital for the early legislative priorities he hopes will define his presidency.

But Bush could try to force Clinton's hand by formally signing NAFTA before he leaves office. Having notified Congress of his intention to enter into the agreement, he is allowed to sign it after Dec. 17. Administration officials say no decision has been made, although Bush has been reluctant to take any steps that would limit Clinton's options.

As long as the agreement is signed by May 31, it will be handled under special fast-track procedures; Clinton may then take as long as he wants to send the legislation implementing the trade agreement to Capitol Hill. Qualifying for the fast track is crucial, because the procedures bar amendments and generally expedite congressional consideration.

The fast track expires in June, and

By David S. Cloud

although Congress may vote to extend the procedures, Clinton could avoid a messy problem if he can keep NAFTA a separate fight.

Whatever course Clinton takes, as a Democrat he certainly will have stronger support in Congress than Bush did. But it will be important for him to maintain the allegiance of House Majority Leader Richard A. Gephardt, D-Mo., a leading opponent of NAFTA during the Bush administration who previously made no secret of his desire to see the agreement renegotiated.

Lately, however, Gephardt has been silent on the issue, indicating that he may be willing to act as a mediator between Clinton and the NAFTA opponents in Congress.

A key unknown is what effect the large freshman class entering the House in January will have on the debate. Interviews with numerous newly elected members suggest that opposition to NAFTA was a popular position on the stump, particularly in the Midwest.

"People are extremely nervous. They believe it will export jobs," said Republican Rep.-elect Peter Hoekstra, who supports NAFTA but wants changes to protect asparagus growers in his western Michigan district.

NAFTA is also proving unpopular in parts of California, a state that many economists predict could be helped by expanded trade with Mexico. California Democratic Rep.-elect Xavier Becerra opposes the agreement because, he says, the Bush administration paid little attention to non-trade issues in U.S.-Mexican relations, such as immigration and political reform.

Without provisions to improve the lot of Mexican workers, he says, the agreement invites U.S. companies to move south to take advantage of cheaper wage rates. "My chief concern is, of course, American workers," says Becerra. "But if we allow companies to leave because of Mexico's lower wage rates, not only have our own workers lost but Mexican workers don't get the benefit, either."

Campaign Tension

Clinton was able to finesse his position on NAFTA during the campaign. Before he captured the Democratic nomination, when he was seeking to distance himself from fellow Democrats on economic issues, Clinton endorsed the concept of free trade with Mexico. But after the draft text of the pact was completed in August, he delayed taking a position, saying he needed time to study the 2,000-page agreement.

For two months, Clinton was silent on NAFTA while Bush and his campaign aides accused him of waffling under pressure from organized labor, an important constituency for the Democratic nominee. At one point, Bush accused Clinton of suffering from "straddle sores."

Behind the scenes, urged on by organized labor, a group of House Democrats was lobbying Clinton to reject the agreement and commit himself to reopen negotiations once in office. In an Oct. 3 letter signed by 97 members, including Whip David E. Bonior, D-Mich., Chief Deputy Whip Barbara B. Kennelly, D-Conn., and Kaptur, the lawmakers cited controversial estimates that the United States might lose as many as 500,000 jobs to Mexico if the agreement goes through.

"We are writing to urge you not to endorse the NAFTA because of the adverse consequences for U.S. working people, consumers and family farmers, and the serious exploitation of low-wage workers in Mexico," the letter read. "We believe, Governor Clinton, that you could negotiate a much more equitable agreement."

But Clinton did not follow their advice. He endorsed NAFTA the next day in a speech at North Carolina State University.

On the Fast Track

Congress created special fast-track procedures for handling trade bills as part of the 1974 Trade Act. Under the law, now set to expire June 1, legislation to implement a trade agreement must get an up or down vote within 90 days after the president formally submits it to Congress. No amendments are allowed.

In the case of the U.S.-Canada Free-Trade Agreement, completed in 1988, key committees and the White House engaged in an informal "shadow markup" to resolve differences before the legislation was formally submitted. The process took less than a month; it was preceded by three months of hearings. *(1991 Weekly Report, p. 1259; 1988 Almanac, p. 222)*

Conceding that the agreement had "shortcomings," he added that whatever flaws existed could be rectified in side agreements with Mexico on the environment and worker rights and would not require renegotiation.

Clinton's speech was a hard blow for NAFTA opponents. But it was also carefully tailored to signal that Clinton understood their qualms and would deal with them, one way or another, once in the White House.

For example, he gave a nod to the Teamsters union, which is strongly opposed to NAFTA provisions that would lift restrictions on Mexican truckers operating in the United States. "I want to note that the agreement allows Mexican truckers to drive in the United States without having to satisfy all the U.S. safety and training standards," Clinton said. "That troubles me."

Among other pledges, Clinton said he would spend more than Bush promised on worker retraining and would establish a U.S.-Mexico commission empowered to enforce pollution laws on both sides of the border. Both proposals are favored by Gephardt and legions of other Democrats.

What NAFTA Critics Want

Putting on a brave face, opponents say Clinton's speech, though far from perfect, soothed their dismay somewhat. "We worked very hard to get him to change the rhetoric of that speech," says Kaptur. She added that, although she was disappointed that Clinton ultimately came down against renegotiation, "he did indicate a willingness to address issues that the Bush administration did not and to ensure that the agreement is fair to labor."

While most of the criticism has focused on the allegedly inadequate protections for worker rights and the environment, many opponents are at least as bothered by NAFTA provisions to lower tariffs or other barriers that would expose certain U.S. industries — as well as their workers — to stiffer competition from south of the border.

At the United Auto Workers (UAW), for example, officials cannot stomach a provision that would phase out the current 25 percent U.S. tariff on light-truck imports from Mexico over five years. "We're worried that it is an incentive to shift entire truck-production facilities down to Mexico," says Alan V. Reuther, a UAW lobbyist.

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Environmental Groups Look for Ways . . .

Stewart J. Hudson of the National Wildlife Federation does not say so directly, but there is no mistaking his message: He thinks opponents are using scare tactics to convince Congress that the North American Free Trade Agreement (NAFTA) is a bad deal for the environment.

Hudson believes just the opposite. Like the Bush administration, which negotiated the agreement, he thinks the pact linking the United States, Mexico and Canada into a single trading bloc is without a doubt the "greenest trade agreement ever negotiated." His organization is the first — and so far the only — major environmental group to endorse NAFTA. Hudson says the pact is not perfect and could be improved, but "that's outpatient stuff. Major surgery is not required."

R. MICHAEL JENKINS

National Resources Defense Council attorney Justin Ward

That is not the view of many other environmental groups and self-styled consumer advocates who argue that while NAFTA contains some important improvements over previous trade agreements, it still threatens to make pollution along the U.S.-Mexico border worse, to induce U.S. companies to head south to take advantage of lax environmental enforcement and to open up to challenge U.S. laws designed to protect food safety and the environment.

"The agreement unfortunately contains no specific provisions to ensure better enforcement of environmental laws throughout North America," said Justin Ward, an attorney with the Natural Resources Defense Council (NRDC) in recent testimony before the Senate Finance Committee. "Congress should not accept, as an article of faith, that liberalized trade and investment will automatically produce positive environmental results."

The debate over how green NAFTA really is will have important consequences once Bill Clinton takes office and sends the pact to Capitol Hill for approval. During the campaign, Clinton criticized the agreement and President Bush's view that strengthening Mexico's economy is the best thing the United States can do to improve environmental compliance below the border. But Clinton came out against renegotiating the text, saying environmental protections should instead be bolstered through side agreements with Mexico.

Clinton said he would put Vice President Al Gore in charge of negotiations to create a joint U.S.-Mexico environmental protection commission. The body would be charged with cleaning up border pollution and enforcing environmental laws in both countries, but particularly in Mexico, which has impressive environmental statutes on paper but minimal enforcement.

"If we don't have the power to enforce the laws that are on the books, what good is the agreement?" Clinton asked in a speech on NAFTA last month.

Improving enforcement is the key to improving NAFTA, critics agree. But how should it be done?

With a president taking office who is more sympathetic to their agenda, environmental groups are being careful to stress their points of agreement with Clinton rather than their differences. In particular, most critics applaud Clinton's proposal for a border commission with substantial enforcement powers. But deep differences remain and, ultimately, Clinton may have difficulty satisfying environmental critics who want wholesale changes to the text.

Lori Wallach, an attorney for Public Citizen, a public policy lobbying organization founded by Ralph Nader, said she was disappointed by Clinton's unwillingness to support renegotiation of NAFTA's environmental sections. But she remains hopeful that the Clinton administration can be persuaded to adopt some of the group's proposals, even if it is through side agreements with Mexico. "That's sort of renegotiation," she says.

Some environmental groups believe that a provision should be inserted into the text that would define a country's failure to enforce its own environmental laws as an unfair trade practice. As part of the agreement, all three

What does the UAW want Clinton to do? Like many labor unions that are members of the AFL-CIO, officials say they are withholding judgment about Clinton's position on NAFTA. Ideally, they would like him to withdraw the agreement and negotiate a new pact with more protections for U.S jobs, such as a minimum wage covering all of North America to deter companies from moving to Mexico to take advantage of cheaper labor.

At the very least, the UAW wants Clinton to fix the light-truck tariff provision — either by lengthening the phase-in period or keeping the tariff at the existing level — and, in addition, to eliminate several other provisions they claim will hurt U.S. autoworkers. And union officials are not picky about Clinton's method.

"Whether you're talking about supplemental agreements or changing the basic agreement, I don't think we're going to get hung up on how it's done," says Reuther.

The UAW is not alone in having problems with specific tariff provisions. NAFTA would subject a wide array of industries to stiffer competition from Mexico, some right away, others after a few years. They include truckers, glass manufacturers, electronics workers, fruit and vegetable growers, sugar planters and textile manufacturers. Most are backed by sympathetic members of Congress who claim that they will vote against NAFTA unless their particular fix is made.

"If Clinton looks at this," says a top labor union official, "he's going to

... To Ensure a 'Green' Trade Agreement

countries pledged not to lower their environmental standards to attract investment. But NAFTA contains no mechanism for enforcing that pledge.

Making non-compliance an unfair trade practice would allow the United States to impose duties on products exported by companies in Mexico that pollute the environment. "If polluters do not pay for their pollution, the NAFTA will simply create a large distorted market," said a critique of NAFTA released last month by 11 environmental and consumer groups, including the Sierra Club, Public Citizen, Friends of the Earth, and Defenders of Wildlife.

The incoming Clinton administration seems unlikely to adopt such a powerful and unprecedented enforcement mechanism, if only because it could be used against the United States. Such a move also would face enormous opposition, not only from businesses but from Mexico and Canada, which might view the idea as an attack on their sovereignty. But it indicates how far critics of the agreement want to go to improve environmental protections.

R. MICHAEL JENKINS

National Wildlife Federation lobbyist Stewart Hudson

Other environmentalists, such as Hudson of the National Wildlife Federation, believe the proposal goes too far. "Before we start crafting two-by-fours we ought to know how they are going to work," he says.

Public Citizen and most environmental groups also are calling for the new administration to rework NAFTA's section on health and safety standards. The agreement obligates the three countries to work toward common standards to protect the food supply and the environment.

The idea behind such harmonization is to prevent one country from adopting phony standards — such as banning a commonly used pesticide without proof that it poses health risks — in order to impede imports from another country. But harmonization is sort of a dirty word to environmentalists. They argue that it is code used by trade negotiators who want to weaken health and safety laws by adopting international agreements that define any standard that is tougher than those accepted by the General Agreement on Tariffs and Trade (GATT) as a trade barrier.

The danger, they claim, is that such agreements open avenues for foreign governments and businesses to challenge U.S. environmental laws, as occurred in 1991 when a GATT panel declared that a U.S law prohibiting imports of tuna caught using methods that kill dolphin was an illegal trade barrier.

To prevent standards from being weakened to the lowest common denominator, NAFTA pledges that the three countries will "work jointly to enhance the level of safety and protection of human, animal and plant life and health, the environment and consumers."

But critics contend that such language, while laudatory, is not binding and might well be undermined by provisions elsewhere in the agreement. According to a Public Citizen analysis, the agreement is riddled with loopholes and ambiguities that would "expose numerous existing U.S. federal, state and local environmental and consumer laws to challenge." Adds the NRDC's Ward, "We were told that there was no danger that the U.S. will have its laws challenged successfully, but the fine print continues to leave some questions."

Under NAFTA, Mexico or Canada could try to overturn certain U.S. health or safety laws that were more protective than widely accepted international standards by arguing that the laws discriminate against their imports. The U.S. law would have to meet a series of tests specified under the agreement or it could be declared an illegal trade barrier. In its report, Public Citizen cited the Delaney Clause, a U.S. law that prohibits pesticide residue on processed foods, as an example of a statute that would be more likely to be overturned if NAFTA goes through.

Hudson disagrees, arguing that NAFTA is a vast improvement over other trade agreements. "I think these fears are illusory. The agreement substantially reduces, if not eliminates, any possibility that U.S. standards could ever be successfully challenged under the agreement," he says.

—David S. Cloud

find that there are a lot of constituents out there that, in the white heat of getting an agreement, did not have their concerns addressed." AFL-CIO officials are hoping that Clinton will put the agreement on the back burner.

Soon after Clinton takes office, many trade experts are expecting him to take steps to shore up congressional support for the treaty — following through on his promise to negotiate side agreements with Mexico that would toughen protections for the environment and worker rights. Clinton also has promised legislation to expand federal retraining programs for workers who lose their jobs because of NAFTA. That could get wrapped into a larger jobs bill that Clinton wants.

If Clinton is not going to renegotiate NAFTA, what opponents want most is a shot at amending the implementing legislation. That bill, which will bring U.S. law into conformity with the terms of the trade agreement, will be put together in private drafting sessions by administration officials and congressional leaders. There is an opportunity to make narrow changes, which may need the other countries' approval, before the bill is formally introduced and becomes unamendable.

But a few isolated amendments are not going to satisfy hard-core opponents such as Sherrod Brown who consider NAFTA irredeemably flawed. It is too early to say whether he will have enough allies to derail NAFTA, but he is coming to Washington to try. And with a Democrat in the White House, he thinks his concerns will get a more sympathetic hearing. ■

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A Clinton Perspective on Trade

By ALAN WM. WOLFF

The 1992 campaign is not a choice between "free trade" and "protectionism." Although the Bush campaign would like you to believe this, nothing could be further from the truth. In a speech at Georgetown University, Bill Clinton stated "The American people aren't protectionists. Protectionism is just a fancy word for giving up, we want to compete and win."

As president, Bill Clinton would continue the long Democratic tradition of support for open trade. He has called for a successful conclusion of the current multilateral trade talks and endorsed the North American free-trade agreement – while addressing environmental and worker concerns.

If this election is not about a false choice between free trade and protectionism, it is about enhancing the competitiveness of American industry. The key question is which candidate has the energy and the ideas to help revitalize the American economy and ensure a higher standard of living. Gov. Clinton is willing and able to tackle this challenge by finding ways in which government can be a positive contributor, not a disinterested observer.

Many CEOs from America's high-tech companies share this view. In endorsing Gov. Clinton, John Sculley, of Apple Computer, said "I'm tired of sitting on the sidelines and watching America lose its competitiveness . . . We have got to get back to strategic advantage. And I think we can do that if there's clearer vision at the presidential level."

Gov. Clinton recognizes that America's competitiveness rests on the vitality of the private sector. U.S. firms must expand employee involvement, improve the quality of their products and forge better relationships with their customers and suppliers. But government can play a constructive role by creating an environment in which American workers and companies can compete and win. Alongside worker training, tax incentives for investment and technology, investment in the nation's infrastructure and initiatives to accelerate the commercialization of new products, there must be a fresh look at trade policy.

The Cold War is over. The hierarchy between the "high politics" of foreign policy and diplomatic concerns, and the "low politics" of U.S. economic commercial interests, is no longer appropriate. It is not enough to operate under a simple philosophy that open markets are good or to switch to protectionist solutions for troubled industries. I would suggest six ways in which a Clinton administration would make substantial improvements in trade.

First, we must end the confusion about the goal of America's trade policy. Its central purpose is to serve the national economic interest by enhancing the competitiveness of American industry and services. Too often, we do not test our negotiations by whether our producers are better off. To give you a recent example, the United States just gave KLM Royal Dutch Airlines the right to land anywhere in the United States. Our negotiators received in return the right for our airlines to land at any airport throughout *all* of Holland. This approach does not serve America's long-term interests.

Second, U.S. trade policy must be pro-active. If foreign governments are distorting markets to promote their industries, either through protection or subsidies, Washington must act decisively and act early. We must either convince foreign governments to change their behavior or we must take actions that will offset the foreign industrial targeting. The United States cannot afford another Airbus — the European government-backed civilian aircraft consortium that has received $23 billion in subsidies and put thousands of American jobs in the aerospace sector at risk.

Third, the United States must insist on results from its trade negotiations. There have been more than 20 agreements with Japan over the last 12 years that should have had a positive effect on U.S. electronics trade with Japan. However, the trade deficit grew from $3.6 billion to $19 billion. If this were not due substantially to market barriers in Japan, there would not be the same need for trade policy concern. Negotiations cannot be primarily over abstractions such as "openness." The bottom line must be whether trade agreements are helping U.S. companies export goods and services at a level consistent with their competitiveness. Bill Clinton has pledged that he will insist on results from our trade agreements, and that countries that fail to comply will face sanctions.

"Agnes, is that really a Russian harp seal fur you bought? What about our trade deficit?"

Fourth, we must improve our understanding of the nature of international competition. We face formidable, seasoned trade negotiators across the bargaining table. They very often know more about their industries and ours than we know about either — they talk with their industries and understand their problems. We need to increase the training for government service, give negotiators and government analysts greater access to advice from those in the private sector, and end the adversarial relationship between government and business.

Fifth, we must reorganize for a more effective, efficient government in the post-Cold War era. Gov. Clinton has said he will establish an Economic Security Council, with a small, highly skilled staff like that of the National Security Council, to assure that issues affecting America's trade position and its competitiveness are regularly considered at the highest levels of government.

Sixth, we must reduce our reliance on trade protection as a solution to our competitiveness problems. Gov. Clinton has proposed a detailed technology policy, which calls for shifting resources toward civilian R&D, diffusing research results to our small and medium-sized manufacturing firms, eliminating red tape that prevents the U.S. government from getting detailed advice from the private sector and broadening the mission of our national labs. This increased attention to competitiveness will lead to less restrictive trade policy outcomes because there will be alternatives to trade measures as solutions.

Few in business would say America's past trade policies will be adequate to serve our interests in the future. This is by no means solely a criticism of the last two Republican administrations. But times have changed, and with them the need for a change of strategy. Trade policy is only one aspect of what's needed, but it is among the most important.

Alan Wm. Wolff, a lawyer in Washington, is a supporter of Gov. Clinton.

JOURNAL OF COMMERCE, November 12, 1992

Memo to Bill Clinton on Trade

By JOHN MAGGS

TRADE SCENE

To BC
From Transition (Intl. Issues)
Re Trade, et al.

The Team has been discussing two policy areas that will be closely connected in your administration: trade and competitiveness. We feel that even before you decide what your goals will be, and who will carry them out, you must lay down some principles showing how trade and competitiveness will interact. We make the following recommendations:

1. Balance the interests of "national security" and "economic security," instead of subordinating one to the other. The voters responded when you promised not to sacrifice American jobs for lofty foreign policy goals, but recognize that the reverse can sometimes be a mistake.

The truth is there have been as many cases of narrow domestic economic pressures inhibiting foreign policy in the Bush years as there have been sellouts of American interests. Why is the United States now limiting uranium shipments from Kazakhstan, where the mineral is one-fifth of that republic's exports? Why are there new quotas on apparel from Bulgaria? The United States certainly has an overwhelming interest in promoting trade with the former Soviet empire. The truth is that domestic industry will always have a powerful voice in foreign policy. The challenge for you is to make the right call each time.

2. Keep competitiveness policy in check and acknowledge the danger that it could turn into a pork feast for Congress. One reason so many Bush people are opposed to the government picking winners and losers is that they don't want to say no to the losers. You will have to, if you really want to establish a successful partnership with industry. In signing off on a list of critical technologies, don't be dazzled by the promise of some boom-and-bust high-tech businesses. Examine all types of investment, hedging on high and low risk choices as any investor should. Beware of expensive proposals to keep a sick industry alive for a few more years.

3. Move early on the plan to reorganize the Commerce Department and Trade Representative's office (so far the worst kept secret of the transition) but don't predicate trade and competitiveness policy on this reorganization. Many have failed trying to end agency turf battles over trade policy, so accept that it will take some time. To avoid past problems, have your nominees for Commerce and U.S. Trade Representative publicly promise to resign within a year, whether or not the reorganization goes through.

As we have discussed, it makes sense to re-package the Department of Commerce as an incubator for competitiveness policy, and create a Department of Trade to negotiate agreements, enforce trade laws and promote trade. Instead of constant fights at low-level interagency meetings, trade and competitiveness should clash only at cabinet meetings, when you are there to make the call.

To make this work, we will need the support of the congressional committee chairmen who will be ceding some control over trade matters. The trade-off is to give them responsibility over the development of competitiveness policy. We urge an early hunting trip with John Dingell to explain his vital role in this process.

4. Prepare for trade blowups. Too often in the Bush years, the administration seemed unprepared for conflicts that arose over trade policy. A dispute over the killing of dolphins by Mexican tuna fishermen led to a humiliating rebuke in the GATT because no one at a high-level in the U.S. government recognized its implications. The issue was then so mishandled by interagency squabbling that the president lost any credit he could have claimed for ending the dolphin slaughter. Interagency "watch" committees, tested in the Bush years, could head off these problems early.

5. Restore the bipartisan tradition of trade policy so badly frayed during this campaign. While there may seem little reason to do this with such a solid majority in Congress, Republicans are going to be your vital allies in hammering out a moderate, aggressive trade policy and resisting those Democrats who would close U.S. markets to protect uncompetitive manufacturers.

One good step would be to hire some Republicans for mid-level trade jobs who can be trusted to carry out your goal of a more aggressive trade policy. Diversity here will help build a consensus in Congress.

That said, it would be a bad mistake to ride roughshod over Democratic trade hawks early in your presidency. Much of their saber-rattling has been aimed at attacking the Republican administration and getting you elected. Better than many, these Democrats know how to compromise and understand that closing markets is no long-term solution for trade deficits.

6. Finally, drop the suggestion that it is disloyal to lobby for foreign companies. The people who elected you are tired of influence-peddling in Washington, but it is un-American to suggest that it is worse to lobby for foreign than for American companies. Yes, you should toughen restrictions on lobbying by officials who leave the government, but these rules should not be stricter for work done on behalf of foreign companies.

Your promise to make appointees sign a pledge not to lobby their former agencies for five years is scaring off the trade experts we will need to run the government. Also, we should tell nominees to avoid the waffle that it is a sin to have lobbied for foreign governments but acceptable to have worked for foreign corporations — it contradicts your own promises and leaves ambiguous work done for foreign government-owned companies.

If you want to avoid confirmation battles, end this jingoistic rhetoric and cut the length of the lobbying restriction to two or three years. We are going to need the best and brightest to change America.

John Maggs is a trade correspondent for The Journal of Commerce in Washington. Trade Scene's Richard Lawrence is on vacation.

JOURNAL OF COMMERCE, December 10, 1992

Playing Clinton's China Card

By MARK COHEN

This June, President-elect Bill Clinton will face one of the toughest decisions in international trade: whether to renew most favored nation status for China, in spite of its human rights abuses.

The debate has become a national distraction. An equally significant issue is what the United States' posture should be toward China in June 1997. That's when Hong Kong reverts back to Chinese sovereignty.

Mr. Clinton should seize the Hong Kong issue early in his administration and focus the trade and human rights discussion on those most deserving of our support. These efforts also will reach out to the approximate 120 million people of Greater China, comprising southern China, Hong Kong and Taiwan.

There are a number of issues that Mr. Clinton should consider:

1. President Clinton should consider entering into a free-trade arrangement with Hong Kong. Binding this market closer to the United States will help calm nervous markets in Hong Kong. If such an agreement were approved by Chinese authorities, it also would establish one of the best insurance policies for Hong Kong after 1997.

2. Mr. Clinton might establish a new "rule of origin" for goods originating from Hong Kong with Chinese content. Current rules require Chinese re-exports through Hong Kong to be "substantially transformed" in Hong Kong to be deemed a product of Hong Kong. This is a subjective and unpredictable test.

If, for example, the law was changed to permit a product to be deemed "made in Hong Kong" if it has 75% Chinese value and 25% Hong Kong value, that would send a strong message that the United States favors a certain and predictable transition for Hong Kong exports to the United States.

3. President Clinton should arrange for an inter-agency review of all U.S. bilateral agreements with Hong Kong and China to minimize disruption in 1997 and ensure that China will not interfere in commercial relationships with Hong Kong.

At a minimum, the United States should obtain binding commitments from China that it will not interfere in Hong Kong where U.S. companies or projects are involved.

The recent statement by Chinese authorities that China may abrogate contracts entered into by the Hong Kong government, unless such contracts have been approved by China, only reinforces this need.

4. The president should continue to use the full range of U.S. trade remedies at his disposal. The recent successful conclusion of U.S. "Section 301" investigations into China's intellectual property practices and lack of market access for U.S. goods achieved far more for American businesses than the MFN debate.

The president also should initiate a fact-finding case on all of the implications for bilateral U.S. trade and investment of the reversion of Hong Kong in 1997, with a view toward easing the transition. As one further weapon, he also might consider import relief cases against unfairly priced or injurious Chinese imports that are produced by state-controlled companies.

5. Mr. Clinton should consider reforming our antiquated anti-dumping laws to ensure that products exported from market-oriented companies in Hong Kong and southern China are not unduly burdened by proceedings targeted to state-controlled companies.

In recent years, China has been the subject of several anti-dumping and anti-subsidy cases in which duties of over 100% have been imposed. Although the highest duties have typically been imposed on state-controlled industries, even privately invested joint ventures have been adversely affected.

The United States should make it clear it believes imports from market-oriented companies pose less of a threat to our economy than imports from state-owned companies.

6. The president should support China's entry into the GATT. Hong Kong has been a GATT member since 1986 and will apparently continue to enjoy this role after 1997. The president, however, can require that China undertake certain disciplines, such as eschewing forced labor for exports, reducing non-tariff barriers, reducing government interference in business and protecting Hong Kong's status.

In general, the most effective approach is one that demonstrates U.S. interests flexibly and intelligently. The United States should not undertake efforts which, in the first instance, disproportionately harm American interests. Revoking MFN for China is one such effort.

Making MFN conditional on specific human rights improvements, as Congress has suggested, may ultimately backfire. The uncertainty over tariff treatment could inspire the kind of state-controlled mercantilism in China that has created the current $12 billion trade deficit. It also distracts from providing safeguards for an established partner.

Ultimately, in protecting Hong Kong, the United States will serve the long-term interests of both international trade and human rights in China.

Mark Cohen, a Washington lawyer, is a frequent lecturer on China.

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Tough and Smart on China

BY HARRY HARDING

When Bill Clinton moves into the Oval Office, he will face a potential confrontation with China that could disrupt his focus on domestic affairs.

For 18 months after the Tiananmen crisis of 1989, the Bush administration undertook a seriously flawed policy toward China. It muted its rhetoric, resisted congressional penalties against Peking, and sent senior officials to China despite a ban on high-level contacts. Moreover, it unilaterally relaxed several of its own sanctions, in the vain hope that Peking would reciprocate.

Then, under pressure from Congress, Bush switched from carrots to sticks. He used the threat of higher tariffs and stricter export controls to persuade China to alter its arms sales and foreign trade practices. He also endorsed Taiwan's membership in GATT and approved the sale of 150 F-16s to the island.

This new policy achieved better results. China agreed to protect foreign intellectual property, end unfair export practices, and provide greater market access to U.S. firms. It also ratified the Nuclear Non-Proliferation Treaty, and agreed to honor the Missile Technology Control Regime. After a false start, American China policy was finally on track.

Still, not fully aware of this change in direction, many in Congress call for a more confrontational stand. They want to make China's most-favored-nation status contingent on improvements in Peking's human rights policies, foreign trade, and arms exports. They also want to establish a new radio service, originally called Radio Free China, to broadcast news and information to the Chinese people. Despite their flaws, Clinton has endorsed both proposals.

As a result, Chinese leaders view Clinton's election with suspicion. They see that, alone among Western nations, the United States is not only maintaining sanctions against China, but considering modifying China's MFN status. They regard the Radio Free China proposal as a bid to subvert their government and the sale of F-16s as a violation of the 1982 communiqué on arms sales to Taiwan. They are threatening retaliation against any of these moves.

In this context, two developments could push the situation into crisis. Either Peking could retaliate against the F-16 sales to Taiwan, or Clinton could introduce the new China policies he proposed during the campaign. Given the testy mood in each capital, if one side acts provocatively, the other is unlikely to back down.

A crisis between Peking and Washington would not mean military confrontation, but it would be an expensive distraction for the new administration. A trade war would raise prices for U.S. consumers and hand China's growing markets over to America's rivals. A diplomatic contretemps would tempt China to throw out existing Sino-American agreements on trade and proliferation and stop cooperating on other international issues. It would strangle the cultural exchanges that are bringing new ideas into China. Moreover, in a confrontation with China, the United States would not have the support of of its Asian allies.

Clinton says he wants to avoid coddling dictators in Peking. But he should be smart as well as tough. Congress will not reconsider China's MFN status until June. Clinton should use that time to forge a strategy based on calculation, not emotion:

- Clinton should distance the United States from human rights abuses in China and press for the release of specific prisoners. He should also establish a new radio service for China, but place it under the respected Voice of America. Above all, he must understand that the systemic changes he wants will ultimately come from domestic forces, which will be fostered more by continued commercial and cultural [illegible] with the United States than by economic sanctions.
- Clinton should continue discussions with China over its trade practices, arms sales, and military modernization program, using multilateral forums where appropriate. He must also engage China in areas of potential cooperation, including the disputes in Indochina and the Korean peninsula. He should make clear that the outcome of these negotiations will strongly influence his policy on China's MFN status.
- If this dialogue shows promise, Clinton should moderate his position on MFN, threatening to withdraw it only if there is significant and sustained retrogression in Peking's human rights policies, foreign trade, or arms sales. He could adopt a similar policy for all other countries whose MFN status is reviewed annually.

The responsibility for avoiding a crisis is not Clinton's alone. Peking, too, must refrain from acting precipitously. It should accept the F-16 sales to Taiwan. It should honor its existing commitments to the United States and negotiate in good faith on remaining issues. It should supplement its economic reforms with political change. And it will have to accept a reasonable linkage of its MFN status to its foreign and domestic policies.

A strategy of reciprocal restraint will not produce a second honeymoon between China and the United States. But it could prevent the confrontation that would be so costly to both. ■

Harry Harding is a senior fellow in the Brookings Foreign Policy Studies program. He is the author of A Fragile Relationship: The United States and China since 1972 *(Brookings, 1992).*

A Cabinet-Level Dept. of Trade

By WILLIAM V. ROTH Jr.

The time has come to take a serious look at consolidating our trade-related departments and programs. Consistent with this approach, I am introducing a bill to establish a cabinet-level Department of Trade.

While there are many areas of our government that call for reform, none is more urgent or important than trade.

Consolidation of our trade functions will achieve several goals. First, by streamlining our government's functions, the United States will be able to speak with a single, strong voice on trade matters.

Second, a new department dedicated to trade will expand our exports by giving American firms and workers the tools necessary to win in international competition.

As it stands now, our trade interests have no central authority to turn to for straight, dependable, consistent information on trade policy, and our trade competitors are free to "shop the system" for the best deal for their interests. America simply can no longer afford such a scattershot approach to trade.

The new department will consolidate our principal executive branch trade functions and will incorporate the related economic affairs and business elements of the existing Commerce Department.

As such, the International Trade Administration, the functions of the Under Secretary for Economic Affairs (except for the Bureau of Census), the U.S. Travel and Tourism Administration and the Bureau of Export Administration will move from the Department of Commerce to provide analytical and policy implementation support for the new department.

The Export-Import Bank, the Overseas Private Investment Corporation, the U.S. Trade and Development Program and the Bureau of Private Enterprise of the Agency for International Development also will be transferred to the new department.

The Department of Trade will comprise a work force of less than 4,000, making it the leanest department in the U.S. government. But while the new department promises to be lean, it will also be muscular. The bill directs the new Secretary of Trade to submit a report with recommendations for establishment of a Professional Trade Service Corps to ensure that our trade personnel are of the highest caliber.

Under my trade reorganization legislation, the U.S. Trade Representative will become the new Secretary of Trade and will continue to be responsible for trade policy, coordination and negotiation. Such an approach reflects the sensible principle that in restructuring government, we should start with organizations and processes that work.

The USTR does work. But it can also work better. By elevating the USTR to the Secretary level and by consolidating trade leadership in one office — that of the Secretary of Trade — there should no longer be any question as to who is boss when it comes to matters affecting U.S. trade interests.

Moreover, from their newly elevated vantage point within the Secretary's office, our trade representatives will be able to draw upon the integrated resources of the Department of Trade to carry out their trade negotiation and policy-making responsibilities.

As it stands now, the USTR must draw on the resources of the Commerce Department to get its job done. The small staff at USTR is not sufficient to handle all the detailed work required for increasingly complex negotiations such as the North American free-trade agreement and the Uruguay Round.

Under my reorganization proposal, American businesses will benefit from a Trade Department second to none. For the first time, a single department dedicated to trade will be responsible for both policy-making and policy implementation.

Among the bill's main provisions is establishing a new Bureau of Trade Policy and Analysis to provide analytical and policy support to the Secretary of Trade. While our trade agenda has expanded enormously over the past decade, our ability to meet new needs has not.

Future major trade negotiation will be in areas such as competition policy and the environment. There also are issues related to the growing regionalism in the world economy and how that will affect the evolution of our trade system.

Clearly, addressing these and other crucial trade issues requires additional expertise at USTR beyond a few more staff. This legislation takes two components within the Commerce Department — the International Economic Policy and Trade Development offices — and places them under the leadership of the new Secretary of Trade.

In addition to upgrading its trade policy and analysis capabilities, the United States must do a better job of monitoring and enforcing its trade agreements. For example, if the Uruguay Round is concluded successfully, it will require very close attention and monitoring to ensure that our trading partners fulfill their obligations.

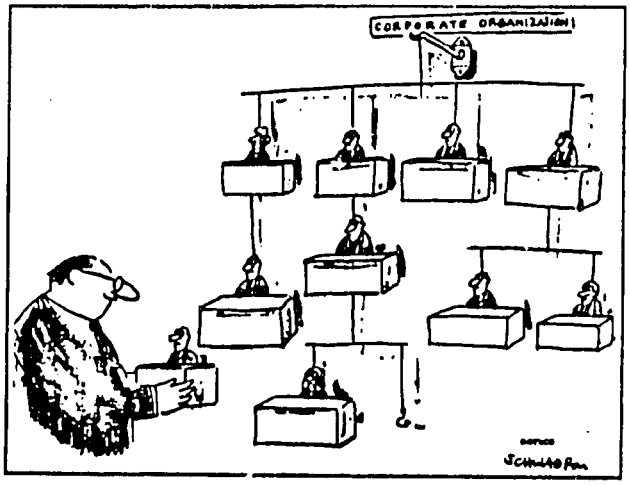
Third, and perhaps most importantly, we must consolidate our export promotion programs. As in other areas of trade, our export promotion functions are dispersed throughout the government.

What we need is a national export vision. A new Bureau of Export Promotion will increase our ability to compete abroad by combining our trade marketing and financing arms under one roof.

The centerpiece of the new Bureau of Export Promotion — the U.S. and Foreign Commercial Service — will be beefed up in two important respects. The Commerce Department's Travel and Tourism Administration and the Agency for International Development's Trade Development Program both will be transferred to the U.S. and Foreign Commercial Service.

This legislation also directs the new Secretary of Trade, as chairman of the Trade Promotion Coordinating Committee, to submit a coordinated annual appropriations request for trade promotion in accordance with a national export strategy.

The idea is to increase overall U.S. exports. Quite simply, increased exports mean more jobs for more Americans.



William V. Roth Jr. is a Republican senator from Delaware. This article is excerpted from a Senate speech he delivered this week.

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EDITORIAL/OPINION

Shoring Up US Export Finance

By GARY KLEIMAN

As the Clinton administration assumes office with a pledge to expand U.S. markets overseas, it must take steps to improve the nation's export finance programs.

The role of the Export-Import Bank and other agencies that supply trade finance is uncertain. The reason, according to a recent congressional report, is that U.S. export finance resources "do not follow an integrated strategy" that seeks the highest return on export-assistance dollars.

That fragmentation and weakness leaves American firms at a competitive disadvantage. The government's export-finance apparatus must be transformed from a blunt tool to a precision instrument.

The federal government spent nearly $25 billion on export marketing, loans, guarantees and insurance in fiscal year 1991. The Department of Agriculture received half that money, although farm goods represent only 10% of exports. The Ex-Im Bank backed large commodity transactions, despite arguably more pressing needs in other sectors.

According to the General Accounting Office, the research arm of Congress, the Ex-Im Bank routinely fails to identify industries that have competitive products but little access to trade finance. Small and mid-sized firms with the least sales and financing capacity are most hurt by this neglect. They receive only 10% of Ex-Im Bank commitments, far below prevailing demand.

Moreover, Ex-Im Bank is unable to attract enough loan commitments from U.S. commercial banks, even though they are beginning to increase their export finance activity.

By contrast, many foreign governments organize their credit support efforts systematically. In Europe, for example, governments typically spend more money and assign more staff under a unified plan, and provide a wider range of financial incentives and services.

Those services include grants for attendance at trade events and market development; targeted funds for small and mid-sized firms; and greater access to export financing through local field offices and automatic approvals.

Their support for participation in trade fairs ranges from 30% to 70% of total costs. The European Community in Brussels offers a separate subsidy of up to 50% for qualified exhibitors.

The Department of Commerce, on the other hand, has eliminated all support for displays. It requires the trade shows it sponsors to recover all expenses and has increasingly transferred management responsibilities to private organizers who can turn a profit. Those forums often exclude small and infrequent exporters.

To aid companies in tapping new markets, France and Great Britain underwrite the cost of in-house research and in-country exploratory trips. The United States, by comparison, provides no direct assistance. Instead, it sells product- and market-specific publications for a nominal fee. These standardized materials are often of little use, since they are only updated periodically and are not tailored to individual company needs.

Foreign exporters also have the advantage of government export-promotion programs focused on specific industries and regions. For example, the British Overseas Trade Board has a three-year plan identifying North America and Asia as primary targets for finance activity. Its Opportunity Japan Initiative aims to double U.K. exports to that country. In 1993, a similar campaign will be directed at the United States.

By contrast, the Commerce Department, through its 125 Foreign and Commercial Service outposts in embassies worldwide, cites "best prospects" for export sales. In 1991, its offices uncovered almost 1,500 leads, which formed the basis for later event planning and reporting.

This ad hoc approach does not follow any common definition of strategic importance or commercial return set by Washington. It also lacks a follow-up procedure.

Finally, European networks for furnishing assistance are far more decentralized and widespread than the American network. In France, 25 regional offices deliver services, and in Germany over 50 banks nationwide belong to the AKA Trade Finance Consortium. In both countries, loan and qualification conditions are determined in advance and applied broadly under clear government preferences.

The Ex-Im Bank has only one office outside of Washington in the United States. That impedes the access of applicants for export finance and delays the approval process.

Admittedly, the Ex-Im Bank, through a new city-state initiative, is offering advance processing and counseling at some 50 centers nationwide, with a focus on small business. But the effort falls far short of the scope and speed of service provided abroad.

The federal government must adopt a more activist, coordinated stance. Agencies like the Ex-Im Bank, the Overseas Private Investment Corp., the Commerce Department and the Small Business Administration should pool their resources and expertise to provide cost-effective assistance.

They could start by creating a "one-stop credit shop" to facilitate administration and outreach.

Such a move would represent a long-overdue reversal of Washington's uncertain and overlapping focus, and presage a larger scale shift in reorganization of the trade finance apparatus that would advance the cause of U.S. economic success worldwide.

"He's been stuck there since Christmas 1991."

Gary Kleiman is senior partner in Kleiman International Consultants in Washington.

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Trade to benefit the poor

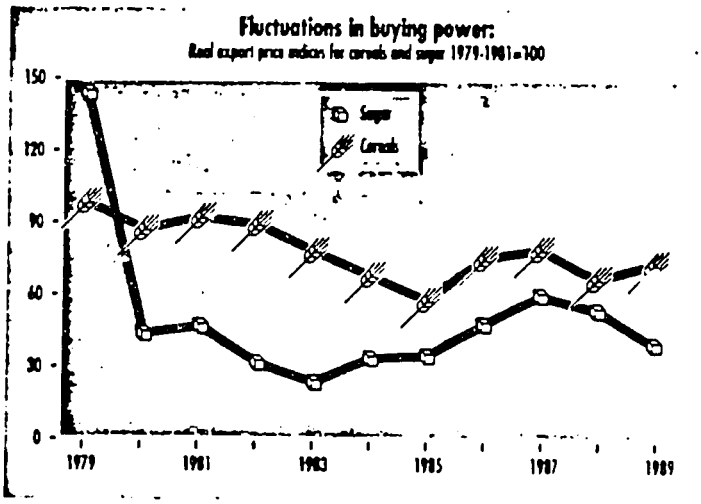
Inequity in world trade adversely affects the ability of poor nations and poor households to meet their basic needs. The relationships are complex but three factors are of special importance: the terms on which trade is conducted, protectionism that restricts market access, and the servicing of debt.

Many developing countries rely on exports of primary commodities – minerals and agricultural products such as coffee, sugar, cotton and fruits – to finance imports. Small farmers and landless labourers often depend on income from such primary products.

In 1990, agriculture, fishery and forestry exports accounted for about 19 percent of exports from Africa and 31 percent from Latin America. As a result of declines in the value of such commodities, the export income that producer countries receive buys less and less. Africa's earnings from agricultural exports bought 29 percent less manufactured goods and crude petroleum in 1990 than in 1979-81; in Latin America, export earnings bought 12 percent less.

This decline in purchasing power is mirrored within countries. Farmers get less for their products in real terms – their income buys fewer goods.

Declining prices are only part of the problem, however. Unstable prices are another. The United Republic of Tanzania, for example, earns about a seventh of its foreign exchange from cotton, but prices fluctuate wildly. Worldwide, export prices for tea, coffee and cocoa have varied widely since 1979. The range is enormous, with income from a fixed volume of exports buying about 25 percent more goods at the highest point and about 45 percent less at the lowest than it did in 1979. Such price instability makes planning national and household budgets very difficult.



Problems with unstable and declining commodity prices are compounded by the effects of the debts amassed by many developing countries since the 1970s, when low interest rate loans were widely available. Since then, interest rates have risen rapidly, increasing payments due on the debts.

By the end of 1990, external debts for all developing countries totalled US$1 319 000 million. Servicing these debts forces countries to maximize exports and use a large proportion of their earnings to meet interest payments – 20 percent or more for some countries.

In 1989 the cost of servicing of medium- and long-term debt in developing countries exceeded export earnings for agriculture, fisheries and forestry by more than $27 000 million.

Export quality regulations help trade

Thailand is the world's largest rice and cassava (tapioca) exporter and the second largest exporter of large shrimps. It also exports fruit and vegetables, nuts, grains, meat and animal products, fish and processed foods. About 60 percent of the country's foreign exchange comes from food exports.

Thailand previously had problems with below-standard food exports – from mycotoxins in grains, to unacceptable pesticide residue levels. In the early 1980s, with FAO assistance, the government improved its analytical services for food contaminants, additives and mycotoxins. A voluntary Export Inspection and Certification System was established, initially for processed fruit and vegetable exports. A statutory system will be adopted in the future.

Export premises are registered and their operations regulated. Exporters are licensed, and products are inspected and export certificates are issued, as required by the importing country. Approved products are marked 'Thailand – Approved for export'.

Already, several countries, including Japan, Australia and Sweden, have accepted these export certificates for certain products as the only requirement for entry to their country.

This debt burden limits the ability of nations to improve agricultural productivity or make provisions to protect food security.

During the 1980s, partly as a result of these problems and partly because of domestic policies, many developing countries had to restructure their economies to increase productivity and improve their balance of payments. They increased their exports of agricultural commodities but, because prices fell, their earnings were reduced. As a result, internal subsidies and other social programmes were cut, leaving vulnerable groups unprotected. In Ghana, for example, one study suggested that the food security of the poorest households suffered despite an increase in agricultural production.

Poor people are often very efficient at using land and credit to increase their incomes, but they lack access to them. Improving that access, by making credit available to women, for example, can bring major benefits. In Africa, women play a major role in small-scale farming and as entrepreneurs in urban areas.

Increasing the incomes of poor households and providing employment opportunities will not yield positive results unless the goods produced can be sold. Protectionism is the major barrier to international markets. Tariffs and other disincentives, such as differing standards and quotas, discourage the growth of processing industries in developing countries.

These issues lie at the heart of the Uruguay Round of the General Agreement on Tariffs and Trade. The voices of the poorest, however, are the weakest at the table.

The industrialized nations are the major agricultural traders. According to the Organization for Economic Cooperation and Development (OECD), industrialized countries supported their agriculture with direct and indirect subsidies amounting to almost US$300 000 million in 1990.

Some OECD countries subsidize their agricultural exports, leaving developing countries unable to compete. They allow the import of raw agricultural commodities with little or no tariff barriers, whereas processed commodities, which would bring greater returns for developing countries, face much higher tariffs.

Attention to these macroeconomic issues is vital for the nutritional well-being of the poorest, who usually bear the brunt of the effects of these policies. ■

In brief

■ Declining terms of trade for agricultural commodities reduce the purchasing power of agricultural exports from developing countries.

■ Servicing massive external debts further limits poor countries' ability to meet food security needs.

■ Protectionism prevents access to many developed country markets, especially for processed agricultural commodities.

■ Attention to these macro-economic issues is vital for the nutritional well-being of the poorest, who usually bear the brunt of the effects of these policies.

Honest trading

Ethical trade practices protect the public, scrupulous traders and industries. Throughout history, governments have had to set standards and regulate the food supply – to prevent fraud, stop adulteration of food and ensure its safety.

In nineteenth century Europe, mustard hulks, pea flour and juniper berries were added to pepper, ash leaves to green China tea, and poisonous copper and lead salts were used to colour sweets.

Laws to prevent such abuses help food suppliers to compete fairly in the market-place. Today, that market-place has become international and so too has the need to establish standards. The FAO/WHO Codex Alimentarius Commission sets advisory standards and codes of practice to meet the needs of producers, processors, industry, governments and consumers.

For these codes to be effective, however, governments must take responsibility for their enforcement.

Report to Congress and the
President on Investigation

United States International Trade Commission

SEPTEMBER 1992

EXECUTIVE SUMMARY

The Caribbean Basin Economic Recovery Act

The Caribbean Basin Economic Recovery Act (CBERA) marked its 8th year of operation in 1991. The CBERA affords nonreciprocal preferential treatment to most products of designated Caribbean Basin countries by reducing the tariff rate to free or, for a small group of products, by establishing tariff rates below the most-favored-nation (MFN) rate.

A total of 24 Caribbean, Central American, and South American countries were eligible for CBERA benefits in 1991.[1] No new countries were designated for or suspended from CBERA benefits during the year. However, the October 1991 U.S. embargo on most trade with Haiti effectively suspended that country from the program.

Benefits under the CBERA were expanded in 1991. Effective September 1991, the United States extended new or expanded duty-free entry under the CBERA to 94 previously ineligible or restricted products.

U.S. Trade with the Caribbean Basin in 1991

For the 6th consecutive year, the United States registered a trade surplus with the Caribbean Basin countries. The trade surplus was driven by continued growth in U.S. exports to the region, which rose to $10.2 billion in 1991 from $9.7 billion in 1990. The Caribbean Basin accounted for 2.5 percent of total U.S. exports in 1991, and ranked as the 10th-largest export market for the United States—ahead of such countries as Singapore and Italy. Total U.S. imports from the Caribbean Basin countries rose for the third consecutive year to $8.3 billion in 1991 from $7.6 billion in 1990. Imports from the Caribbean Basin countries accounted for 1.7 percent of total U.S. imports worldwide in 1991, placing the region as the 14th-largest supplier of U.S. imports—ahead of nearby Venezuela and Brazil.

The countries designated under the CBERA were responsible for all but a small portion of the trade between the United States and the Caribbean Basin. Total imports from the CBERA countries increased for the 4th consecutive year to just over $8.2 billion in 1991 from $7.5 billion in 1990. The rise in U.S. imports from the CBERA countries continued to be fueled by a rapid expansion of textile and apparel imports. A few countries—notably Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Jamaica—dominated this boom. Most textile and apparel articles are not eligible for duty-free entry under the CBERA, however. Increasing textile and apparel imports from CBERA countries, as well as a shift away from imports of basic commodities to imports of higher valued manufactured goods (one of the goals of the act), are at least partly responsible for the increase in the average rate of duty on products of CBERA countries—from 1.3 percent in 1983 to almost 9.0 percent in 1991.

Almost two-thirds of all U.S. imports from the CBERA countries, valued at $5.4 billion, entered free of duty under various U.S. provisions. Some 23.2 percent of all imports from the CBERA countries, valued at $1.9 billion, entered MFN duty free; 13.6 percent, valued at $1.1 billion, entered duty free under the CBERA. The portion of imports entering duty free under the CBERA in 1991 was double the 6.7 percent in 1984, the first year of the program, but has remained unchanged since 1989.

[1] The countries were: Antigua and Barbuda, Aruba, the Bahamas, Barbados, Belize, the British Virgin Islands, Costa Rica, Dominica, the Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.

A small number of CBERA countries continued to dominate trade with the United States under the act. The Dominican Republic, Costa Rica, Guatemala, Honduras, Jamaica, and Haiti accounted for four-fifths of all CBERA imports in 1991. The Dominican Republic and Costa Rica alone accounted for over one-half of all CBERA imports. These two countries have been the leading suppliers under the CBERA in almost every year since the program became operative in 1984. The Dominican Republic was the leading CBERA source of footwear uppers, medical, surgical and dental instruments, cigars, jewelry, electrical switching apparatus, and molasses. Costa Rica was the leading supplier of beef, pineapples, melons, and fresh fish. Leading CBERA suppliers of other important products were Jamaica (nonbeverage ethyl alcohol and rum), Haiti (baseballs and softballs), and Guatemala (sugar and tobacco).

Several countries did not utilize CBERA provisions during 1991 or experienced a significant decline in sales to the United States. These countries included Antigua and Barbuda, Aruba, Belize, the British Virgin Islands, Grenada, Montserrat, the Netherlands Antilles, St. Kitts and Nevis, and St. Vincent and the Grenadines. Some of these countries experienced poor economic performance in their key export sectors. A few exported primarily to Europe because of historical and political ties. Others, with service-based economies, relied on revenue from tourism and financial services rather than on export earnings.

Impact of the CBERA in 1991

Although the total value of duty-free imports entered under the CBERA in 1991 was $1.121 billion, less than half of these imports would not have received duty-free entry without the CBERA. The value of such goods increased by 22 percent between 1990 and 1991, from $422 million to $515 million.

Since the CBERA has been operative, six products have consistently ranked among the leading items that actually benefited from CBERA tariff preferences, i.e. were not excluded by the act or would not otherwise have entered the United States free of duty either at MFN rates or under provisions of the Generalized System of Preferences. These items were: beef, pineapples, frozen concentrated orange juice, rum, ethyl alcohol (except in 1984), and raw cane sugar (except in 1989). In 1991, for the first time, leather footwear uppers also ranked as a leading item benefiting from the CBERA. U.S. imports of leather footwear uppers under CBERA provisions nearly tripled in value during 1990-91, rising from $25.9 million to $77.7 million, and increased from 2.8 million pairs to 6.3 million pairs during the same period. Some U.S. footwear manufacturers have expressed concern about the future impact of CBERA imports.

The $515 million in imports actually benefiting from the program was 6.3 percent of the customs value of total imports entered from CBERA beneficiaries. In each year between 1984 and 1991, the value of CBERA duty-free U.S. imports was equal to about 0.02 percent of U.S. GNP. With CBERA duty-free imports at such low levels, the overall impact of the act on the U.S. economy and consumers was minimal in 1991, as in previous years. On average, about 1 percent or less of U.S. domestic sales was displaced by the leading competing duty-free imports from CBERA countries. In 1991, the six products with the largest displacement effects from competing CBERA duty-free imports, in value terms, were ethyl alcohol, beef, frozen vegetables, tobacco, cigars, and frozen orange juice. The largest effect occurred for ethyl alcohol, for which $31.2 million of U.S. domestic sales, or 2.05 percent of the value of the total domestic market, was displaced by CBERA-origin products.

Probable Effects of the CBERA in the Future

The U.S. International Trade Commission identified 122 new investments in CBERA-related projects and 18 expansion projects in 1991, more than double the number identified in 1990. A total of $297.4 million in investment, triple the value of investment in 1990, was reported for the 140 projects, with $264.1 million going for new projects and $33.3 million in investments to expand existing projects.

This report uses CBERA-related investment activity to estimate the possible future trade effects of the act on the U.S. economy. Despite the increase in investment reported in 1991, the act is not likely to significantly affect the U.S. economy in the near future.

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Most of the new investment reported in 1991 was directed toward only a few CBERA countries—namely Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Jamaica. These countries, which rank among the leading suppliers of imports under CBERA provisions, have aggressive export promotion policies and provide significant foreign investment incentives.

Despite the act's minimal impact on the U.S. economy, business and government officials interviewed during this investigation reported that the CBERA has benefited the economies of the CBERA countries. The CBERA was reported to have increased investor awareness of new and previously overlooked market opportunities for offshore production for the U.S. market in the Caribbean Basin countries. The act also was credited with stimulating agricultural and industrial diversification in the region and the export of nontraditional products to the United States.

Although some of the new investment taking place in specific CBERA countries during the past year focused on products eligible for duty-free entry, the CBERA also has encouraged investment in areas not eligible for duty-free benefits under the act such as textile and apparel sewing and assembly operations. Much of this new investment is the result of processing-for-export operations that take place within a rapidly growing number of specially designated free-trade zones. Other areas receiving new investment as a result of the CBERA but not eligible for CBERA trade preferences include data processing, tourism, and petroleum processing.

Fourteen projects with capital requirements totaling an estimated $233.4 million received low-interest loans from Puerto Rican financial institutions under section 936 of the U.S. tax code in 1991. Jamaica was the single largest beneficiary in 1991, with projects in that country receiving approximately $150 million in section 936 loans. The second-largest recipient was the Dominican Republic, with $31.1 million, followed by Barbados with $22.0 million, and Trinidad and Tobago with $20.0 million.

Fieldwork was conducted in El Salvador, Guatemala, and Panama to review economic conditions and the impact of the CBERA. All three of these countries are recovering from extended periods of political instability and, through application for membership in the General Agreement on Tariffs and Trade (GATT), are making efforts to integrate more closely with the world economy. Additionally, each of these countries is liberalizing its trade and investment regimes, and is pursuing regional integration measures to varying degrees. Among the challenges they face in diversifying their economies are poor infrastructure and investor uncertainty in light of previous political and economic strife.

The possibility of a North American Free-Trade Agreement (NAFTA) has aroused a degree of concern in the region. Officials in the Caribbean Basin countries are concerned that investment and trade will be diverted away from the region as Mexico strengthens its economic ties with the United States. The formation of a Central American Common Market and increased economic cooperation among the Caribbean Basin countries is being pursued as a way to forge a closer relationship between the NAFTA trading partners and the CBERA beneficiaries.

Why Caribbean Aid Makes Sense

By RICHARD BERNAL

Recent reports on "60 Minutes" and "Nightline" alleging that U.S. taxpayers subsidize the export of U.S. jobs to the Caribbean Basin have caused a furor. As the ambassador of Jamaica to the United States, I empathize fully; I understand the angry reaction to allegations that tax dollars are being used to send jobs overseas, adding to the unemployment problem in the United States.

I don't wish to intrude in the U.S. domestic debate on this issue or to defend the administration of the programs in question. I would like to offer a perspective, however, that has been overlooked in the debate: that, in fact, there has been a net gain in employment rather than a loss because of the complementary production programs featured in the television reports.

The hidden story here — and one that wasn't emphasized in either show — is that the United States has been losing employment in the textile and apparel sectors for more than a decade. Most of the jobs have been lost to nations in the Far East, whose exports of garments to the United States have risen dramatically during that time.

In response to the rapid job loss to Asian nations, industry, labor, past administrations and the Congress created a program that allows U.S. manufacturers to meet severe price competition from the Far East with a new source of less expensive labor in the Caribbean Basin. An important part of this plan was to keep the more highly skilled and higher paid textile manufacturing and cutting jobs in the United States. Under this arrangement, U.S. manufactured textiles are cut in the United States and sent to Caribbean Basin nations such as Jamaica, where they are sewed and shipped back to the United States for sale domestically or for export. The use of lower wage Caribbean Basin labor thus makes U.S. apparel competitive and actually saves U.S. jobs in the textile industry.

At the same time these sensational "job export" stories were appearing on television, the U.S. Department of Commerce was reporting an increase in the job-creating exports of U.S. apparel after years of decline.

According to Commerce Department figures, exports of knitted apparel, which includes trousers, overcoats and blouses, increased 41.3% in the first six months of 1992 and was up 78% from 1990. About two-thirds of this knitted apparel is assembled in the Caribbean Basin from fabric produced and cut in the United States. The reality of the global economy is that apparel made in the United States can only be competitive with the help of inexpensive labor in the Caribbean.

Yes, Jamaicans are doing work once performed by U.S. citizens. But these jobs in Jamaica preserve U.S. jobs in the textile industry that would otherwise be lost to the Far East. It is wrong to assume, therefore, that the loss of U.S. sewing jobs in this industry is a net loss for the U.S. economy.

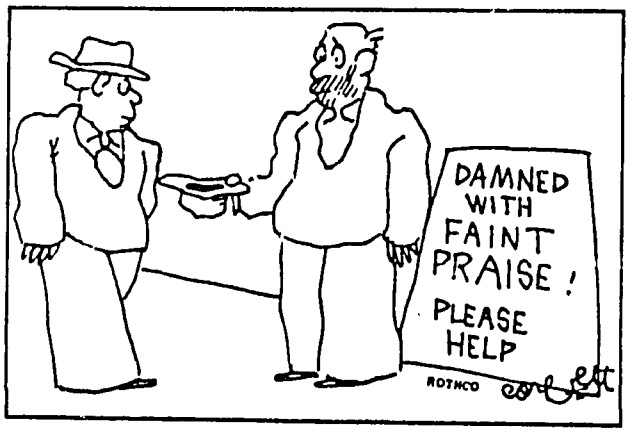
Without minimizing in any way the harsh impact on the people that once worked in these industries, it is a fact that these lost jobs have been replaced by new U.S. jobs fostered by increased trade between the United States and the Caribbean Basin. The countries in this region, including Jamaica, are good customers of the United States. Three-quarters of the goods and services we import are from the United States. As our economies grow and our people increase their consumption — in part because of garment assembly jobs — we will purchase more from the United States.

To be sure, I find the controversy surrounding the garment assembly operations in the Caribbean disturbing. The elimination of these jobs would be disastrous for the Jamaican economy. But as an economist, I welcome the current debate as a way of demonstrating the interdependence of the countries in this hemisphere and to highlight the growth of regional trade made possible by initiatives like the North American free-trade agreement.

By lowering the barriers to trade and commerce between the United States and its neighbors, the free-trade agreement will certainly cause dislocations in the U.S. economy as some industries take advantage of lower wage labor in Mexico and the Caribbean Basin. But when I refer to lower-wage labor, I do not mean exploitative wages or unregulated labor conditions. Jamaica has active labor unions, a strong history of protecting workers' rights and ensures decent employment conditions. Yet our wage rates are significantly lower than those in the United States, providing the opportunity for U.S. companies to better compete in world markets.

What the United States obtains from these job shifts are new consumers in Jamaica and the Caribbean ready to purchase goods and services from the United States.

We cannot, as a region, turn the clock back, nor can we allow ourselves to be economically marginalized by powerful regional trading blocs in Europe and Asia. There are opportunities to be seized by taking advantage of our individual strengths, producing a net increase in economic activity, trade and jobs throughout the region.



Richard Bernal is Jamaica's ambassador to the United States.

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HIGHLIGHTS

U.S. Imports

U.S imports of MFA products in 1991 reached a record of almost 12.8 billion square meter equivalents (SME) valued at $29.0 billion, exceeding 1990 levels by 4.7 percent in volume and 3.9 percent in value (table 9). Although a marked increase from the negligible gain in 1990, the growth in 1991 still remained under the 6-percent average annual rate during 1985-90.

Apparel is the principal MFA import, although its share of the total shrank somewhat in 1991, to 77 percent by value and 48 percent by volume. Nevertheless, apparel imports grew by 2.4 percent to a record of almost 6.2 billion SME (table 3). They had fallen slightly in 1990 after surging in 1989. The growth in apparel imports in 1991 came almost entirely from cotton apparel, especially underwear (category 352), miscellaneous apparel (359), and trousers (347/8) (see section B). In contrast, imports of manmade-fiber garments, the largest apparel import segment, declined slightly for the second consecutive year. The weakness in this segment resulted mainly from a continued decline in imports of manmade-fiber sweaters (645/6) in the wake of U.S. antidumping proceedings and the resultant issuance of antidumping orders on shipments of such goods from the "Big Three" suppliers—Hong Kong, Taiwan, and Korea. Significant decreases were also recorded in imports of knit shirts (638/9) and men's woven shirts (640), helping to offset a sizable gain in other apparel (659).

Fabric imports showed the greatest growth in absolute terms during 1991, rising by 332 million SME, or by 10 percent, to a new high of 3.5 billion SME. The growth was spread among the fiber categories, although in terms of actual volume the predominant fibers—cotton and manmade—accounted for almost all of the increase. Gains of more than 40 million SME occurred in nonwovens (223), knits (222), sheeting (313), and twills and sateens (317).

For the two remaining sectors, yarn imports ended their 4-year decline in 1991, while imports of made-up and miscellaneous textiles remained unchanged. Yarn imports rose by 11 percent, to nearly 1.1 billion SME, although they remained far below annual levels reached during the second half of the 1980s. Imports of made-up and miscellaneous products, such as carpet and other textile home furnishings, almost reached the record 1990 level of nearly 2.1 billion SME.

Import sources

Combined, the major suppliers showed no import growth in 1991 (table 10). Imports from China, the largest supplier by volume, and Hong Kong, the largest by value, rose by roughly 1 percent each, to 1.7 billion SME (nearly $3.8 billion) and almost 1.0 billion SME ($3.9 billion), respectively. Imports from Taiwan rebounded by almost 8 percent in 1991, although they remained slightly below their 1989 record high. Imports from Korea declined for the second consecutive year in 1991, falling by 12 percent to 859 million SME ($2.4 billion), keeping the Big Three from showing any overall growth that year.

Imports from the European Community also dropped for the second consecutive year, by 12 percent, to 952 million SME, the lowest level in at least 5 years. Canadian shipments rose by 14 percent in 1991, continuing their rapid growth since at least 1988, spurred on in part by the bilateral free-trade agreement in effect since 1989. The growth enabled Canada to supplant Korea as the fourth-largest individual volume supplier, with shipments of 880 million SME, although it is a distant 12th in terms of value.

Substantial growth was registered in imports from Mexico, with whom the United States and Canada have just concluded negotiations for a North American Free-Trade Agreement (NAFTA). After showing little growth in recent years, despite the liberalization of Mexican quotas, imports from Mexico increased by 25 percent in quantity and 30 percent in value. Similarly, the growth in imports from the Caribbean Basin picked up sharply in 1991, rising by 23 percent in volume to a record 1.1 billion SME. This marked the first time that Caribbean Basin shipments exceeded the 1 billion-SME level. Trade with Mexico and the Caribbean countries largely involved the assembly of garments from U.S. components.

Bilateral agreements

The United States had import-restraint agreements or quotas with some 40 countries in 1991. These countries supplied 83 percent of total MFA imports by value for that year.

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USDA Backgrounder

Roger Runningen (202) 720-4623

November 20, 1992

News Division, Office of Public Affairs, Room 404-A, U.S. Department of Agriculture, Washington, D.C. 20250

U.S. - EC AGREEMENT ON OILSEEDS AND THE URUGUAY ROUND

The agreement reached today by the European Community and the United States paves the way for a speedier resolution of the remaining agricultural issues in the GATT Uruguay Round negotiations. This will free up negotiations to continue in other areas of the Round.

Today's agreement spells out the conditions for resolving the oilseeds dispu in a manner that is satisfactory to both the United States and the European Community. It will halt the dramatic increase in European Community oilseed production.

Today's agreement also clarifies the position the two parties will take on other issues contained in the Dunkel Agricultural Text, which was proposed nearly a year ago by Arthur Dunkel, director general of the General Agreement on Tariffs and Trade. The Dunkel Text is a general form of an agricultural agreement which has been the guideline for the GATT Uruguay Round discussions throughout 1992.

The agreement reached today by the European Community and the United States contains the following guidelines:

OILSEEDS

The agreement contains an acreage trigger for European Community oilseeds production. If EC acreage exceeds the trigger, oilseed producers in the EC will receive smaller EC subsidy payments on all oilseed plantings. This will restrain plantings and oilseed production.

The European Community will ensure that any oilseed byproducts produced from oilseed plantings on EC set-aside acres will not undermine the market for oilseed exports.

If the United States believes the agreement has been breached, the European Community agrees to undertake binding arbitration.

The European Community also agrees to provide a reduced tariff rate on 500,000 tons of corn to Portugal beginning in 1993/94.

GATT URUGUAY ROUND

Internal Supports. The European Community and the United States agree to support a GATT Uruguay Round agreement that will require a 20% reduction from a 1986-88 base in the average level of farm supports across commodities as determined by the so-called Aggregate Measure of Support (AMS). These reductions are from a 1986-1988 base period and therefore have already been achieved in the United States so no further reductions are required for U.S. commodities.

- more -

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Direct payments that are appropriately linked to production-l...ting programs will not be subject to the reduction commitment if certain conditions are met (for crops: fixed acreage base/fixed yields or payments made on less than 85 percent of base level production; for livestock: fixed number of livestock head).

Export Subsidies. The United States and the European Community agree to support a GATT Uruguay Round agreement that reduces by 21% the volume of agricultural commodities that receive export subsidies and reduces subsidy outlays by 36%. These cuts are from a base period of 1986-90 as defined in the Dunkel Text.

Market Access. The United States and the European Community have agreed to instruct their negotiators to complete as quickly as possible their country lists of proposed reductions in agricultural tariffs (as well as farm subsidies).

Consultation on Non-grain Feed Ingredients. The United States and the European Community agree to consult if EC imports of non-grain feed ingredients increase to levels that undermine the implementation of the reform in EC farm programs.

GATT Rules. The European Community and the United States have agreed that during the six-year implementation period internal support measures and export subsidies that fully conform to reduction commitments and other criteria will not be subject to challenge under GATT rules on subsidies. However, countervailing duties will still apply if such subsidized imports cause or threaten injury.

OTHER BILATERAL ISSUES

The United States and the European Community have agreed on a resolution of current disputes between the two parties on corn gluten feed and malted barley sprouts.

The European Community also has agreed to extend into 1993 the agreement that permits the entry of 2 million tons of corn and 300,000 tons of sorghum into Spain under reduced import charges.

FINANCE

FINANCE

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I

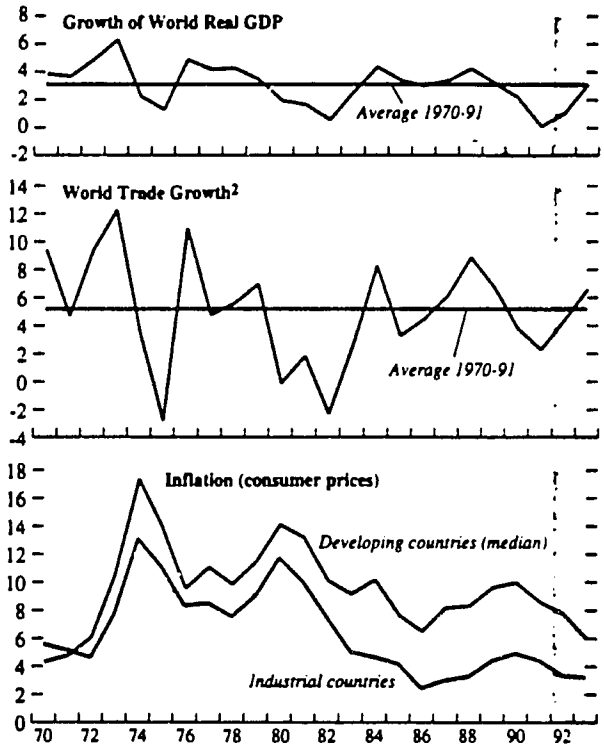
Overview

World economic activity showed signs of revival in the first half of 1992 as some major economies slowly began to emerge from the cyclical downturns of 1990-91. During the next 12 months, world growth is expected to continue to recover at a moderate pace: following stagnation in 1991, world output is projected to expand by 1 percent in 1992 and by 3 percent in 1993, close to the average growth rate during the past two decades but somewhat less than experienced after the two previous—and more pronounced—recessions in 1974-75 and 1981-82 (Chart 1). Recent progress in reducing inflation is likely to continue in most countries. The growth of world trade is forecast to rise from 2¼ percent in 1991 to 6¾ percent in 1993.

Notwithstanding signs of recovery in the industrial countries, the expansion continues to be slow and uneven, and the balance of risks remains on the downside. An important impediment to a stronger performance is the continued need in several countries for balance sheet adjustments to unwind the effects of earlier speculative excesses in real estate and other asset markets. In addition, the persistence of large budgetary imbalances in a number of countries is adversely affecting business and consumer confidence. As experienced recently, large divergences in economic policies among countries are also contributing to tensions in financial and foreign exchange markets, with the U.S. dollar having fallen to historic lows against other major currencies. In most countries, the need to control inflation remains a constraint on economic policy, and there is little scope for further actions to support activity in the short run beyond the steps that have already been taken to reduce short-term interest rates in some countries and the adoption of an economic package in Japan. Major efforts to reduce fiscal imbalances, however, are urgently required in many countries to improve confidence and strengthen prospects for sustained growth over the medium term.

In many of the developing countries, growth has remained relatively strong, despite the weak international environment, as an increasing number of countries have made substantial progress toward stabilization and economic reform. However, inadequate policy efforts remain an obstacle to sustained growth in many other countries. In some Eastern European economies, there are indications that the sharp contraction of output may be coming to an end and that economic reforms are beginning to bear fruit, but the situation remains fragile. In the countries of the former Soviet Union, where the transformation process has only just begun, further output losses are expected.

Chart 1. World Indicators[1]
(In percent)



[1]Shaded areas indicate IMF staff projections.
[2]Excluding trade among states of the former U.S.S.R.

Industrial Countries

Since the early 1980s, most of the industrial countries have sought to conduct their economic policies in the context of a medium-term growth strategy. The basic elements of this strategy include the pursuit of price stability; the promotion of

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higher rates of investment and saving, especially through reductions in government deficits; and the elimination of obstacles to efficient resource allocation and job creation through structural reforms. Despite progress in some areas, the record in achieving these objectives has been disappointing.

- The greatest progress has been made in reducing inflation, which has slowed markedly during the past decade, in some cases to levels not seen since the 1960s. In many countries, however, inflation needs to be reduced further.
- Although budget deficits have declined substantially in some countries during the 1980s, in others budgetary imbalances have remained very large or have recently widened following earlier consolidation. This has contributed to the persistence of historically high real long-term interest rates, despite the recent weakness of activity. The peace dividend has enhanced the scope for trimming budgetary outlays, but it is increasingly clear that pressures on expenditures will intensify in coming years as a result of aging populations, the rising cost of health care, the demand for investment in infrastructure, and concerns over the environment.
- Much remains to be done to dismantle barriers to trade, to reduce industrial and agricultural subsidies, and to improve the functioning of labor markets, particularly in those countries where unemployment has remained high. The delay in concluding the Uruguay Round of trade negotiations is particularly worrying, and a failure to conclude the Round would be a major setback.
- There has been greater progress in liberalizing financial markets, but to reduce the risk of excessive leveraging and unsustainable increases in asset prices as experienced in the 1980s in many countries—and thereby reap the full benefits of financial liberalization—the authorities will need to strengthen oversight and pay greater attention to developments in asset markets in formulating the appropriate policy stance.

The failure to implement fully the medium-term strategy has contributed significantly to the difficulties currently facing many industrial countries. These began in the late 1980s, when inflation was rekindled in several countries following a steady decline in the 1982-86 period. The rise in inflation in 1988-90 was partly attributable to pressures on capacity, which could have been alleviated by more determined efforts to curb budget deficits and to eliminate structural rigidities, particularly in labor markets. Moreover, in many countries monetary policy inadvertently accommodated speculative increases in asset prices, while the monetary easing that occurred in part in response to the stock market crisis in late 1987 was not reversed sufficiently quickly.

The subsequent tightening of monetary policies was eventually successful in reducing inflationary pressures, but at the expense of an inevitable weakening of economic activity. The slowdowns were particularly protracted in those industrial countries that allowed the greatest acceleration of inflation during the late 1980s, while countries that maintained generally good control over inflation typically suffered only moderate slowdowns in economic growth. Thus, even though other factors also played a role, improved adherence to the objective of seeking price stability was generally rewarded—not only by lower inflation, but also by smaller fluctuations in output and employment.

In contrast to the results in the area of inflation, the failure of many countries to implement the medium-term strategies for fiscal consolidation and structural reform has continued to impede economic performance—as illustrated by the sluggish recovery from the recessions or slowdowns of 1990-91. In Europe, the high level of interest rates stemming from German unification and from the persistence of large fiscal imbalances in several other countries, together with inadequate progress in correcting structural problems in labor markets, has contributed to the sluggishness of activity. In North America, short-term interest rates have been reduced considerably and appropriately in light of the weakness of activity and the progress achieved in reducing inflation. However, the effectiveness of these actions in supporting recovery has been limited by the high level of real long-term interest rates and by generally depressed levels of consumer and business confidence. These problems, in turn, reflect the lack of adequate progress in reducing the structural budget deficit in the United States, the heritage of high inflation for most of the past two decades, and the need to correct the financial imbalances that resulted from the heavy private sector borrowing and asset price inflation of the 1980s.

Looking forward, it is again clear that deficiencies in achieving medium-term policy objectives constitute critical barriers to additional policy measures to support more robust recovery. As discussed below, this is particularly the case in the fiscal area. With respect to monetary policy, efforts to stimulate activity by reducing short-term interest rates are counterproductive when such efforts erode the credibility of the commitment to contain future inflation and, therefore, are reflected in high long-term interest rates. In countries where short-term interest rates have been substantially reduced, additional interest rate reductions would not now appear to be warranted. Moreover, the monetary authorities in these countries will need to remain alert to signals of increasing inflation and to be prepared to undertake prompt upward adjustments to short-term

interest rates. In Germany, the same principle implies that an easing of monetary conditions must await clear evidence that inflationary pressures are receding, particularly in the absence of greater progress in reducing the budget deficit.

Turning to developments in specific countries, growth in the United States picked up in the first quarter of 1992, supported by a recovery of consumption and residential construction and by continued strong export growth. Consumers and investors have remained hesitant, however, and the pace of recovery slowed again in the second quarter, prompting a further lowering of short-term interest rates. Nevertheless, on the basis of stronger balance sheets, the marked decline in short-term interest rates, and the improved international competitiveness of U.S. producers, real GDP is projected to increase by 2 percent in 1992 and by 3 percent in 1993.

For close to a decade, the chief economic policy problem in the United States has been the large federal budget deficit, estimated at 6¼ percent of GDP in FY 1992 (excluding net outlays for deposit insurance and net social security receipts). Lack of progress in reducing the deficit in 1990–91 was due in part to the weakness of the economy but the medium-term fiscal prospects have also deteriorated further. By affecting inflation expectations and by diverting scarce resources away from private sector investment through its effects on long-term interest rates, the persistently large structural deficit constitutes an impediment to growth both domestically and globally. It has been a major reason for the accumulation of large external deficits in the United States during the past decade, and it remains a potential source of tension in financial and foreign exchange markets.

A determined new effort to reduce the federal budget deficit in the United States is urgently required as a necessary condition for a more satisfactory economic performance over the medium term. A comprehensive program to reduce expenditures (and to control their future growth) and to increase revenues would help to improve confidence and would foster a decline in real long-term interest rates. Such measures would also reduce the risk of a pickup in inflation as activity strengthens. Some deficit-reduction measures, including the elimination of distortionary tax expenditures and a reduction of support to agriculture, would also help to address long-standing structural problems.

In the European Community (EC), following a slowdown in 1991, growth is expected to recover gradually during 1992–93, with real GDP rising by 1½ percent in 1992 and by 2¼ percent in 1993. As in North America, however, the recovery is less robust than in previous cyclical upturns, with a recent intensification of exchange rate tensions contributing to uncertainty and weak confidence. The United Kingdom has not yet emerged from recession, and growth has remained weak in Italy. There are now signs of recovery in the eastern German Länder, but activity has again slowed in west Germany following a pickup in the first quarter of 1992. In France, activity also slowed in the second quarter following a strong pickup in the first quarter. Although economic activity in the EC is expected to strengthen somewhat during the period ahead, growth in 1993 is unlikely to be strong enough to reverse the recent rise in the rate of unemployment, now standing at close to 10 percent.

The reasons for the Community's lackluster growth and high unemployment are complex. Notwithstanding the push to liberalize and deregulate that has been generated by the Single Market program, many structural impediments remain to be tackled, particularly in the areas of labor markets and government subsidies. Moreover, the tightening of monetary conditions in Germany necessary to contain inflationary pressures associated with unification has spilled over to the rest of the EC, where domestic considerations do not in all cases warrant high interest rates. In addition, in those EC member states where progress in reducing inflation and budget deficits has been inadequate, such as Italy, interest rates are particularly high and have recently been pushed up further as a result of exchange market tensions.

The necessary efforts to reduce macroeconomic imbalances in the EC have been given new impetus by the Maastricht agreement to move to full economic and monetary union (EMU) by the end of the decade. The implementation of measures to meet the agreed convergence criteria for participation in the final stage of EMU is essential to reduce exchange market tensions and to permit a lowering of real interest rates and an improvement in the Community's growth performance over the medium to longer run. Indeed, it is highly unlikely that growth could be maintained at a satisfactory pace in the absence of efforts to reduce excessive fiscal deficits and bring down inflation to sustainable levels. Early measures to bring the German budget deficit well below the Maastricht ceiling of 3 percent of GDP, in accordance with the authorities' objectives, would facilitate budget consolidation and achievement of convergence by other EC countries through the beneficial effects such measures would have on monetary conditions throughout the Community. Labor market and other structural reforms will also be crucial to foster stronger growth. It is encouraging, in this context, that the basic principles of a fundamental reform of the Common Agricultural Policy have now been agreed.

Activity slowed markedly in Japan during 1991 following several years of rapid expansion and signs of overheating. Real GDP increased significantly in the first quarter of 1992, but the most

recent months have seen a weakening of some indicators, including private consumption. The present slowdown reflects the unwinding of earlier inflationary pressures and a desirable, but painful, correction of real estate and stock prices. To ease the adjustment process, a number of policy measures have already been taken, including substantial reductions in short-term interest rates and a front-loading of public investment spending, and an additional large economic package was announced at the end of August. These measures should help to support confidence and stimulate the growth of real GDP, which is expected to recover to 3¾ percent in 1993 following a slowdown to 2 percent in 1992. In light of Japan's earlier efforts to consolidate the fiscal position, the recent action should not jeopardize the credibility of the country's medium-term budgetary objectives.

Despite the near-term risks, Japan's medium-term outlook remains strong, with potential growth of about 3½ percent. The country has prepared well for the pressure on public finances associated with the aging of the population in the coming two to three decades, through the determined pursuit of fiscal consolidation and the accumulation of a surplus in the social security sector. The success in the fiscal area should permit the authorities to focus greater attention on structural reforms, particularly in the areas of financial markets, competition policy, agriculture, and land management. Such structural reforms would benefit domestic consumers directly and would also help to defuse tensions over trade.

Developing Countries

The developing countries are projected to grow by 6¼ percent in 1992 and 1993, the strongest growth in more than a decade. The only regions where the outlook has deteriorated are southern and eastern Africa, where a number of countries are suffering from the effects of a severe drought and civil disturbances. For other developing countries, the sluggishness of world demand and the weakness of commodity prices have been mitigated by the favorable impact on debt-servicing costs of the decline in short-term interest rates in the United States and Japan and by debt-restructuring agreements. In the Middle East, reconstruction after the recent conflict is contributing to a marked recovery of activity.

Beyond these special factors, there is also encouraging evidence that stabilization and economic reform efforts are beginning to bear fruit in an increasing number of countries. Overall, as many as 35 countries—accounting for over 50 percent of output in the developing world—can now be characterized as successful adjusters, even though the reforms have not yet been completed in all cases. A core group of these countries, predominantly located in Asia, began the reform process more than a decade ago. During the past three to four years, however, a growing number of countries in all regions have begun to overcome their earlier adjustment difficulties. The experience of these countries suggests important lessons for other countries undertaking adjustment and reform.

During the recent period of sluggish global growth, the successful reformers have registered sustained and relatively rapid increases in output. The key to their performance has been determined efforts to reduce fiscal deficits and to control inflation. Equally significant has been their recognition of the importance of market forces: most of these countries have acted to liberalize foreign trade, to cut subsidies, and to privatize state enterprises. In many cases, financial market reforms have also been adopted to mobilize financial resources and to ensure that resources are allocated efficiently.

For a growing number of developing countries, recent improvements in economic performance have been accompanied by a reversal of capital flight and substantial capital inflows in the form of both direct and portfolio investments. This is a welcome indication that confidence in the outlook for these countries is improving. At the same time, the authorities need to recognize that the capital inflows can easily be reversed and that appropriate policy adjustments are required to prevent overheating. In several countries, a tightening of fiscal policy would help to make room for higher investment and would permit a reduction of high interest rates, often a major reason for the capital inflows. Allowing a real appreciation of the currency may be appropriate in some cases. It may also be possible to speed up privatization, which would help to retire both domestic and external government debt.

The considerable decline in the aggregate debt-export ratio of developing countries—from 178 percent in 1986 to 123 percent in 1992—suggests continuing progress in managing the debt problem, particularly in many of the highly indebted middle-income countries. This has been partly the result of effective stabilization policies and economic reforms conducive to higher export growth. In addition to the beneficial effects of lower world interest rates, debt-reduction operations also have contributed significantly in a number of cases.

For the least developed countries, most of which are located in Africa, progress in alleviating the debt burden has been slow, but a number of initiatives by official creditors, the main holders of this debt, have helped to contain the cost of debt servicing. However, further measures are necessary to promote economic reforms and higher growth in the poorest countries, including an early implementation of commitments to raise official financial and technical development assistance and to improve

access for developing country exports. In view of the special needs of low-income countries, the IMF has recently extended the commitment period for access to its concessional enhanced structural adjustment facility (ESAF).

Former Centrally Planned Economies

The early phases of the economic transformation process in Eastern Europe were associated with a marked drop in output in 1990 and 1991. Although further substantial output declines are expected in 1992, there are grounds for cautious optimism that the output contraction may be coming to an end in some of these countries. In addition to the inevitable transitional disruptions associated with the dismantling of the command system, the reasons for the huge output losses include the breakdown of trade among the former members of the Council for Mutual Economic Assistance (CMEA); the obsolescence of much of the capital stock; rigidities in capital and labor markets; and financing constraints. The slowness with which supply has responded to market forces and the difficulties in developing new products and finding new markets—notwithstanding a marked increase in exports to the industrial countries—have prolonged the adjustment period.

In Eastern Europe, governments moved relatively quickly in 1990-91 to liberalize prices and to open their economies to external competition. Although progress in these areas has been substantial, the recent experience has highlighted the limits to the pace of structural change and the crucial link between structural reform and financial stability. Much remains to be done to establish the institutions and structures of a market economy. Uncertainties over property rights, the lack of an effective financial system, and an inadequate supply of management and financial skills are major obstacles to improved economic performance. In addition, despite early progress with small enterprises, privatization of medium to large enterprises has generally been delayed. These problems have been compounded by larger-than-expected fiscal imbalances and a lack of adequate monetary control. The prospects for recovery will depend on the success with which these problems are addressed.

The countries of the former Soviet Union are still in the very early stages of the reform process. In the Russian Federation, important structural reforms have been introduced in 1992, including extensive price reform and unification and liberalization of exchange markets. The implementation of other major systemic changes and of effective stabilization policies, however, has yet to be achieved. If the intended strengthening of monetary and fiscal control does not materialize, inflation will remain excessive, which would impede urgently needed improvements in resource allocation. In addition to the measures announced in July, further efforts will be required to reduce the budget deficit, contain credit expansion to loss-making enterprises, and establish effective monetary arrangements within the ruble area. In support of the stabilization effort, and to promote the necessary restructuring in industry, there is also an urgent need to introduce commercial accountability and hard budget constraints for state enterprises, and to accelerate privatization and other structural reforms.

The other countries of the former Soviet Union are experiencing much the same difficulties as Russia. Despite early steps to liberalize prices, output has been slow to respond to market forces, and numerous obstacles continue to hamper trade among the states of the former Soviet Union. A continuing lack of stability in the ruble area reflects excessive credit expansion in a number of countries and the failure to coordinate monetary policy in the ruble area. Several countries are now in the process of introducing separate currencies, in part to achieve a greater degree of monetary independence. In these countries, the need for strong stabilization policies is no less urgent than in the ruble area. Furthermore, countries that leave the ruble area need to ensure the prior establishment of payments arrangements to avoid any unnecessary disruption of trade with countries remaining in the ruble area.

The support of the international community is vital to help to limit the costs of transition and to reduce the risk of setbacks in the reforming countries' own policy efforts. Three mutually reinforcing types of assistance are essential. The first is policy advice and technical assistance in building market institutions. The second is adequate financial support to permit the buildup of reserves and to help to finance investment projects. Finally, the rest of the world, and especially the industrial countries, will need to open their markets further, on a nondiscriminatory basis, to the exports of the reforming countries so that these countries can benefit from the multilateral trading system that underpins the success of all market-based economies.

* * *

To facilitate analysis of trends in developing countries and in the former centrally planned economies, the Statistical Appendix has been modified to show data separately for the two groups. The former centrally planned economies comprise the countries of the former Soviet Union, Eastern Europe (including the states of the former Yugoslav Federation), and Mongolia.

Privatization

The Lessons of Experience

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Summary

The World Bank Group supports privatization in the context of its broader goals of economic development and the reduction of poverty.[1] An efficient private sector makes essential contributions to the attainment of these goals. Among the means available for promoting private sector development is the privatization of state-owned enterprises (SOEs). Privatization, when correctly conceived and implemented, fosters efficiency, encourages investment (and thus new growth and employment), and frees public resources for investment in infrastructure and social programs.

Privatization is a complement to, not a replacement for, the other aspects of the development of the private sector in the World Bank's member countries. In many instances privatization will be less important for the growth of the private sector than the emergence of new private businesses. Measures that support free entry by private operators will be crucial in shifting the balance of economic activities from the public to the private domain.

This book reviews the experience of countries with state-owned enterprises and with the privatization of these enterprises. The main lessons of experience are clear:

- Private ownership itself makes a difference. Some state-owned enterprises have been efficient and well managed for some periods, but government ownership seldom permits sustained good performance over more than a few years. The higher probability of efficient performance in private enterprise needs to be considered in choosing whether to invest public funds in SOEs or in health, education, and other social programs.
- The process of privatization, although not simple, can work and has worked; this is true for a variety of enterprises in a variety of settings, including poor countries.

These lessons are already being put into practice. Privatization is widespread and accelerating. More than eighty countries have launched ambitious efforts to privatize their state-owned enterprises. Since 1980,

more than 2,000 SOEs have been privatized in developing countries and 6,800 worldwide. Up to 1990, many of the SOEs sold in Bank borrower countries were small or medium in size. The past two years, however, have witnessed an increase not only in the number of large SOEs being sold or readied for sale but also in the number of countries adopting privatization and in the pace of sales.

The World Bank Group has actively supported privatization in more than 180 Bank operations, 50 advisory support and investment operations by the International Finance Corporation (IFC), and three projects by the Multilateral Investment Guarantee Agency (MIGA). Because the three institutions have complementary roles, Bank Group support adds up to more than the sum of its parts.

Why Privatize?

Developing countries have created SOEs for many reasons: to balance or replace weak private sectors, to produce higher investment ratios and extract a capital surplus for investment in the economy, to transfer technology to strategic sectors, to generate employment, and to make goods available at lower cost. Although many SOEs have been productive and profitable, a large number have been economically inefficient, incurred heavy financial losses, and absorbed disproportionate shares of domestic credit.

Of particular concern to governments is the burden that loss-making SOEs place on hard-pressed public budgets. SOE losses as a percentage of gross domestic product (GDP) reached 9 percent in Argentina and Poland in 1989; through the 1980s about half of Tanzania's 350 SOEs persistently ran losses that had to be covered from public funds; in Ghana from 1985 to 1989 the annual outflow from government to fourteen core SOEs averaged 2 percent of GDP; and in China about 30 percent of SOEs were loss-making in 1991. The losses have important consequences: Mexico's minister of finance has noted that a fraction of the $10 billion in losses incurred by the state-owned steel complex would have been enough to bring potable water, sewerage, hospitals, and educational facilities to an entire region of the country (Aspe 1991).[2]

Virtually all developing countries, beginning in the 1970s and continuing through the 1980s, adopted programs to remedy the causes of poor SOE performance—but without changing ownership. The World Bank, through its lending and policy dialogue, actively worked with borrowers to implement these reforms. Many of the reform programs had positive results. But they proved difficult to implement and even harder to sustain, both in industrial countries—such as New Zealand and Japan—and in developing countries. In the Republic of Korea, where a reform program put a group of SOEs in the black for three years in the mid-1980s, losses have since reoccurred. A number of SOEs that the Bank's *World Development Report 1983* cited as well on the road to improved performance because of exemplary reform efforts—manufacturing SOEs in Pakistan, the Senegalese bus company, and fertilizer SOEs in Turkey—either have failed to improve in performance or have deteriorated. Growing recognition by governments of the limited and unsustainable nature of past reforms helped fuel the drive toward privatization in the 1980s.

SOEs can be placed on an economic-financial performance spectrum that ranges from very good to very bad. Although the same is true for private firms, there is considerable evidence indicating that the median point on the private enterprise spectrum lies higher than the median on the public enterprise spectrum. This is true under all market and country conditions. The decision concerning what to privatize and what to reform should thus tend toward privatization as the outcome most likely to produce positive gains. The likelihood that SOEs will cause problems places the burden of proof squarely on their advocates. The evidence in this book repeatedly points to the conclusion that ownership itself matters.

The Impact of Privatization

The benefits from properly executed privatization have proved to be considerable, as is shown by cases in Latin America, Africa, and Asia, as well as in industrial countries. Privatization improved domestic welfare in eleven of twelve cases analyzed by the World Bank in Chile, Malaysia, Mexico, and the United Kingdom.[3] Productivity went up in nine of the twelve and showed no decline in the other three. Expanded investment and diversification of production resulted in rapid growth in many of the firms studied; for example, the Chilean telephone company doubled its capacity in the four years following sale. Labor as a whole was not worse off, even taking into account all layoffs and forced retirements. Consumers were better off or were unaffected by sale in a majority of cases. Buyers of the firms made money, but in the main the other stakeholders—labor, consumers, and government—gained as well.

Studies and data from outside the World Bank also show that privatized companies grow more rapidly and are better able to contain their costs than before privatization. In forty-one firms fully or partially privatized by public offerings in fifteen countries (most of them industrial, but the list includes Chile, Jamaica, and Mexico) returns on sales,

assets, and equity increased and internal efficiency improved because of better utilization of physical and human resources. The firms improved their capital structure and increased capital expenditures. Their work forces also rose slightly, thanks to higher investments.

Most privatization success stories come from high- or middle-income countries. It is harder to privatize in low-income settings, where the process is more difficult to launch. But even in low-income countries the results of some privatizations have been highly positive, as shown below.

Revenues from sales have been large in some countries, but in most, net revenues have been modest because of small transaction size, the costs of settling enterprise debts, and payment of delinquent taxes and transaction fees and because many sales have been on credit. More important, privatization has reduced subsidies to SOEs and has led to increases in government income when taxes paid by privatized firms have exceeded the sums previously paid by SOEs. In Mexico transfers and subsidies from the government to SOEs declined by 50 percent between 1982 and 1988; the stabilization program after the 1982 shock was the most important cause, but privatizations, which began in 1984, helped lock in these reductions.

Conditions for Success

Two main factors affect the outcomes—in terms of economic productivity and consumer welfare—of privatization (see figure 1). One is the nature of the market into which the enterprise will be divested—that is, whether it is competitive or noncompetitive. Privatization of enterprises in competitive and, in particular, tradable sectors such as industry, airlines, agriculture, and retail operations is likely to yield solid and rapid economic benefits as long as there are not economywide distortions that hinder competition. Even with such distortions, privatization can have the benefit of reducing the fiscal burden of SOE subsidies and exposing fully the costs of the distortions.

The second factor is country conditions: the overall macroeconomic policy framework and capacity to regulate. Privatization of both competitive and noncompetitive enterprises will yield more immediate and greater benefits the more market-friendly the policy environment (the top panels of the figure). For this reason, the World Bank Group often supports privatization as one part of an overall government program of exchange rate, fiscal, trade, and price reforms. When privatization involves enterprises in noncompetitive markets—usually large SOEs operating as natural monopolies in such areas as power, water supply, and

Figure 1. Privatization: A Framework for Decisionmaking

Country conditions	Enterprise conditions	
	Competitive	Noncompetitive
High capacity to regulate; market-friendly	*Decision* • Sell	*Decision* • Ensure or install appropriate regulatory environment • Then consider sale
Low capacity to regulate; market-unfriendly	*Decision* • Sell, with attention to competitive conditions	*Decision* • Consider privatization of management arrangements • Install market-friendly policy framework • Install appropriate regulatory environment • Then consider sale

telecommunications—a legal and regulatory system must be in place to protect consumers. Good policies and regulatory capacity are correlated with income; thus, middle-income countries tend to be in a better position to privatize rapidly enterprises in noncompetitive sectors.

The privatization process itself is also easier if the enterprise is in a competitive sector and the environment is market-friendly. The sale of an enterprise in a competitive sector in a favorable country setting (the upper left-hand panel in the figure) requires little more than adequate attention to transparency in the transaction and the lifting of any inappropriate regulations or price controls. In unfavorable country settings, where the existing private sector is small, capital markets are thin, and the interest of external investors is limited, the sale of enterprises even in competitive sectors may be more difficult. But the benefits in economic gains are potentially large, especially in comparison with the continued operation of a loss-making SOE.

Privatization turned a near-moribund textile company in Niger into a profitable exporter. A finance corporation in Swaziland, closed as an SOE, became a profitable private company in two years. Privatization helped put an agroindustrial enterprise in Mozambique on a profitable footing. Privatizations succeeded because they brought in owners with the necessary resources and skills and, more important, a direct stake in the performance of the company. They ended enterprises' ready access to government subsidies and protection and often contributed to increased

competition. This is not to say that privatization always and only produces positive results; negative outcomes have occurred. It is the task of governments and the agencies assisting them—including the World Bank Group—to structure the enabling environment and the transactions in such a way that the potential of privatization is fulfilled.

For the sale of enterprises in noncompetitive sectors (the right-hand side of the figure), the steps are more numerous and the process is more difficult. The enterprises are larger, foreign investment issues are even more salient, and again—especially in lower-income countries—capital markets are thin. Successful privatization of natural monopolies requires a regulatory framework that separates out potentially competitive activities, establishes the tariff regime, clarifies service goals, develops cost-minimization targets, and creates or strengthens an agency to supervise the process. Governments will need to be alert to ensure free entry whenever competition is possible. Particularly in lower-income countries, contracts, leases, and other ways of privatizing management are a step in the right direction: they are beneficial in their own right, and they launch a transition to full privatization. Even if management of the entire enterprise is not privatized, services such as billing, construction, and office maintenance can be contracted to the private sector.

Implementation

Governments need not attempt to plan the privatization process down to the last detail, but they must set the principles, choose between potentially conflicting objectives, and supervise the fairness and outcome of the process.

Defining the Objectives

The economic benefits of privatization are maximized when governments make improved efficiency the number one goal—by using privatization to enhance competition and by ensuring a competitive market that reinforces the benefits of privatization. Maximization of revenue should not be the primary consideration. It is better to eliminate monopoly power and to unleash potentially competitive activities than to maximize revenues from sales into protected markets. And it is better to construct appropriate regulatory frameworks to protect consumer welfare than to increase revenue by selling into an unregulated market.

Similarly, short-run distributional considerations, although they cannot be ignored, should not be pursued at the cost of managerial competence. Privatization should aim to improve corporate governance, and that may mean forgoing widely dispersed ownership in favor of an owner with enough of a stake to have strong motivation and the control needed for turning around a troubled SOE. In addition, sale of SOEs through public offerings, which is attractive because it mutes the charge that domestic elites or foreign investors are being favored, is difficult to launch and manage, and delays have been a common result.

What, How Much, and How Fast to Sell

Many countries began divestiture by selling small and medium-size SOEs in competitive sectors. Such sales are simple and quick, involve little restructuring or postsale regulation, and are politically low-risk. Start small, learn by doing, and move on to larger, more complicated transactions: this was the primary lesson of the successful experience in Mexico.

But there is no single strategy, and the choice of where to begin depends on investor interest, on government capacity, and on identification of the sectors and enterprises most in need of new investments and improvements in efficiency. A growing number of governments are opting to launch their privatization programs with sales of large and often poorly performing public utilities. They believe that the window of political opportunity may be but briefly open, that divestiture of a major SOE will signal commitment to investors and markets, and that the economic returns of enhanced efficiency in a large firm will outweigh the potential risks. This strategy has most often been used in Latin America (for example in Argentina), and to good effect.

Surprisingly, a number of loss-makers have been successfully sold. Most of the IFC's privatization transactions involved SOEs that were making recurrent losses; many had actually been closed. These companies required investments for modernization, and privatization provided access to private investment capital.

Privatizing Management

Management contracts, leases, or concessions, as methods of privatizing management, are particularly beneficial in low-income countries with weak capital markets and banking institutions, limited investor interest, and weak regulatory capacity. When management contracts (whereby the government pays a fee to a private company to manage the firm in question) are correctly drawn up, the gains can be considerable, but they necessitate good drafting and good supervisory capacity in government. Leases provide greater incentives to reduce costs and maintain the long-term value of the assets, since the private party assumes commer-

cial risk and pays a performance-based fee to the government. Concessions go even further: the holder, in return for a long-term lease, assumes responsibility for capital expenditures and investments. Experience with this mechanism in developing countries is still both slight and relatively recent.

Preparation for Sale

Restructuring—legal, organizational, and managerial changes, financial workouts, and labor shedding—is often a necessary prelude to sale, especially for large firms. (Small and medium-size SOEs can be successfully divested with hardly any prior restructuring.) Changing management and settling the liabilities of the SOE are standard measures in successful transactions.

Layoffs do not always accompany privatization; in Mexico, Philippines, and Tunisia privatizations actually led to increased employment. But where large-scale labor shedding is required, it is best handled by the state. Buyers may demand protection and subsidies in exchange for taking on excess labor, reducing the efficiency gains from privatization. The government is better able to mediate union demands and to design measures for alleviating the social costs through retraining, severance pay, unemployment insurance, and other elements of the social safety net. The support of workers has been elicited by undertaking public awareness campaigns explaining the costs and benefits of privatization and of the alternatives, by allotting workers free or subsidized shares in the privatized firms, and by granting adequate severance packages.

Large new investments for plant modernization or rehabilitation prior to sale should be avoided. Getting the private sector to finance investments and take the risk is a prime reason for privatization in the first place. There is also little evidence that governments recover the costs of physical restructuring in the form of higher sales prices.

Pricing and Valuation

Letting the market decide the sale price through competitive bidding is the optimal method. Enterprise valuation is difficult in the best of circumstances and is doubly so in developing countries and in former socialist economies that are undergoing macroeconomic changes. In these situations, information is weak, comparables are few, and the market is thin. Although some external or independent valuation is useful for setting a floor price and ensuring a fair process (particularly in countries with weak capital markets), technical methods seldom

determine the market price for an enterprise. Overvaluation and unrealistic price expectations can delay the process or even lead to valuations that bear little resemblance to what any buyer will offer.

Financing

Government decisions often compound the financing constraints imposed by weak financial systems. A surprising number of governments have put SOEs on the market while at the same time issuing high-yield, low-risk, tax-free government bonds, which compete with the SOEs as an investment. Some governments have further narrowed the sales market by excluding or favoring certain ethnic groups and by placing restrictions on foreign participation. Ways of satisfying political concerns without curtailing the market include reserving free or subsidized shares for groups that would otherwise not be able to participate, keeping a "golden share" for government (with voting rights restricted to decisions on major changes in the firms), and combining sale of a controlling interest to a foreign investor with widespread distribution of the remaining shares to citizens and employees.

Selling for cash is preferable to accepting debt, even if this means a lower price. Outright sale cleanly severs the link between enterprise and state, and cash sales provide the liquidity needed to pay enterprise liabilities, including severance pay. Many countries have resorted to government-financed sales for debt because financial systems are not deep enough, the SOEs are not sufficiently attractive, and the preferred buyers are illiquid. Lowering the price, selling in tranches, or even giving small assets away may be preferable to lavish use of debt.

Debt-equity swaps can ease financing constraints and help improve a country's investment climate. In Argentina, Chile, and the Philippines, swaps have helped bring foreign investors and commercial banks into transactions that might not have occurred in their absence. Nevertheless, swaps must be used carefully. The government may be better off to sell the asset and use the proceeds to buy back debt on the market. Heavily indebted countries may not have a choice, however, as a large debt overhang may deter investors from buying SOEs—particularly large companies that require new investment. In these circumstances, debt-equity swaps can be useful.

Investors' concerns about whether they can raise sufficient capital to modernize and expand may be a stumbling block to the sale of large SOEs. This is particularly so in infrastructure, where sales income is in local currency, raising worries about convertibility and exchange risks. Recent Latin American experience shows that when macroeconomic and

regulatory frameworks are sound, investment capital can usually be raised without any guarantees. But in other cases, where perceptions of country risk are high, some assistance from international agencies and bilateral donors in accessing financial markets may be required to finance investments in newly privatized enterprises. Such support is currently provided to private investors by the IFC and, more recently, through MIGA, which insures noncommercial investment risk.

Managing the Transaction

An important lesson of experience is that transparency is always essential. This means competitive bidding procedures, clear criteria for evaluating bids, disclosure of purchase price and buyer, well-defined institutional responsibilities, and adequate monitoring of the program. Lack of transparency can lead to a perception, justified or not, of unfair dealing and to a popular outcry that can threaten not only privatization but also reform in general. Both transparency and speed are served when policy responsibilities for privatization are centralized in a strong agency, answering to the political top, with a clear mandate and authority and a small, highly competent staff.

Privatization in Eastern Europe and Central Asia

In the former socialist economies, enterprise numbers are larger and the economic and social importance of SOE sectors far greater than in the rest of the world. Whereas in mixed economies privatization is a tool for increasing efficiency, in the former socialist economies many view divestiture as an end in itself, essential to the transformation from a command to a market system.

To date, the number of enterprises divested in former socialist economies (excluding the former German Democratic Republic) is small in relation both to sector size and to early expectations of how fast transfers would take place. The causes of delay include weak legal frameworks; an insufficient (or very expensive imported) auditing, consulting, and financial apparatus; thin local capital markets and lack of liquidity in the population; and suspicion of investors—foreigners because they are foreign, and domestic because they were, usually, part of the *nomenklatura* (the roster of officials approved by the Communist party). It must be recognized that the costs of inaction and delay are very great. Presently, enterprises receive neither central commands nor adequate market signals; this is the worst possible situation. There is a strong case for massive and rapid privatization to create quickly a property-owning

Box 1. A Checklist for Privatization

- ✓ The more market-friendly a country's policy framework—and appropriate policy is correlated with capacity to regulate—the less difficulty it will have in privatizing an SOE, and the higher the likelihood that the sale will turn out positively.
- ✓ SOEs functioning in competitive markets, or in markets easily made competitive, are prime candidates for privatization. Their sale is simple, compared with that of public monopolies, and they require little or no regulation.
- ✓ An appropriate regulatory framework must be in place before monopolies are privatized. Failure to regulate properly can hurt consumers and reduce public support for privatization.
- ✓ Countries can benefit from privatizing management through management contracts, leases, contracting out, or concessions.
- ✓ The primary objective of privatization should be to increase efficiency—not to maximize revenue (for example, by selling into protected markets) or even to distribute ownership widely at the expense of managerial efficiency.
- ✓ Rather than restrict the market by excluding foreign investors and favoring certain ethnic groups, governments should experiment with "golden shares" and partial share offerings to win acceptance for foreign and other buyers.
- ✓ Avoid large new investments in privatization candidates: the risks usually outweigh the rewards. Rather, prepare for sale by carrying out legal, managerial, and organizational changes, financial workouts, and labor shedding.
- ✓ Experience shows that labor does not, and need not, lose in privatization if governments pay attention to easing the social cost of unemployment through adequate severance pay, unemployment benefits, retraining, and job search assistance.
- ✓ Ideally, let the market set the price and sell for cash. Realistically, negotiated settlements and financing arrangements or debt-equity swaps may be unavoidable.
- ✓ In all privatizations, in all countries, the transaction must be transparent.

group of sufficient size and political weight that will respond to price signals and support the steps necessary for the transformation.

Innovative methods of privatization are being devised, including giveaway schemes to the population at large (often called "mass privatization"), state-assisted financing, distribution of free or low-cost shares to employees in privatized firms, and use of new types of invest-

ment-management companies to run groups of companies and diversify risk. Mistakes are bound to occur, and the emphasis should not be on avoiding risk but on ensuring flexibility. Experimentation with all available privatization methods should be supported. As experience accumulates, the methods that work best should be strengthened, and mistakes or oversights corrected.

Therefore, although the set of tactics optimal for the former socialist economies may not yet be clear, the general strategy for achieving these countries' objectives, given their circumstances, is apparent: privatize; privatize in all possible ways that encourage competition; and adopt methods that do far more than privatize firms one-by-one, including the transformation of all enterprises into joint stock companies.

The lesson that ownership matters has been heeded: increasingly, governments worldwide are moving to tap private management and finance and to privatize. Governments intent on privatizing face a challenge: the benefits of efficiency and innovation only materialize if privatization is done right. The lessons of experience provide guidance on how to privatize successfully (see box 1). The task of the World Bank Group is to assist countries to realize the promise of privatization while minimizing the costs.

Russian privatisation: a policy for the people

Russian industrial structure	Number of companies	Average number of employees
Electrical energy	982	407
Fuel energy	352	2,080
Ferrous metallurgy	205	4,093
Non-ferrous metallurgy	174	2,971
Chem/Petrochemicals	561	2,173
Engineering	6,306	1,568
Wood processing	3,885	465
Construction materials	2,161	480
Glass & ceramics	164	963
Light industries	4,034	617
Food industries	5,480	253
Other	1,936	940
Total	25,240	821

Source: Goskomstat, 1987

Three options:

Source: Russian government

1. The offer of 51% of the shares to the work collective at 1.7% of book value

2. Free allocation of 25% of shares to the collective (managers & workers), 10% for workers and 5% for managers at 0.7% of (low) book value. Workers would enjoy 30% discount on shares

3. Free allocation of 20% of shares to members of a group formed from collective which, over a year, restructures the company; a further 20% sold to entire collective at 0.7% of book value

The October revolution

The privatisation of Russian industry promises to create a society of capitalist shareholders, writes **John Lloyd**

The privatisation of the bulk of Russia's industry, which began officially yesterday, is revolutionary in design. By creating a class of responsible property owners capable of exercising rational economic choices, it seeks to resurrect a bourgeoisie which the now-discarded Soviet regime once sought to consign to the dustbin of history.

"Privatisation on this scale," said Mr Anatoly Chubais, the deputy prime minister in charge of privatisation, "is unprecedented in the history of Russia ... of the world".

Moreover, privatisation – the most visible and important part of the Russian reform programme – is now seen as unstoppable. The parliament, which has often shown itself to be an uncertain and febrile body, has endorsed it. Mr Ruslan Khasbulatov, the speaker and no friend of the government, called it "effectively irreversible".

That is not to say it is universally popular. The Russian government is so deeply disliked that almost everything it does is greeted with suspicion. On the political level, the roughly one-third of the deputies who maintain communist or nationalist positions are bitterly opposed. One of them, Mr Gennady Savenko, last week threw a fistful of privatisation vouchers in the face of Mr Chubais, shouting "all property of any worth will end up in the hands of the rich!"

This is a widely held view. As Mr Konstantin Ovchinnikov, a government chauffeur, remarked: "There used to be a communist slogan about the west: it was where 'the rich get richer and the poor get poorer'. That's what privatisation will mean." This overwhelmingly poor society, which was accustomed to officially promoted egalitarianism, has grown even poorer over the past two years. Now it is being asked to tolerate the rapid expansion of a conspicuously wealthy

The young officials charged with the privatisation project acknowledge this, but counter it. "There already was in the socialist times a privileged class – huge and hidden," says Mr Maxime Boiko, chief aide to Mr Chubais. "In a market economy, of course, it becomes open and evident. But I think this country has a large tolerance for inequality."

The privatisation scheme, which officially opened yesterday, is complex. In its first stage, vouchers with a value of Rbs10,000 – giving the bearer the right to buy company shares – are to be distributed to every member of the public through 40,000 branches of savings banks across the country. In a country of 150m people, this means that about Rbs1,500bn in vouchers will be distributed.

At the same time, between 5,000 and 7,000 enterprises representing about 70 per cent of Russia's vast productive capacity are completing "privatisation plans" in close consultation with their workforces. These plans are essentially choices between three main options laid out by the State Committee for Property, headed by Mr Chubais. They are:

- The assignment of 25 per cent of the shares to the "work collective" (managers and workers) for free, a further 10 per cent would be available to workers and 5 per cent to managers at 0.7 per cent of the shares' book value, which state auditors assigned to them. Workers would enjoy a further 30 per cent discount on these shares.
- The offer of 51 per cent of the shares to the collective at 1.7 per cent of their book value.
- The assignment of 20 per cent of the shares, for free, to those workers and managers who chose to form a group committed to restructuring the company, a further 20 per cent would be sold to all members of the collective at 0.7 per cent of book value.

Under each option, the work collective can use both its vouchers and cash to buy the shares, though a limit of 3o per cent of the total has been set on the number of shares which can be bought through vouchers. In addition, at least 10 per cent of the shares must be available to the general public to buy with their vouchers.

The general public can sell their vouchers for cash, or use them to buy shares in the privatised companies, which are to be auctioned after December 1. The vouchers must be spent before the end of next year or they will lose their value. They are to be redeemed by the government, while the cash spent on the purchase of shares by the public will go to local and regional authorities.

No one is certain how many citizens will opt to sell their vouchers. Even before yesterday's distribution, a secondary market had begun in which people, especially the elderly, had pre-sold their vouchers, reportedly for around their face value or slightly above.

Mr Chubais believes, on the basis of his own polls, that only some 30 to 40 per cent of the population will sell their vouchers. Other estimates made by opposition deputies claim that 80 per cent will do so.

For those who hold on to their shares, and who are not members of companies to be privatised – such as state school teachers, municipal workers and others – the 300 or so mutual funds already set up are likely to be attractive.

In theory foreigners are for the most part as free as Russians to take part in this "sale of the century". They are restricted from investing in some defence and energy enterprises, and they have been excluded – except by special permission – from the privatisation of shops and small businesses which is already under way.

But in practice, it seems likely that most foreigners will stay out of the Russian market until ownership and control patterns have emerged over the next year or two – the estimated time it will take fully to privatise the large companies. The legal structure is still raw and incomplete, the enterprises are little known; and their managements are not yet familiar with the demands of a market economy.

Mr Chubais pointed out that some foreign companies have concluded some "very interesting" deals under which they would assist the work collectives in buying shares in exchange for a part of the share capital. Despite this, privatisation is unlikely to prove a quick bonanza for foreign capitalists, as the communists and nationalists claim.

But will privatisation bring about the dynamics of a genuine market economy, as the government intends? Or will the exercise merely result in companies nominally owned by their workers and managers, but continuing to demand state protection and cheap credits, and threatening production strikes if they do not get them? Such tendencies are evident in many private enterprises which already exist. Indeed, the entire process clearly means different things to different people.

To many, privatisation has already happened. On most calculations, more than 20 per cent of the Russian workforce is employed in the "private" sector – in about 200,000 co-operatives created as private enterprises, in former state shops which already have been taken private, and in foreign companies and joint ventures. In addition, there are many larger companies which have recently been taken over by their workers and managers. Some have done so through a now-repealed Soviet law, while others have been taken over illegally, with management agreeing with their workers to create a company owned 100 per cent by themselves, and bribing local bureaucrats to register it.

This process, known as "wild" or *nomenklatura* privatisation, has given rise to a sector known as closed joint stock companies. In these, shares are not traded. Management usually exercises *de facto* control, and in many cases is now buying back shares issued to workers in exchange for roubles, hard currency or imported goods. This practice has largely gone unpunished and is likely to irritate those companies now being told to privatise according to the rules.

Privatisation may mean quite another thing within the larger, state-controlled sector, in which managers and workers constitute a potentially conservative (and largely united) class. Despite the progressive collapse of effective state control over companies the government formally owns, they generally have not adopted market-oriented pricing, investment or marketing strategies. Instead, they have kept prices and wages as high as possible while demanding government support or cheap credit from commercial banks to keep them going – so far successfully. Meanwhile, the lack of bankruptcy legislation (which is expected to be enacted later this month) has meant that none of these enterprises could legally go out of business.

This resistance is wholly natural. The *intended* consequence of privatisation is to separate the winners from the losers; that is, to produce industries which can eventually compete on an international level. This – coupled with the more restrictive monetary policy the government says it is determined to adopt – will certainly mean the end for many companies, and unemployment for their workers. There is a vast amount at stake.

For this reason, the industrialists' lobby – represented most notably by Mr Arkady Volsky, head of the Union of Industrialists and Entrepreneurs, and General Alexander Rutskoi, the vice-president – is actually a much tougher opponent to the government than the noisier critics on the far left and right. In a recent interview in Rabochaya Tribuna, a daily newspaper, Mr Volsky said the privatisation programme was "too strict", and called for the legal right of the collectives to buy all their own shares and form the kind of closed joint stock companies created by the so-called "wild" privatisations.

Ultimately, since Russia is at least partly democratic, the people should decide. But they appear confused. This is no surprise since they are being asked to grapple with strange concepts and unfamiliar choices, and the post-Soviet bureaucracy is not making the job any easier. For most Muscovites, the only official notice of yesterday's voucher scheme was a typewritten memo posted in the ill-lit halls of their apartment blocks.

The government is planning an information drive including media advertising, packages explaining the options to companies and even a privatisation game show on TV. But it is grossly overstretched, despite resources for the programme supplied by the European Bank of Reconstruction and Development, with assistance from the World Bank and the EC.

"This is the start of capitalist education in this country," said Mr Chubais on the eve of the campaign. It will be a long, hard lesson.

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The Old Competition With Marxism Isn't Over Yet

By Thomas Magstadt

THE demise of Soviet-style communism in Europe spelled the end of the cold war, but not the end of the Marxist challenge to capitalism. The democratic trends, apparent in regions of the world where liberalism has never before taken root, create a false impression.

Free enterprise appears to be on the march everywhere. Individualism appears to have triumphed over collectivism. And history appears to have consigned Marxism to the "dustbin" Marx reserved for capitalism. But socialism is not dead.

Indeed, Marx's second coming may be just around the corner. Moreover, a resurgent Marxism will mount a more formidable challenge to the ideas and institutions associated with Western classical liberalism than Soviet communism ever did.

The logic of political circumstances in many regions of the world suggests that an antiliberal backlash is imminent. In the former Soviet Union and Eastern Europe, the attempted transition from central planning to the free market has brought hardship and disillusion. Nowhere has the transition been smooth.

In Russia, Boris Yeltsin faces a major challenge from conservative opponents of radical market reforms who want to keep the old structures of state control largely intact. Poland's 1991 elections, as well as more recent opinion polls, leave little doubt that the people are profoundly disenchanted with economic "shock therapy." In Czechoslovakia, Vaclav Klaus's zeal for privatization undoubtedly helped Vladimir Meciar's Movement for a Democratic Slovakia and contributed to the Slovak decision to secede. In Romania, voters also handed ex-communists a victory at the polls.

In September 1992, when Angola held its first-ever open, multiparty elections and the Marxist Popular Movement for the Liberation of Angola won a convincing victory, Western observers could shrug it off as a fluke. After all, Angola remained under Portuguese colonial rule until the mid-1970s and was then ravaged by a civil war that lasted 16 years.

Shrugging off Lithuania is not so easy. In mid-November the Democratic Labor Party (DLP), headed by Algirdas Braszauskas, won a landslide victory over the anticommunist party, Sajudis, in Lithuania's first post-Soviet elections. The DLP gathered a total of 80 seats in the 141-seat parliament; the alliance led by Sajudis won about half as many seats. The major issue: President Vytautas Landsbergis was blamed for pushing economic reforms too far, too fast.

The electoral setbacks for market-oriented liberal parties in Slovakia, Romania, and Lithuania, as well as defeat of the anticommunist UNITA in Angola, are straws in the wind. It is possible that other governments, in the former Soviet Union and elsewhere, will fall in free and fair elections. If so, it will mark the beginning of a new era in the struggle between free-marketeers and Marxists – an era in which ballots, not bullets, will determine who wins and who loses.

It is also entirely possible that a backlash against International Monetary Fund (IMF)-induced austerity measures in Africa and Latin America will redound to the benefit of socialist parties.

IF Marxism does make a comeback, it will have a wider moral and political respectability than it had during the heyday of the cold war.

Marxism-Leninism was a singularly Russian invention. The "Soviet" leaders who peddled it – with the exception of Mikhail Gorbachev – were brutal and clumsy. As a result, from the October Revolution in 1917 until the Soviet collapse in December 1991, Marxism was burdened by the legacy of Leninism and Stalinism. Of course, there were many turn-of-the-century Marxist intellectuals in Europe, including Russians, who opposed Lenin and rejected his penchant for violent revolution. But it was Lenin's Bolsheviks who ultimately prevailed.

The next wave of socialists will be very different from the Bolsheviks. They will come to power not by subversion and revolution, but by winning open, multiparty elections. They will not carry the stigma of state terror and totalitarian repression. They will represent a morally viable socialist alternative to classical liberalism – a major advantage in societies where "capitalism" has long been associated with exploitation, colonialism, and imperialism.

Liberal democracy cannot rest on its laurels. President-elect Clinton assumes power at a critical moment. The United States needs a foreign policy based on enlightened self-interest and designed to demonstrate anew that democracy and capitalism are both economically and morally viable. In practical terms, that will mean the US must find new and innovative ways to help economically distressed "transitional" democracies. If this means easing IMF pressures for belt-tightening, anti-inflationary policies or exemption from GATT rules governing reciprocity and fair-trade practices or temporary tolerance of subsidies to consumers and producers, so be it.

The challenge for free-market liberals in the West will be to show not only that capitalism is more efficient than socialism, but also that it is compatible with distributive justice.

■ *Thomas Magstadt writes frequently on international affairs. His latest book is "Nations and Governments: Comparative Politics In Regional Perspective" (St. Martin's Press, 1991).*

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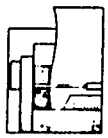
PERSONAL VIEW

Russia on the brink

By Jeffrey Sachs and David Lipton



Russia's economic reforms are falling prey to confusion, communist counterattack, and neglect from the west

The reformers, led by the acting prime minister, Mr Yegor Gaidar, have achieved great successes in launching a radical privatisation programme freeing prices opening the economy and undertaking fundamental legal reforms But these achievements are on the verge of being swept aside by hyperinflation Although data are sketchy inflation now looks to be around 30 per cent a month and rising Still worse, the policy responses to this threat have been mostly confused or harmful

The urgent need is to staunch the haemorrhaging of rouble credits from the Russian Central Bank to enterprises and the budget But aside from the small number of reformers in the cabinet, few Russian political leaders understand or acknowledge the monetary aspects of the explosive inflation Many hold that further credits will stimulate production and thereby reduce prices, the same fantasy that once gripped Latin America

Many politicians and bureaucrats believe that a return to price controls, artificial exchange rates and state orders are the real solution to inflation

The deep economic problem is the same as it has been for many years Russia and many of the other new eastern European and former Soviet states are still bankrupting themselves by directing resources - now, via cheap credits - to the oversized military industrial complex and associated civilian heavy industries It is mind-boggling, for example, that steel production in the Soviet Union was 80 per cent higher than in the US, even though its economy was less than one-eighth the size Of course, there is no conceivable reason to produce so much steel but it is viewed as a calamity when the steel factories reduce their output in the face of limited demand

Much of the political elite in Russia remains mesmerised by heavy industrial capacity, and this clouds understanding of Russia's predicament Almost no one speaks the simple truth that Russia's capacity in heavy industry was built by starving the society of shops, medical facilities, consumer industries, housing construction and banks Preserving the old structures not only risks financial catastrophe, but promotes continuing neglect of Russia's real and urgent needs elsewhere in the economy.

Poland's reforms provide some lessons for Russia With the start of market reforms in 1990 the Polish government maintained macroeconomic discipline in the face of a 55 per cent decline in industrial production (much more than has occurred in Russia) Workers and resources that had been in heavy industry helped build other sectors of the economy, especially services and consumer industries

As a result, Poland's private sector has grown by 710,000 small businesses and 50,000 corporations since the end of 1989 More than 2m people (about 15 per cent of non agricultural employment) have joined the private sector, which now accounts for more than half of GDP and which continues to grow rapidly.

Contrary to the fears that were expressed in Poland in 1990, and that paralyse Russia today, Poland's consumers have benefited enormously by the changes Shortages, queues and hyperinflation are gone Ownership of consumer goods such as television sets, videos and cars has soared Economic life is becoming normal.

In Russia, the military-industrial complex has bitterly resisted the decline in production After a fall in production of around 15 per cent at the start of this year, the military and industrialists demanded, and received, large flows of cheap credits to pay workers and buy inputs to try to maintain production. It was widely accepted that the "industrial recession" must end.

The money supply has approximately doubled since July 1, when the floodgates of credit were opened The credits allowed the enterprises to produce, but did not generate customers for the output Inventories have swelled and enterprises have continued to cut their output More and more, the credits find their way directly into higher wages and into the foreign exchange market, where the value of the rouble has been collapsing

It is hard to judge how much is power politics and how much is confusion in Russia's disastrous monetary policies. Surely, the lobbying pressures of the industrialists play a role. The main "centrist" leader, Mr Arkady Volsky, headed industry under former Soviet President Mikhail Gorbachev, and his goal is to preserve the old industrial structures Many other politicians, such as Mr Anatoly Sobchak, mayor of St Petersburg, defend the military-industrial complex because their constituencies depend heavily on military production In Ukraine, the head of the largest nuclear missile plant became prime minister this week

But the role of confusion should not be underestimated.

President Yeltsin stands to lose all by hyperinflation, and yet he is promoting Gorbachev-style "compromises" with the military-industrial complex which will bring financial disaster. The swirl of advice around Yeltsin is thick with old dogmas that industrial decline is destroying Russia, that unemployment is too high a social cost (despite an unemployment rate that is less than 1 per cent), and that inflationary subsidies to industry reduce social burdens

The situation is desperate, but not hopeless The Russian people generally support the reforms though their support has been squandered by irresponsible macroeconomic policies Yeltsin can still reverse his drift back to the hardliners, by recognising the peril of his present course The west, too, could awaken from its reckless disregard of events in Russia, and weigh in on the side of macroeconomic stabilisation.

At the start of this year, when the reformers had momentum, the west was nowhere to be found US President George Bush virtually abandoned the international scene altogether, in pursuit of re-election Japan's role has been even more irresponsible, as it put the return of four tiny islands from Russia above other considerations And while western Europe did more, its commitment has still been shockingly slight, given the risks of disaster on its own borders

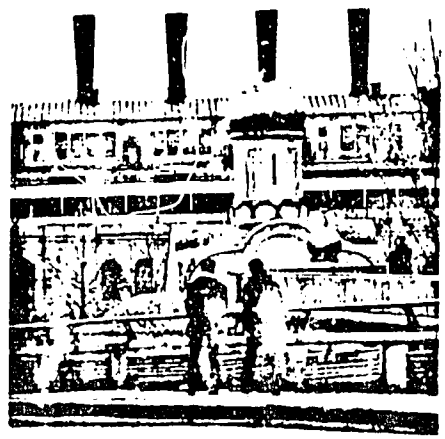
The International Monetary Fund, sent by the west to co-ordinate its assistance, has had not a single monetary expert in residence in Moscow, and the sporadic IMF visits have just scratched the surface. The $24bn aid package promised by the west has remained undefined and unfulfilled.

The limited flows coming to Russia, mostly from export credit agencies, have been one or two-year loans that are not linked to reform. Even the debt has not been rescheduled.

There can be no illusions: Russia's transformation to a democratic market based society will require years of change, including constitutional reforms, new elections, privatisation, and so on There will be deep frustrations as well as achievements But the process could soon turn from orderly change to dangerous chaos if there is hyperinflation

Yeltsin and his reform government still have the chance to steer their country away from the brink of disaster. The west can help them at this pivotal moment The need for greater financial support, technical assistance and debt relief is clear. The world's leaders, especially the next US president and Russia's neighbours must recognise the urgency of the task.

Jeffrey Sachs is professor of economics at Harvard University. David Lipton is a fellow at the Woodrow Wilson Centre. The authors are economic advisers to the Russian government.



Tony Andrews

Devotion to 'industry: a waste of Russia's resources

Western Europe's commitment has been shockingly slight, given the risks of disaster on its own borders

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Sound Banking for a Strong Market

Hans J. Blommestein

An efficient banking system is the backbone of a free-market economic system. That is why one of the crucial challenges faced by the countries of central and eastern Europe is the establishment of a banking system that allocates savings to its most productive uses. Only a market-based system of financial intermediation will allow funds to flow from people and organisations with excess funds to those who require them – towards, in particular, private enterprises which require capital for their development, even their survival.[1]

If the businesses of central and eastern Europe are to be able to adapt themselves to their new economic environment, they will require an efficient banking system – which, moreover, is vital to ensure the quick and reliable movement of funds through the economy. To facilitate trade in goods and services, payers and payees must have confidence that the payment system will process transactions efficiently, on time, and free of excessive risk. A sound banking system is crucial also in the conduct of efficient monetary policy.

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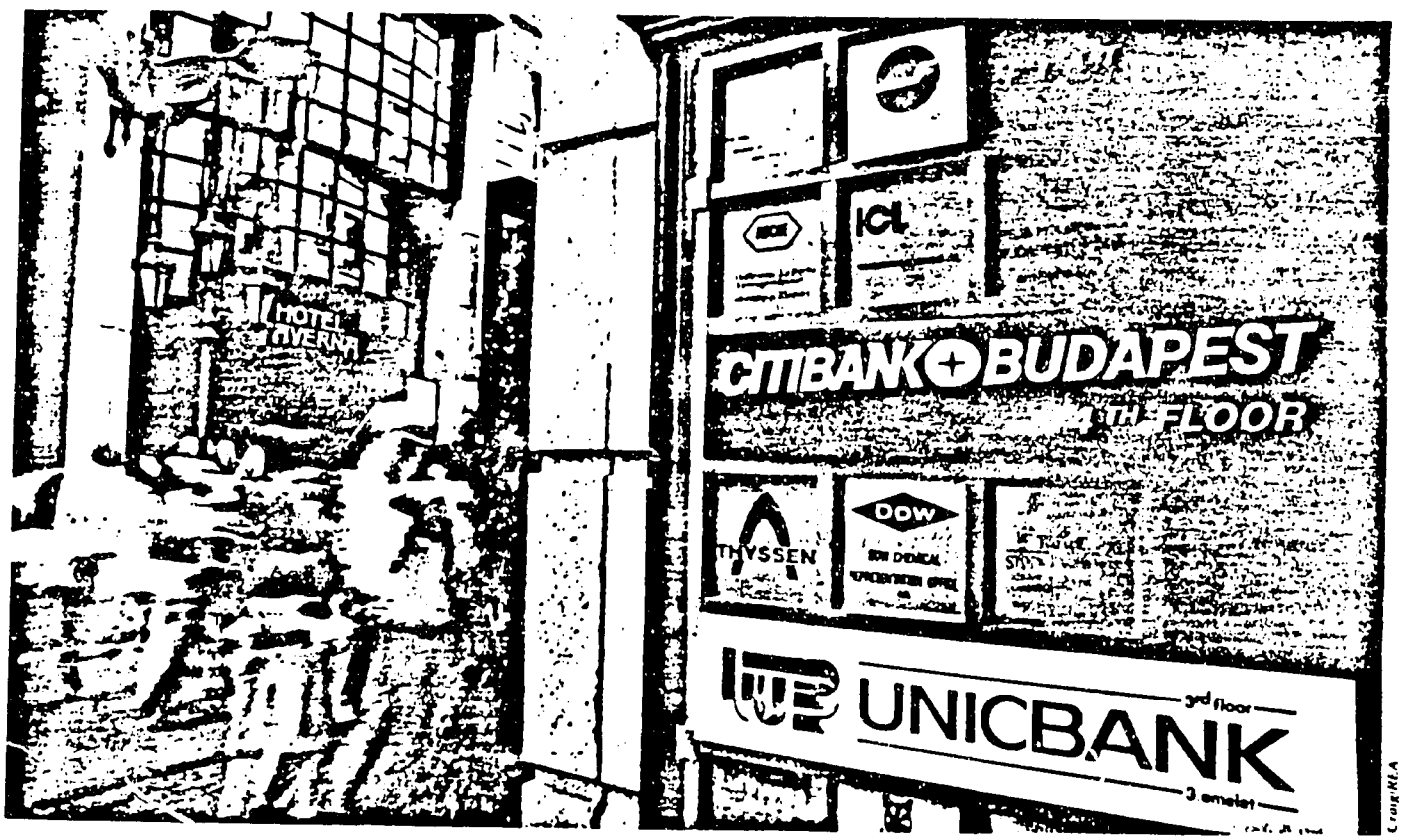
With efficient financial intermediation of the type found in OECD countries, decisions on lending and borrowing and, ultimately, interest rates are driven by market forces. The repressed financial systems of the central and eastern European countries (CEECs), by contrast, were charact-

1. **Bank Restructuring in Central and Eastern Europe**, OECD Publications, Paris, forthcoming 1992.



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erised by distorted real deposit and lending rates, excessive reserve requirements, administratively determined credit ceilings and the planned development of 'privileged' financial circuits. In many cases, real interest rates earned by intermediaries have been negative, with adverse consequences on the development of financial markets.[2] In addition, the development of a sound banking system is severely hampered by the overhang of bad loans to loss-making state enterprises, lack of capital, near-absence of competition, inadequate regulatory and supervisory systems, archaic payment systems, and non-existent money markets.

Under these circumstances, financial liberalisation by itself, by fully freeing interest rates, is not the answer. For example, when the supervision of the financial system is inadequate, a jump in interest rates after liberalisation may encourage excessive risk-taking by undercapitalised banks by providing high-interest loans to customers with large outstanding debts. Banks would thus perpetuate the misallocation of credit, add to non-performing loans, and increase the dependence of weak banks on non-creditworthy customers. The likely result is an increase in macro-economic instability and financial-market fragility. It is therefore necessary to address a number of key structural problems in tandem with the liberalisation of activities in the financial sector.

Regulatory Weaknesses

Experiences in the OECD countries and many developing countries alike indicate the importance of sound regulation in minimising excessive risk-taking by financial institutions, especially if the macro-economic environment is unstable. Efficient regulation is not easy, as is illustrated by recent events involving massive fraud at the Bank of Credit and Commerce International, the Savings and Loan disaster in the United States, insider dealing and share-price manipulation in a number of stock markets, the heavy losses incurred by several banks in the Scandinavian countries and elsewhere, and financial scandals in Japan.[3] An effective regulatory framework that meets basic requirements is nonetheless necessary in building confidence in financial markets – without which other financial reforms have little chance of success.

The new stock exchange in Warsaw is one of the institutions which will help the development of securities markets.

Although the CEECs have made some progress in improving bank supervision, particularly in Czechoslovakia, Hungary and Poland, there are still substantial obstacles. It is difficult – and very time-consuming – to obtain reliable information about the financial health of firms and banks. Experience in the risk analysis of potential borrowers is limited. Tax regimes to make provisions for losses on loans are inadequate. Experienced supervisors and auditors are limited in number. And current supervisory practices are not fully in line with international guidelines.

Early in the transformation process, therefore, banking legislation and regulations must be adapted to ensure that banks manage their risks adequately and that a bank's capital be sufficient to withstand 'normal' losses on loans without jeopardising its solvency. Regulations which specify the classification of assets according to their likely collectability and the treatment of non-performing loans, contingent liabilities and other off-balance-sheet activities, are particularly important. In addition, high priority should be given to training and empowering regulatory staff to enforce the new rules.

Regulations in all financial markets have to be established and co-ordinated. Rules for protecting investors are of central importance. Non-bank intermediaries and all securities-related activities should be made subject to general licensing requirements and supervision. In addition, laws on the enforcement of contracts between market participants must be either put in place or consistently upheld.

Bad Assets

Under communism, planned – largely involuntary – savings were directed through a mono-bank system[4] to uses determined by government planners and politicians, with no regard to economic returns, risk and opportunity costs. Losses of enterprises were automatically financed by the state. And when the current state-owned banks were carved out of the mono-bank system, the new banks simply inherited the existing stock of low-quality loans. Estimates of the volume of bad assets vary widely within each country and across the CEECs, although it is largely agreed that the overhang of such loans makes it virtually impossible for these banks to start operating as market-oriented entities that follow sound banking practices.

2. Hans J. Blommestein and Michael Marrese, 'Developing Competitive Markets', in Paul Marer and Salvatore Zecchini (eds.), **The Transition to a Market Economy in Central and Eastern Europe**, OECD Publications, Paris, 1991.

3. **Financial Market Trends**, No. 50, OECD Publications, Paris, October 1991.

4. The mono-bank system consisted of a central bank and departments or affiliates that performed so-called commercial bank functions (for example, financing industrial or agricultural enterprises) and savings-bank activities.

5. 'Bank Restructuring in Central and Eastern Europe: Issues and Strategies', **Financial Market Trends**, No. 51, OECD Publications, Paris, February 1992.

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A comprehensive strategy to address these bad loans is therefore urgently required. Experiences show that an *ad hoc*, 'wait and see' approach is unlikely to work. Many banks are technically insolvent – they have low capital bases and much of their portfolios are of doubtful value because they contain large exposures to virtually bankrupt or non-competitive enterprises.

As a first step, a special audit should assess the total stock of bad assets. It should be undertaken as quickly as possible and, in principle, it should be regarded as final. Any postponement increases moral hazard for the banks and their customers; in this situation, even healthy enterprises might have a strong incentive to default on their loans, seemingly without penalty, in advance of a strict audit.

Thereafter, different financial restructuring approaches should be considered to ensure that each bank's capital is sufficient to support its future operations, either by increasing the capital or writing off a higher percentage of bad assets in its portfolio. Encouraging state-owned banks to build up loan-loss reserves quickly will mean permitting – on a temporary basis – generous deductions of loss provisions from pre-tax profits.

Where bad assets are too large, other capital-enhancing measures may be necessary – for example, a one-off, recapitalisation of banks from the state budget through a capital grant. But this approach may not be feasible where there are huge volumes of bad assets and/or serious fiscal imbalances. A second consideration is that such grants may send the wrong message to banks and their clients about the importance of curing the structural problems of loss-making firms. It may therefore be necessary to link additional capital injections to restructuring plans of the enterprises that are the clients of the banks.[5]

Lack of Competition

Effective competition between financial institutions remains weak. The financial sectors of most of these countries are highly monopolistic, with a few state-owned banks dominating the market. In addition, there continues to be an effective separation of banking activities. So-called savings banks usually have a *de facto* monopoly on the collection of savings from, and lending to, households. 'Commercial' banks, on the other hand, continue to lend mostly to state-owned enterprises.

As a result, financial markets, and institutions competing in them, are inefficient. Intermediation costs are high, savers and borrowers are restricted in how they arrange and finance their investments, and pressures to develop new financial instruments are weak. This lack of competition also explains why administrative arrangements by central-bank authorities continue to dominate the setting of interest rates.

The contribution of foreign banks to the development of competition has been limited, since they appear to be interested primarily in wholesale banking and other 'niche' activities that appear to offer relatively higher returns. A 'big bang' approach to restructuring the large savings-and-commercial banks may therefore be appropriate, breaking down the separation of banking activities aimed at households and businesses. Co-ordinating the 'big bang' with the cleaning-up of bank balance sheets would enable the authorities to make better judgements about the health of remaining banks. It would facilitate the transformation of state-owned banks into independent commercial entities and, ultimately, their privatisation.

Regulation should ensure that banks have sufficient capital to withstand 'normal' losses on loans.

Anul Rt A

Archaic Payment Systems

The efficient system for settling payments that is vital to a free-market economy is also critical to the functioning of the banking system itself. The experience of OECD countries shows that an efficient settlement system lowers working-capital requirements, reduces transaction costs, and provides the necessary support for an active policy of asset and liability management.

Until recently, payments were settled in most CEECs on an item-by-item basis, with no centralised netting and clearing arrangements. This cumbersome system made information about banks' net positions hard to come by, and banks had neither the capability nor the incentives to

An investment information counter in a Czech supermarket – but institutional investors will require the kind of information that only securities markets can provide... and they require inter-bank deposits.

monitor their reserve positions. As a result, liquidity management by banks, enterprises and households was very difficult. The efficiency of the payment systems was very low, with large delays in clearing and settlement. Consequently, there was considerable net payment float – that is, the difference between total booked credits and debits associated with payments was large.

Some countries, such as Czechoslovakia, Hungary and Poland, have made progress in improving their payment systems. Their inter-bank payments are settled in central-bank funds, information about banks' net positions is more frequently available, and plans for computerised, 'real-time' network systems are well advanced. They also have plans to link domestic network systems to international clearing systems. Yet many banks do not have the technical capability to process and monitor the necessary information in a timely fashion, thus causing inefficient delays in clearing and settling customers' transactions.

Underdeveloped Money and Securities Markets

Another major obstacle facing bank reform in the CEECs is the lack of highly developed money and securities markets. The biggest components of liquid money markets are generally inter-bank deposits and short-term prime securities. At present, there are no liquid inter-bank markets in domestic currencies of any importance in the CEECs, largely because banks have only recently begun developing the necessary communication networks and financial instruments that allow reserves to be moved easily from banks in surplus to those in deficit. In addition, banks in the CEECs seem reluctant to deal directly with one another, possibly because of inexperience in obtaining resources in this way and an unwillingness to disclose information about each other's financial positions.

Securities markets, unsurprisingly, are equally undeveloped. Markets for government bonds and other securitised financial assets take time to develop because they require the setting up of new institutions and trading arrangements. Potential customers, such as institutional investors, and banks and households, are inexperienced or may not yet be in the position to build up significant financial portfolios. It is nonetheless expected that in the wake of the large-scale privatisation programmes, such as those in Czechoslovakia and Poland, securities markets will begin to play a more important role

□ □

The challenges in creating an efficient system of financial intermediation in the countries of central and eastern Europe are enormous. A viable banking reform strategy must, therefore, be comprehensive enough to confront many structural problems. Banking reform itself will not guarantee the success of free-market initiatives in the CEECs. It is the package of economic, social and political reforms as a whole as well as the actions of policy-makers, entrepreneurs and households, that will determine the course of events. On the other hand, a competitive, free-market system cannot flourish without a banking system that effectively and efficiently allocates savings to its most productive uses. ■

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LENDERS OF LAST RESORT

Developing-country debt doubled between 1980 and 1991, reaching a mind-boggling US$1.3 trillion. Three groups of creditors hold the purse strings: private lenders, mainly commercial banks; bilateral agencies under the control of governments of the industrialized world; and multilateral organizations such as the International Monetary Fund (IMF) and various multilateral development banks.

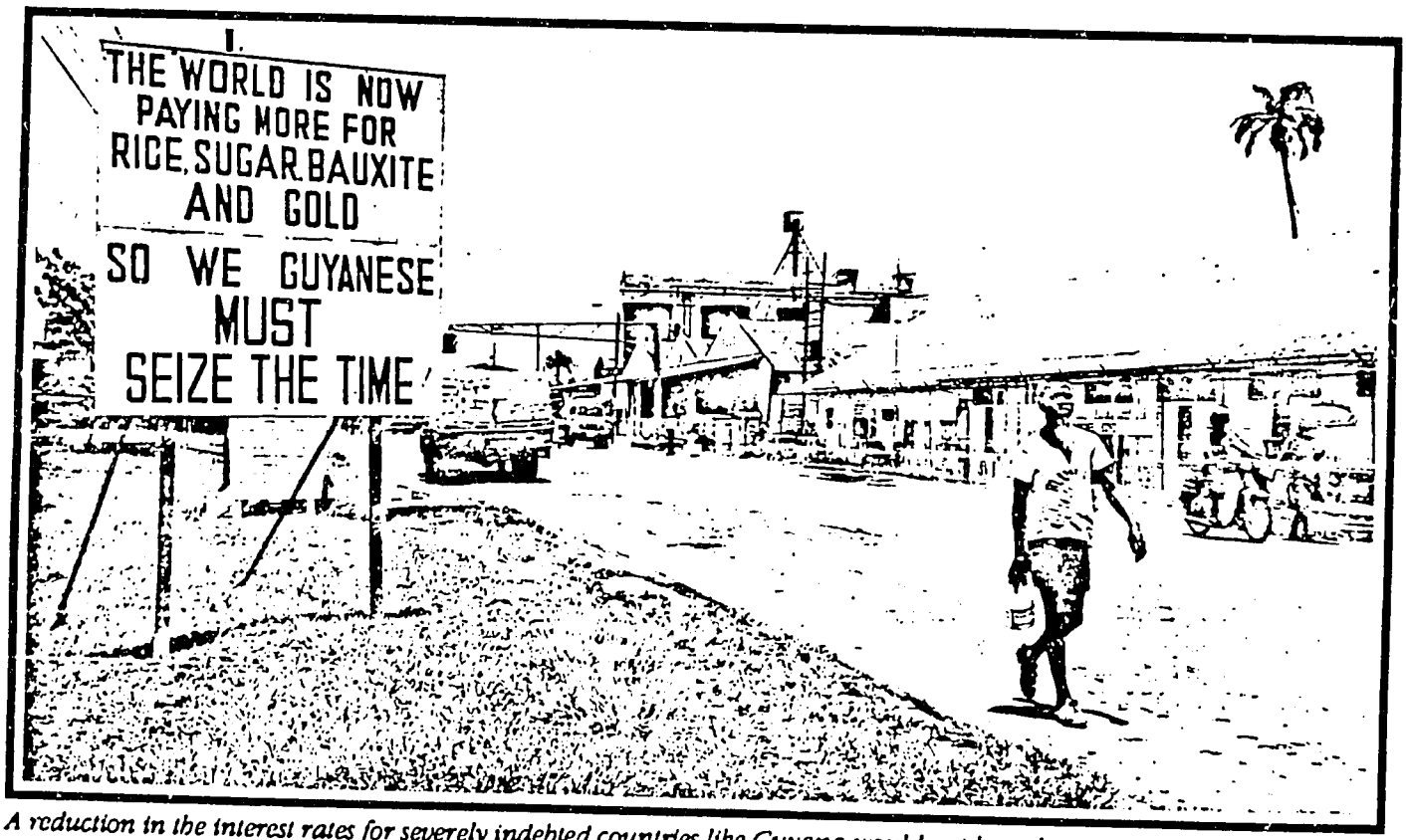
The debt holdings of all three groups of creditors grew throughout the 1980s — private debt rose by 77% and bilateral debt by 84%. But multilateral debt has seen the most startling increase at 319%. Moreover, it shows no signs of slowing down, unlike private debt which has fallen by about $47 billion since 1987. Bilateral debt also appeared to peak in 1990.[1]

These developments are related to the various international initiatives introduced to manage the debt crisis since 1982. These include strategies to restructure and reduce commercial bank debt and other efforts to reduce bilateral debt for the poorest countries. Multilateral agencies have consequently become "lenders of last resort," taking the place of retreating commercial and official bilateral lenders, and in some cases underwriting their withdrawal.

BRADY PLAN DEALS

The Brady Plan was one of the vehicles by which commercial debt was replaced by multilateral debt. Launched in 1989 by the new US Treasury Secretary, Nicholas Brady, the plan aimed to reduce the amount of money owed by developing countries to commercial banks. What this meant in practice was that the World Bank and IMF had to put up guarantees which could be called by the commercial banks if the debtor countries failed to honour their reduced debts. The two multilateral institutions earmarked US$25 billion for this purpose. In 1990 and 1991, the World Bank and IMF each committed more than $2.7 billion to support "Brady debt deals" for Mexico, the Philippines, Uruguay, and Venezuela.[2] In effect, commercial bank debt reduction was purchased at the cost of increases in multilateral debt. For example, in the Mexican package a US$12.7 billion reduction in bank debt required $5.8 billion in additional financing — $3.7 billion of this came from the World Bank and the IMF.

It would be misleading, however, to suggest that the transformation of private debt into multilateral debt can be solely attributed to the Brady Plan and its predecessor, the Baker Plan. (The latter, introduced in 1985 by then US Treasury Secretary James Baker, exhorted banks and agencies to loan new money to developing countries so as to fuel economic growth.) More accurately, private creditors ceased to



A reduction in the interest rates for severely indebted countries like Guyana would not hurt the net income of the multilateral development banks.

lend to much of the Third World in the latter half of the 1980s. Banks liquidated their claims as they were amortized or sold their loans at discounts. This left official creditors, particularly the multilaterals, as the only creditors willing to continue lending to Latin America and Africa.

DEBT RISES

In its 1991 annual survey of developing-country debt, the OECD noted the marked rise in reported amounts of multilateral debt and debt servicing. Developing countries had to pay US$32 billion to service their debts in 1990. Close to one-third of this amount went to the IMF.

The growing indebtedness to multilaterals is a multifaceted problem. The practice until now has been that multilateral debt cannot be rescheduled, making it more rigid than other forms of debt. Countries falling behind in their payments can be ostracized from the world financial system. Moreover, because of this rigidity, many borrowers are paying out more in debt servicing than they are receiving in new loans. In effect, debtor countries are transferring resources to multilateral agencies, in spite of increased lending. Since 1985 the multilaterals themselves have contributed to this negative net transfer, owing to the short-term nature of the IMF's credit facilities and heavy repayments on non-concessional loans. (Non-concessional loans are those given at market rates. They represent about 70% of multilateral lending. Concessional loans carry more favourable terms.)

MONEY FLOWS TO IMF

The magnitude of negative net transfers to the IMF is particularly striking, especially from 1985 to 1991. During the height of the debt crisis, the multilaterals became a destination rather than a source of money. Developing countries paid US$6.1 billion more to the IMF in debt payments and servicing than they received in financing from the multilateral banks. Regionally, IMF net transfers to sub-Saharan Africa turned negative in 1984, reached a peak of -$954 million in 1986, and totaled -$4.0 billion over the period 1984-90.[3] In the Latin American/Caribbean region, Fund transfers turned negative only in 1986 but amounted to -$9.6 billion over 1986-91.[4]

No borrower, however, can expect to receive positive net transfers forever. Moreover, borrowed money properly invested should generate a stream of earnings to help service a country's debt. Still, countries having difficulties meeting their debt obligations have found their problems compounded when multilateral creditors are on balance demanding payment rather than providing finance.

The problem of developing-country indebtedness to the multilateral agencies clearly revolves around the IMF. Since the IMF is a fundamentally different kind of "creditor" agency than the multilateral banks, the solutions must also be different. The IMF's function and financial structure as a short-term revolving fund means that any rescheduling of its credits might quickly compromise its integrity. That is why the Fund moved with such speed to establish the US$8.4 billion Enhanced Structural Adjustment Facility (ESAF) in 1987-88. ESAF's creation marked the first time that industrial countries channeled official development assistance through the IMF. Through ESAF, low-income borrowers could refinance their Fund credits on easier terms. Regrettably, the IMF imposed tough terms of conditionality on would-be borrowers, thereby limiting the use of ESAF resources.

SELL RESERVES

Some experts have called for the sale of a portion of the IMF's gold reserves — worth some US$40 billion on the open market — to help ease the burden of countries indebted to the Fund. Proceeds from the sale could be used to refinance the obligations of low-income members to the Fund on highly favourable terms.[5] Such a proposal would, however, broaden the IMF's toe-hold in the area of concessional lending. Some might argue that the Fund should stay away from concessional lending, leaving it instead to agencies whose main purpose is development assistance, such as the World Bank or bilateral aid agencies. As an institution geared principally to assist countries with short-term balance of payments difficulties, the IMF seems out of place in countries with deep structural problems.

Meanwhile, the IMF is in the midst of a 50% expansion of its lending capacity, brought on by the admission to the Fund of the republics of the former Soviet Union. It is questionable whether the economic plight of these new member countries, or of the Eastern European countries that have also joined the IMF, will be any more temporary than that of African nations. It would not be surprising if a few years from now, these new members face debt servicing difficulties with a perverse net transfer relationship with the IMF.

IMF'S ROLE QUESTIONED

On the eve of a major new expansion in IMF lending, it seems appropriate to question the future role of this organization, especially with regard to developing countries and other borrowers facing long-term structural problems. Perhaps it is time, if not to merge the IMF with the World Bank altogether, then to dovetail its lending facilities for developing countries with those of the Bank. Repayments to the IMF would then be anticipated in advance and funded through longer-term Bank loans, instead of being added to a mounting and unserviceable debt to the IMF.

Percentage of Multilateral Debt in Total Debt Service of Developing Countries.

	1982	1987	1990
All developing countries	6	21	20
Sub-Saharan Africa	13	30	28
Asian low-income countries	12	27	22

Source: OECD.

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As to the multilateral banks themselves, a distinction must be made between their concessional and non-concessional windows. Concessional loans, provided by such agencies as the World Bank's International Development Association, have maturities of up to 50 years at zero or very low interest rates. These soft loans are funded through contributions from donor countries. In contrast, the "hard" windows typically provide 20-year loans at market-value rates. The multilateral development banks fund these loans by borrowing on the capital markets. These non-concessional loans are problematic. For the debtor countries, they cause negative net transfers. For the multilateral development banks, they force a hard-line stance on lending. The banks insist that borrowing countries must service their debts promptly and in full, otherwise the terms on which the banks can borrow on the capital markets would be jeopardized.

Like the IMF, the World Bank has sought to refinance the hardest of its loans with softer funding. In 1989 the Bank introduced a program to help low-income, debt-distressed borrowers. Through allocating US$300 million in concessional "supplemental credits" from the International Development Associations, the World Bank subsidized payments on the non-concessional loans. Some bilateral donors have contributed to this program.[6]

DEBT RELIEF

Such measures are likely to become more popular over the coming years.[7] But they come at a cost, ultimately diverting aid resources from low-income recipients. What are the alternatives? An obvious answer is to consider the possibility of debt rescheduling by the multilateral development banks. The banks' income would not be affected if debt-strapped countries were given more time to pay off the principal of their outstanding loans. One expert calculated that, if the World Bank had rescheduled its loans to Latin American countries by extending the terms of repayment, the relief would have been the same in 1991 as that provided by an additional US$3.1 billion in loans to the region.[8]

It may be possible to go even further. In 1990, the multilateral development banks collectively earned a profit of more than $2 billion, one-half of which went to the World Bank. The banks' income in the past few years has been of similar magnitude. Although the profits of the World Bank group have not grown at the same rate as its lending, its rate of return on assets has been in the range of 1 to 2%. (This indicates a return of about 12 to 24% on capital.) The returns of the other multilateral development banks have tended to be higher — for example, the return on assets in the Asian Development Bank in 1990 was more than 4%. These figures compare favourably with profits enjoyed by successful commercial banks.

ABSORB LOSSES

Thus, there may be some leeway for the multilateral development banks to reduce interest rates without hurting their net income. For example, interest-rate relief could be confined to those severely-indebted low-income countries that owe more than 40% of their debt to the multilateral agencies (including the IMF). In 1988, such criteria would have made Burundi, Guinea-Bissau, Guyana, Honduras, Kenya, Malawi, and Uganda eligible for relief. Outstanding non-concessional loans to these countries amounted to US$2.6 billion, or about 2.2% of all such loans outstanding to the multilateral development banks.[9] Even if the interest on these loans were entirely forgiven, the multilateral development banks would only lose about $50 million in income, an amount that could easily be absorbed. It is doubtful that such measures would cause the bond rating agencies much concern — the reason given by the banks for their unwillingness to contemplate any departures from full and regular servicing of their loans. Indeed, underwriters might see such measures as strengthening the banks' loan portfolio and preferable to the conventional measure of refinancing unsustainable debts.[10]

To end on an optimistic note, it is encouraging that much of the developing world is beginning to emerge from the debt crisis of the 1980s. Unfortunately, the resumption of economic growth is confined more to middle-income countries than to the poorest countries of the developing world. While debt relief is no panacea for any country's economic problems, it can help to reduce the tremendous external financial pressures faced by debtor countries.

The IMF and the multilateral banks have a particular responsibility to help solve the problem of debt, especially as it affects the poorest countries. It is both timely and feasible to contemplate measures to alleviate the debt burden, to the benefit of both the debtor countries and the multilateral agencies themselves.

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HEMISFILE

Perspectives on Political and Economic Trends in the Americas

STOCK MARKETS

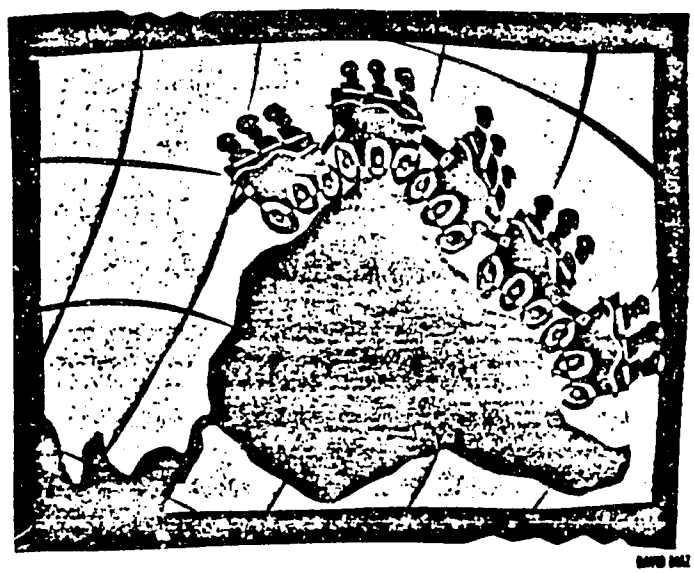
What goes up...

By Alan Robinson

The main Latin American stock exchanges recorded growth rates in 1991 ranging from modest to spectacular, fueled principally by privatization programs and more liberal attitudes to portfolio investment.

While the legendary volatility of these markets threw a scare into investors in the first half of 1992 and effectively halted the flow of so-called "smart money" toward second-tier stocks, it also provided an effective lesson in discrimination. In the future, investors will chose their stocks and their markets with greater care, having learned that Latin American stock markets march or retreat to very different drums.

Opportunities for portfolio investment in Latin America are still pretty limited when *(please turn to page 2)*



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(continued from page one) compared to those in the more mature capital markets. Most Latin American equity markets are small, with only a handful of stocks really active. However, in spite of their roller-coaster record, these markets do provide investment yields that compare well with those available in the more developed markets.

Restrictions on captial movements and foreign exchange markets have been removed or reduced in most cases. Chile has exchange controls, for example, and requires investments to be registered, but foreign exchange transactions can be made freely. Portfolio investment in Mexico is practically free of regulation and approximately 65 percent of the free float of stock in Mexico is owned by foreigners, with an increasing trend toward trading in Mexican securities abroad. Mexican stock transactions are not subject to exchange controls.

Among the trends already established in the region are the abolition of the capital gains tax on individual foreign investors, direct portfolio investment by foreigners (in addition to participation in investment funds or similar vehicles), some easing of restrictions on foreign ownership of shares in publicly listed companies, the elimination of fixed brokerage comissions, and more foreign competition in the brokerage sector.

The regulatory environment has improved rapidly in the main Latin American securities markets, although progress remains uneven. Markets have tightened rules on financial reporting, and there are heavier penalties for insider trading in most countries. (Venezuela has created its own rather curious legal situation in which insider trading, forbidden by the Caracas Stock Exchange, is not explicitly forbidden by its Securities Act).

Some countries have improved investor protection, particularly for minority shareholders who may suffer fraud or default by brokers and traders. The trendsetters are Argentina and Mexico, although some of these changes have been adopted elsewhere and will likely spread throughout the region in the medium term.

Traditionally, domestic sources have financed the largest part of investment. The economic growth of Latin America depends heavily on the strength and efficiency of its capital markets, the development of which was affected by economic stagnation and government intervention throughout the 1980s. Government policies often brought instability and repressed financial intermediation, and market instruments were heavily taxed. As a result, the process of savings and investment in Latin America has not been adequate for the region to achieve the desired economic growth rates. The situation is changing rapidly and the growing popularity of the free-market philosophy in Latin America should gradually liberate the region's financial markets throughout the 1990s, particularly if the successes registered by Chile and Mexico in boosting domestic savings and foreign investment have demonstrable effects on economic growth and job creation.

In 1991 the Buenos Aires Stock Exchange (BASE) leaped from obscurity to become the fastest growing exchange in the world. In 1992, mid-May saw the Merval Index of leading shares up 13.6 percent for the year, followed by a 37 percent plunge by mid-August as the market shuddered under the impact of labor disputes in banking, steel, and the state shipping company, whose employees invaded the BASE and halted trading. Poor first half profits for several top-listed firms and political problems bedeviling the proposed private pension fund scheme encouraged no one. Against this, a real decline in inflation, the Brady Plan deal with commercial creditors, and the ongoing success in privatization have steadied the market.

While the number of listed Argentine companies declined steeply — from 669 in 1962 to 176 in 1991 — market capitalization has shot up from $3.2 billion in 1990 to $18.5 billion in 1991. Stock investment offered a total return of 357 percent in dollar terms in 1991. Some 90 percent of total trading involved 19 companies, with the 10 most active accounting for 70 percent of market capitalization.

The meanderings of the Brazilian stock market are directly traceable to the current political crisis. The short-term outlook is bleak as the rudderless economy drifts toward higher inflation, already over 21 percent a month, and Brazil fails to meet its agreed fiscal targets. Serious doubts are being cast on the viability of the recent Brady agreement.

The Brazilian stock market now is the second largest in Latin America in terms of market capitalization with $43 billion in equities, less than half the size of the Mexican market. Total trading volume jumped from $5.6 billion in 1990 to $11 billion in 1991. By mid-May 1992, Sao Paulo's BOVESPA Index was down 2.5 percent for the month in dollar terms, but up 80.8 percent from the start of the year. The political crisis seems to have derailed the market and all movement will be irrelevant and largely hysterical until the crisis is resolved. The 190 largest firms account for 44 percent of total market capitalization and only about 60 of the 580 companies listed are actively traded. The four most active stocks represent about 70 percent of market turnover. Most shares are non-voting preferred stock with common stock — often owned by controlling family interests — much less frequently traded. There are nine exchanges, the most important being in Sao Paulo (BOVESPA) and Rio de Janeiro (BVRJ) — there are plans to merge the big two — but the BOVESPA is responsible for two-thirds of all stock transactions. Brazil has busy forward, futures, and options markets and a small over-the-counter market.

Since 1984, the Chilean stock market has shown a 2,831 percent appreciation in dollar terms and in 1991 the index of the 40 most traded shares rose 139.5 percent in dollar terms. Trading volume averaged $7.6 million a day, double the 1990 level. Market capitalization was $27.9 million. Of the 223 listed companies, only 10 account for 50 percent of the total. Pension funds with assets of over $10 billion have invested close to 24 percent of that in the market. In July 1992, (please turn to page 12)

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(continued from page 2) the stock market gained 1.1 percent for a total gain of 33.9 percent this year. The market's stability was backed by a strong flow of foreign investment and a healthy trade surplus. There are three exchanges, but the Bolsa de Comercio de Santiago handles the vast bulk of the trading. Institutional investors, including some 26 open ended mutual funds, are dominant.

At the end of 1991, market capitalization of the Mexican stock exchange was $100.4 billion, 42 percent of Gross Domestic Product, a threefold increase in GDP terms from the previous year. The stock exchange index rose by 103 percent in dollar terms. Of the $9.4 billion in estimated total foreign investment, almost half went into the stock market. The market has grown because of privatization (160 companies sold for $10.6 billion in two and a half years) and the prospects of a North American Free-Trade Agreement (NAFTA). There are 199 companies listed, but 70 percent of all trading is concentrated in the top six. In the first quarter of 1992, the market received $6.9 billion in new foreign investment, but investors were reported to be moving upmarket into blue-chip stocks. Between June and August, the market index dipped sharply by 25 percent amid the usual summer slowdown. Top equities are under priced and are likely to react quickly to optimism stemming from the successful close of the NAFTA negotiations.

After soaring over 600 percent in 1990, the Venezuelan stock market did nothing in the first half of 1991 and then finished 34.2 percent up for the year as a whole. Turnover increased by 77 percent from the previous year. However, the attempted military coup in February 1992 hit the market hard and the trading has remained low, with the index falling 26 percent in dollar terms from the start of the year. Falling tax receipts from the oil industry are eroding international reserves and boosting the fiscal deficit, holding out little hope for stock market recovery before the end of the year.

Of the two exchanges, Caracas is the most important, while Maracaibo accounts for just 2 percent of trading. There are 59 listed companies, but 10 account for 75 percent of the index.

The general growth trend in Latin American exchanges is likely to be sustained, in spite of the hectic corrections of recent months. Both Chile and Mexico realized that inflation erodes yields on financial instruments and reduces the value of capital and they took strong measures to control prices. Mexico's success with inflation has enabled it to reduce domestic interest rates, thus lightening the burden of the domestic debt while maintaining real positive yields for investors -- yields which more often than not exceed those available in the US market. These countries have also begun a significant shift from short-term to medium- and long-term markets in an attempt to lessen the more volatile aspects of purely financial investment. But the lesson of the last few months for potential investors is that Latin America cannot be viewed as a block. Each country, each market is different, and the products on offer must be evaluated properly if more fingers are not to be burned.

If Brazil's political crisis can be resolved soon, the planned revamping of its stock markets could lead to steady growth in the medium-term. Argentina's market, carried to new heights by the expectations already generated, is likely to take the path of growth before too long. Venezuela has plenty of room for new growth, as have some of the lesser markets in the region. But the recent scare will make investors somewhat more choosy and there will be less portfolio investment in the smaller markets and greater selectivity in the larger ones.

Since economic growth, savings, and investment in Latin America as a whole are deeply influenced by the region's more powerful economies, it is their progress that will set the definitive tone for the 1990s. Further impetus will be supplied by a successful NAFTA and the series of free-trade area negotiations now underway within Latin America itself. While risks in Latin America are generally higher than in more developed markets, successful investors have found they are justified by the yields available. The growing strength of liberal attitudes in the region is certain to increase the opportunities for foreign portfolio investors. ◆

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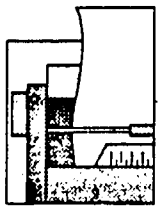
PERSONAL VIEW

Tax the speculators

By James Tobin



Since the breakdown of the Bretton Woods agreement in 1973, exchange rates among leading national currencies have fluctuated, often violently. Much of their volatility reflects short-term speculation, distorting signals the markets give for trade and long-range investment. Most experts agree that the ups and downs have greatly exceeded variations in rational estimates of currencies' fundamental values.

The travails of the world economy since 1973 inspire nostalgic longings for Bretton Woods, or even for a single world currency. Other proposals would keep the floating rate regime while setting limits on fluctuations and formalising the responsibilities of nations to keep exchange rates within agreed bands. In Europe, the recent troubles of the exchange rate mechanism have dramatised such issues.

Here I shall argue for a different proposal, which I first advanced in 1978. An international uniform tax should be levied on spot transactions in foreign exchange (including deliveries on futures contracts and options). The proposal has two basic motivations. One is to increase the weight that market participants give to long-range fundamentals relative to immediate speculative opportunities. The second is to allow greater autonomy to national monetary policies, by making possible greater differences between short-term interest rates in different currencies.

At the time, I anticipated that the proposed tax would be superimposed on a regime of market-determined exchange rates with minimal official interventions. But the tax could also be helpful to systems involving interventions, from agreements on target bands to full restoration of Bretton Woods. It could also be useful as an adjunct to the ERM.

My proposal is a realistic, second-best option. A common currency works to great advantage when sustained by common institutions: free movements of goods, people, and financial capital; laws, courts, taxes, regulations, and customs; a uniform system of social security and other entitlements; assistance to regions and individuals suffering economic reverses. But a common currency is not viable without those institutions; even in Europe it may take a decade or two.

Fixed rates of exchange among national currencies, which central banks are committed to maintain by market interventions, are by no means an approximation of a single international currency. As long as parity changes are possible – and often they are inevitable – private agents will speculate on such changes. In this respect, a system of adjustable pegs of national currencies – for example, pegs to dollars or to gold – differs very little from a floating rate regime. The only difference is that adjustments of pegs occur in discrete and traumatic jumps. Anyone who believes that the shocks to the world economy since 1973 would have been less disturbing under a regime of adjustable pegs has a short memory.

Although a true worldwide common currency is decades premature, vast private funds are prepared to arbitrage away differences in national interest rates and to speculate on movements of exchange rates. My transactions tax is designed to make international money markets compatible with modest national autonomy in monetary and macro-economic policy.

A ⅛ per cent tax on currency transactions is equivalent to a 4 percentage point difference in annual interest rates on three-month bills, a considerable deterrent to those contemplating a quick round trip to another currency. The intent is to slow down speculative capital movements; it would be too small to deter commodity trade or serious international capital commitments.

In 1936, Keynes pointed out that a transactions tax could strengthen the weight of long-range fundamentals in stock market pricing, as against speculators' guesses of the short-rage behaviours of other speculators. The same is true for the foreign exchange markets. Vast resources of intelligence and enterprise are wasted in financial speculation, essentially in playing zero-sum games. A transaction tax might reallocate some of the resources. To the extent that it does not, it would at least produce needed government revenues without bad side-effects. It is estimated that more than $1,000bn in gross foreign exchange transactions occur every business day.

It is obviously necessary to have an international agreement on the tax. My suggestion is that the proceeds go to the World Bank, but other dispositions, including less altruistic ones, could be considered.

While the proposed tax would give national macro-economic authorities somewhat greater autonomy, it would certainly not permit them to ignore the international repercussions of their policies. The leading economies would still need to co-ordinate policies. In particular, they must agree a general level of world interest rates, while allowing for differences among countries appropriate to their national circumstances.

The author is Sterling professor emeritus of economics at Yale University

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EDITORIAL/OPINION

Recycling Latin America's Debt

By ERIC EHRMANN

With private capital churning through Latin American markets at a rapid pace, economic stability in the region continues to depend on international institutions.

The region relies on loans from the International Monetary Fund, the World Bank and the Inter-American Development Bank, and on investments and credits from highly subsidized European state enterprises.

In support of U.S. policy, multilateral lenders have provided billion dollar loans to the region's state enterprises. Those loans have helped to avoid another Latin debt crisis; the region's foreign debt stands at a precarious $430 billion and continues to grow.

Some analysts argue that this lending ensures the 1990s will be a decade of progress and reform in Latin America. But the escalation of lending to Latin governments merely bolsters the "too big to fail" strategy implemented during the 1980s by former Federal Reserve Chairman Paul Volcker and by current New York Fed President E. Gerald Corrigan.

Implicit in the "too big to fail" concept is the notion that Latin America's state-dominated economies are too big to reform. For example, a recent Inter-American Development Bank communique says the bank provides loans to Latin governments and state enterprises with the goal of "promoting a better state, not a smaller one."

Mr. Corrigan, who took over as head of the New York Fed in 1985, believes loans held by Latin governments were too important to U.S. money center banks to have Latins fail to pay interest on them. This philosophy ultimately produced the Treasury's debt relief plans.

Under Mr. Corrigan's watch, the "too big to fail" strategy delayed a federally mandated audit at a major money center bank. That bank, even today, continues to be burdened by heavy Latin debt exposure.

In 1989, when many economists and government officials admitted that loans to Argentina and Brazil would have to be written off (as Morgan Bank did), Mr. Corrigan continued to argue for new loans to the region.

He claimed the Latin debt could still be carried at "par" or book value, 100 cents on the dollar. Today, however, the secondary market bid price for Argentine dollar-denominated debt is 46 cents. In Brazil it's 30 cents.

The "too big to fail" cycle of lending and repayment will continue as long as American politicians postpone a serious reform of the U.S. banking system. U.S. banks now need Latin loan repayments to offset domestic portfolio losses. Therefore, instead of using multilateral loan money for productive enterprises, Latin governments repatriate much of it back to money center banks.

Instead of pressing for new multilateral loans, which represent a quick fix for the debt problem, the United States and other industrialized nations should focus on the economic reform objectives of the lending. They should negotiate a way for Latin governments to use more of their loan money for domestic purposes — including fostering private enterprise — rather than paying the money back quickly.

Argentina, for example, has received more than $3 billion in multilateral funds over the past 18 months to help finance its reforms. But the heavy hand of the state continues to dominate the economy.

With share prices posting declines of 60% since July, Economy Minister Domingo Cavallo is setting up a multibillion dollar intervention fund to stabilize the Buenos Aires stock exchange.

Under that program, a new state entity, the Investment and Foreign Commerce Bank, will become the largest buyer and seller on the exchange.

President Carlos Menem's Peronist government already has plowed $1.8 billion into the bolsa, much of it cash earned from the sale of its remaining shares in the recently privatized state telephone companies.

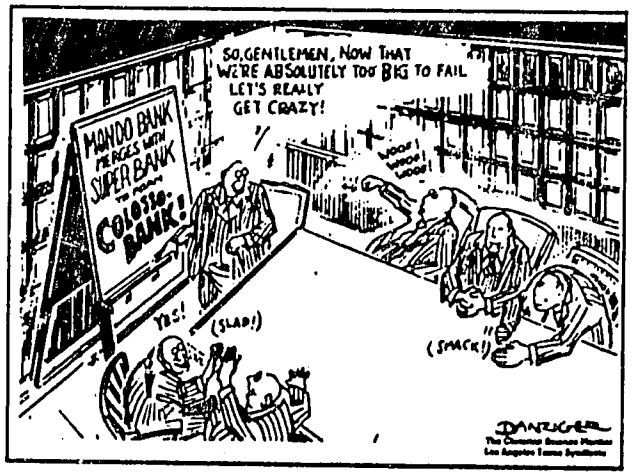
The Buenos Aires press is questioning Mr. Cavallo's creation of a government megafund to prop up the bolsa, while millions of Argentines have fallen below the poverty line through the gutting of social welfare programs. All this intervention, however, is a direct result of "the too big to fail" strategy, and of continued lending by multilateral institutions.

A contrasting example is offered by Peru, whose lifeline to multilateral lenders was cut off after President Alberto Fujimori's "self coup" last spring. That, in turn, threw a new element of chaos into the Latin economic development picture.

The Fujimori government withdrew from the Andean Group (comprised of Bolivia, Colombia, Ecuador, Peru and Venezuela). Peruvian industrialists supported that move.

But, with the capture of Shining Path leader Abimael Guzman, the Fujimori government may find its way back to the multilateral money pipeline. That would only perpetuate the continuing cycle of lending and repayment that is not keyed to domestic reform.

The "too big to fail" strategy will remain in place until Washington comes up with a new foreign economic policy. Until that happens, multilateral lending, which supports Latin state bureaucracies, will remain an impediment to the growth of free markets in Latin America.



Eric Ehrmann of Charlottesville, Va., reports regularly on Latin America.

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Africa faces aid cuts

Recession preoccupies major Western donors

By Roy Laishley in Washington

Africa's financial lifeline — development aid — is under severe threat. Against generally accepted estimates that aid must grow by 4-6 per cent a year in real terms if per capita incomes are to rise, African countries are instead facing the prospect of sharp cutbacks.

Industrial countries' preoccupation with their own mounting economic problems are diverting both attention and funds from the Third World. Development issues — and even Russia — were absent from much of the key discussions at the end-September annual meetings of the International Monetary Fund (IMF) and World Bank in Washington, where the currency turmoil in Europe commanded the near total attention of major donor countries. Calling for urgent action to boost, not cut aid flows, World Bank President Lewis Preston warned that pressures on donor budgets, "exacerbated" by currency instability, "will result in aid cuts which will hit the poor countries hardest."

Faced by stubborn recession, the IMF has again lowered its estimate of industrial country growth this year and next — to 1.7 and 2.9 per cent, from 1.8 and 3.3 per cent in May. The Organization for Economic Cooperation and Development (OECD) has similarly revised its forecast for its members for 1993 downwards to 2.1 per cent from 3 per cent forecast in June. Growth in Africa this year is now projected at 1.9 per cent, the IMF says, down from 2.7 per cent estimated in May, with 3 per cent instead of 3.3 per cent estimated for 1993.

The pressure on Western aid budgets has been symbolized by Sweden, traditionally one of the most generous, which announced a 10 per cent cut in September, and by Norway, another traditionally generous donor, which is also proposing to lower aid levels. The UK's aid budget is threatened by a 15 per cent cut in new austerity measures. US President George Bush has proposed radical changes in US aid.

In this climate the OECD's recent conclusion that "it is difficult to envisage a significant expansion in development assistance," during the 1990s, appears almost optimistic. A similar view is expressed by the Bank and Fund in a paper specially prepared for their Joint Development Committee; prospects for sustaining recent increases "are poor," it says. Both reports show a worrying fall-off in net official flows to Africa in 1991.

UN/Betty Press

Tanzania Finance Minister Kighoma Malima fears there is little chance of a large boost for IDA.

Resource flows to developing countries were at the centre of ministerial discussions at the 21 September Joint Development Committee in Washington. In his report to the Committee, Mr. Preston pointedly remarked that after 25 years, only five OECD countries had managed to attain the generally accepted target for aid of equalling 0.7 per cent of their gross national product (GNP).

For most African countries, immediate concern focuses on the tenth replenishment of the Bank's soft-loan affiliate, the International Development Association (IDA), a major source of concessional funding. IDA-9 was fixed at $15.5 bn (officially, Special Drawing Rights 11.68 bn). To compensate for inflation, new members and new concerns over the environment, the Bank has been pushing for a replenishment of at least $23 bn, $5 bn of it as an "earth increment" for environmental issues.

This level of funding now looks impossible, officials and African ministers concede, with wider implications for related aid flows to the region. The chances of a significant replenishment to IDA look "difficult," Tanzania's Finance Minister Kighoma Malima told *Africa Recovery* at the end of the meeting. "It is going to be very tough" to get even the minimum of SDR13 bn that would keep IDA abreast of inflation, one Bank official says. This is normally translated as the equivalent of $18 bn, but in recent currency movements has moved closer to $19 bn.

A September meeting of IDA donors made little progress in the wake of the currency turmoil affecting major European donors, World Bank officials said. Further meetings have been called for 12-13 November in Paris, but coming just a week after US Presidential elections, another round of meetings is being scheduled for December. Bank and donor officials are still striving for a deal by the end of the year in order to ensure IDA-10 will be fully operational for its 1 July start-up next year. But Mr. Preston said that "we are still far from agreement."

Mr. Preston told the Development Committee that "several major donors remain uncommitted," with support for an earth increment "limited to a few donors." Speaking after the meeting Bank Managing Director Ernest Stern said that even the minimum target was at "serious risk" and gloomily added that, "it was as if Rio never happened," referring to the UN Conference on Environment and Development (UNCED). Only the Nordics and the Netherlands have so far shown strong support, and then dependent on other contributions. A supplement of $1-2 bn

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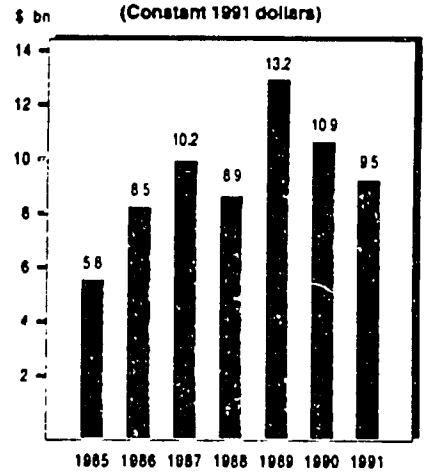
Real net transfers to sub-Saharan Africa
(Constant 1991 dollars)



Source World Bank, IMF

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IMF/World Bank

from page 3

would now be considered a victory.

The Bank's chief economist for Africa Ishrat Husain points out that with every $1 of IDA spent in Africa raising another $4 from donors through the Bank-coordinated Special Programme of Assistance (SPA), any shortfall for IDA-10 will have a harsh knock-on effect for the region.

Serious discussion on the volume of IDA-10 has also been stalled as a result of a stand-off between the US and Japan, the two largest donors. Aid officials say the US has made it clear that it will be difficult to get Congress to authorize a contribution substantially above the present level of just over $1 bn.

Japan, however, has warned that it will not necessarily compensate for the shortfall of other donors, as it did in IDA-9, officials familiar with the negotiations say. To ensure the $18 bn figure in the absence of an increased US contribution, Japan would have to become the premier donor to IDA, which would have implications for the decision-making hierarchy in the Bank.

But even if the $18 bn figure is reached, this will not compensate for at least nine new IDA members, some of them large economies. In Africa alone, Angola, Côte d'Ivoire, Egypt and Zimbabwe are all new claimants on IDA. Bank officials concede that with growing demand for a limited pie, smaller African countries could suffer. This is probably true even with reflows of previous IDA flows, which are projected to boost IDA-10 resources by some $2.5 bn.

Keeping Africa's share

Speaking for the African group, Mr. Malima made a strong plea that sub-Saharan Africa's share of IDA remain at 50 per cent. He says that Bank officials have voiced their intent to preserve the region's IDA share, but ruefully observes that the final outcome will depend on the priorities of "the big players."

Japan's Finance Minister Tsutomu Hata, for one, warned in September that "attention must be paid to the needs of Asia" in IDA-10. Arguments that Asia still contains the largest number of the world's poor, could limit plans for reducing the share of China and India, which between them have traditionally taken 30 per cent of IDA commitments.

Bank and African officials alike stress that any shortfalls on IDA and other aid flows would affect both current adjustment programmes and renewed efforts to reduce poverty. The report to the Development Committee confirms views earlier put by the UN and others that in the poorest countries, "the need for external financing will be larger," as countries simultaneously try to implement market-oriented reforms, reduce poverty and address environmental concerns.

The report stresses that developing countries will have to increase domestic resource mobilization. While committed to doing this, Mr. Malima points out that "there is only so much you can squeeze from a lean person." Increased aid and debt relief is essential, Nigeria's Finance Minister Alhaji Ahmadu Abubakar argues, especially as donors are now demanding expensive political reforms.

At their July economic summit, Western leaders resolved to bridge the dilemma presented by tighter public expenditure by direct

IMF-Todd France

World Bank President Lewis Preston has warned of the danger of aid cuts

Low net flows

For African countries, retained funds from the World Bank continue to be worryingly low. Despite increased commitments for Africa during its 1992 financial year (FY), net disbursements (after repayments) fell to $1.64 bn from $1.87 bn the previous year. When interest and other charges are taken into account, net transfers — the amount of new, additional Bank funding in FY 1992 — totalled only $783 mn compared with $895 mn the previous year.

Slow Bank procedures in some areas and mounting problems at both the national and project level, as well as repayment costs, account for the low level of net flows. Implementation problems are causing growing concern. Bank President Lewis Preston told African ministers in Washington that of a total of $23 bn committed to Africa, $14 bn remains undisbursed and promised to take measure to improve the quality of implementation.

In its latest financial year, the IMF had positive net flows to Africa after many years of negative transfers. Total disbursements rose to SDR887 mn ($1.25 bn, including Egypt) from SDR577 mn ($800 mn) the previous year. After accounting for repayments, net flows from the IMF to Africa were a positive SDR274 mn in FY92, up from a negative SDR300 mn in FY91.

Much of this improvement reflects increased IMF activity in North Africa and for sub-Saharan Africa net flows were still just negative in FY92. Some 20 African countries were still net providers of funds to the IMF, albeit for some countries, such as Mauritius and Morocco, this reflects improving economies. A number of African countries, including Côte d'Ivoire, Egypt and Nigeria, were also in a negative position with the World Bank in FY92.

Overall, Africa, unlike other regions of the world, has since 1980 experienced positive net transfers, in real terms, from all sources, according to data presented to the Development Committee. But in 1990 and 1991 there was a worrying fall-off from the 1989 peak of $13.2 bn (see graph, page 3). The OECD's 1991 *Survey of Financing and External Debt of Developing Countries* also shows real net resource flows to sub-Saharan Africa falling in 1991, to $23.8 bn (1990 $) from $24.1 bn in 1990. Although no separate data is available for net aid receipts, the inference is that they were at least only static in 1991 in real terms, after a 3.6 per cent rise in 1990.

In its latest figures, the UN's Department of Economic and Social Development (DESD), shows a slight improvement, in nominal terms, in net transfers to sub-Saharan Africa (excluding Nigeria) in 1990 and 1991, though only rising to their 1989 level. For Africa as a whole, however, net transfers fell to under $1 bn in 1991. If terms of trade losses are taken into account Africa experienced a "net outflow of real resources in the two first years of the decade," the UN points out.

ing more aid towards the poorest countries and for directly attacking poverty. IDA-10 will reflect this, but donor countries are also arguing the diminishing economic significance of aid and the increased attention that should be given to other factors, such as foreign investment and trade, which can yield bigger returns.

Addressing the UN General Assembly on 21 September, US President Bush argued that with the end of the Cold War, "foreign aid, as

Nigeria Finance Minister Alhaji Ahmadu Abubakar has called for equal sacrifice and more resources from donors.

we've known it, needs to be transformed," moving from "'aid dependency' to economic partnership." If re-elected he would "alter fundamentally" the focus of US assistance, with more emphasis "on building economic partnerships among our private sectors."

But African ministers point to the now near-total dependence of many African states on official flows and the relative weakness of their private sectors, certainly in international terms. In Washington, African ministers also warned multilateral officials that there is a growing sense of imbalance between African and industrial countries on the sacrifices to be made in getting faster and more balanced world growth. "The external effort is not matching the internal efforts," Nigeria's Finance Minister argues. He stresses the need for more foreign investment, more equal access to markets — pointing to the stalled 'Uruguay Round' of trade talks as an example of the failure of industrial countries to make similar sacrifices — and greater debt relief. Mr. Malima makes the same point; "very little progress" has been made in alleviating Africa's debt burden, he argues.

Their point is taken by the Bank's Ernest Stern who said that the cost of adjustment in the rich countries was "being put on the backs of the developing countries." Without adequate aid, one of the casualties could be the very economic and political programmes that donors argue are needed to enable countries to end their dependence on aid and benefit from economic cooperation, African ministers warn. ■

THE WALL STREET JOURNAL WEDNESDAY, DECEMBER 9, 1992

How Africa Ruined Itself

By George B.N. Ayittey

Prompted by the horrific combination of starvation and predatory violence, the West is now intervening in Somalia. But there are many African leaders for whom nothing the West does is enough – even a massive and dangerous humanitarian effort. For such leaders the West, if it acts at all, acts badly in Africa (or too late), and thereby bears a large share of the responsibility for Africa's problems. This view is demonstrably wrong.

The rhetoric of victimization and blame was very much on display in late September, when President Abdou Diouf of Senegal addressed the U.N. General Assembly, before Somalia's condition had reached its current crisis point. Mr. Diouf, who is chairman of the Organization of African Unity, chastised the West for ignoring Africa. He was echoing the sentiments of other African leaders, for whom "marginalization" is the new term of abuse. The abandonment of Africa by the West for Eastern Europe, they all warn, will vastly impede their efforts to alleviate Africa's squalor. The Clinton administration should ignore these rantings.

It is true that the tribulations of Africa and the solicitations of its leaders have at times been greeted with charitable indifference in world councils. But the constant whining of Africa's leaders now draws cynicism and yawns in Africa itself. The truth is: Africa has been marginalized by African leaders themselves.

Laggards Insisting on Foreign Aid

While Eastern Europe, Latin America and Southeast Asia have been steadfast in reforming their economies, African leaders have remained laggards, insisting on massive inflows of foreign aid to underwrite almost every reform. Even the devastation of African war – in Angola, Ethiopia, Mozambique, Namibia and now Somalia – has not been enough to prompt action within Africa itself. "People are dying in droves daily from bullets and starvation," laments Mahmoud Farra, a Somali refugee in Britain, "yet African leaders are doing nothing to stop the war." How can the world take Africa seriously when its own leaders and elites are not serious about tackling its problems?

After years of mismanagement, most African countries today are poorer than they were when they achieved their independence in the 1960s. This is not a justification for colonialism but a statement of fact. Between 1965 and 1987, the average annual growth rate of gross domestic product per capita was 1.1% for all of Africa and 0.4% for sub Saharan Africa – 0.1% if Nigeria is excluded. Between 1986 and 1991 real GDP fell by 0.7% a year (including Arab North Africa, but not South Africa).

The performance of sub-Saharan or black Africa has been the worst in the Third World. Between 1980 and 1989, black Africa's real GDP per capita contracted by an average of 1.2% while East Asia grew by 6.2% and South Asia by 3%.

According to Africa's own elites, including such veteran African leaders as Julius Nyerere and Kenneth Kaunda, the causes of Africa's problems are forever external: Western colonialism and imperialism, the effects of the slave trade, exploitation by multinational corporations, the injustice of the international economic system, inadequate flows of foreign aid – and now "marginalization."

But a new and angry generation of Africans reject this claptrap and lay greater emphasis on *internal factors*: misguided leadership, systemic corruption, economic mismanagement, senseless civil wars, tyranny, flagrant violations of human rights and military vandalism.

Somalia is not the exception. Angola, Liberia, Mozambique, Sudan, Uganda and Zaire now lay in ruins and other countries are heading down the same path.

These internal factors are themselves products of defective economic and political systems established and retained by many African leaders after independence. Most of these systems are characterized by an extreme concentration of economic and political power in the hands of the state – and ultimately one individual.

In Africa, the state reserves for itself the right to intervene, plan and restructure almost every conceivable aspect of Africa's economy and society. Socialism may be dead but statism lives in Africa. State hegemony in the economy has now become the bane of Africa's development, suffocating and devouring its productive base.

The centralization of economic power in Africa has turned the state into a huge patronage machine and bred elite cronyism. Lucrative state jobs have been parceled out to friends and government largess doled out to loyal supporters. In Africa's pork-barrel politics, avaricious elites have absconded with the goods, leaving the people to starve.

The labyrinth of controls and regulations instituted by the state have provided ruling elites with the chance for illicit enrichment. To help the unwary navigate the maze of regulations, ministers demand bribes and "commissions." In many African countries, the World Bank and International Monetary Fund arrived too late. The state treasury had already been "privatized" by the elites.

By concentrating so much political power at the center, the state also became an irresistible prize for which all sorts of groups and individuals compete. Once seized, the instruments of state power are used by these groups and individuals to enrich themselves and further the interests of their own ethnic groups or professional class. All others are excluded.

It is this fight for state power that has been the source of Africa's inane civil wars and chronic political instability – not colonialism or Western "exploitation" or "marginalization." In almost all African systems, the peasants, the real people of Africa and producers of its real wealth, have been abused by the state and excluded from the political process.

In many African countries, those who took over the reins of power after independence were worse than the colonialists they replaced. In Somalia, the civilian administration that assumed power in 1960 was hopelessly corrupt and incompetent. It was overthrown in a coup (in October 1969) by Major General Mohammed Siad Barre, who adopted socialism along with the designation "Jalle" or "Comrade." Government was centralized under a Supreme Revolutionary Council and Somalia turned to the Soviet Union for tutelage.

By 1979, the economy was in tatters. Socialist policies had failed to engineer economic development, and foreign loans and credits only earned Somalia the title "The Graveyard of Aid." For two decades, 1965-87, GDP per capita grew at a miserable 0.3% annual rate, and food production per capita declined an average of 2% per year from 1975 to 1985.

An increasingly unpopular and corrupt Barre regime resorted to brutal force to remain in power. Torture, mass executions and pillage were the order of the day. Entire regions were devastated by a regime in combat with its own people. The "liberators" who drove Barre out in January 1991 were little better, fighting among themselves and causing further carnage.

Sadly, Somalia is not the exception. Angola, Liberia, Mozambique, Sudan, Uganda and Zaire now lay in ruins. More distressing, many other African countries are heading down the same path of corruption and self-destruction.

Libya, for example, ought to have one of the highest per capita incomes in the world, with a population of only four million and vast oil wealth estimated at $10 billion in 1990. But mismanagement, foreign exploits and corruption have so eroded the country's economic base that Libya sometimes defaults on its foreign bills and some government employees go unpaid for months.

In Algeria a former prime minister, Abdelhamid Brahimi, said recently that officials of the ruling Front de Liberation National had pocketed $26 billion in bribes and commissions on foreign contracts. The current prime minister called the charge "grossly exaggerated" but did not deny its gist.

In Sierra Leone a special commission recently detailed how the ruling elites have plundered that country's resources with impunity. Former Inspector General of Police James Bambay Kamara, for example, owns 37 pieces of land, with the most expensive valued at 7.5 million leones (the country's unit of currency), while his salary is about 182 leones a year. His three bank accounts include one in London.

Freeloaders and Patronage Junkies

Under various programs, the World Bank, IMF and other international agencies have been nudging African governments toward reform. But the commitment to genuine reform within Africa itself has been superficious and slow. Freeloaders and patronage junkies fiercely resist a dismantling of the statist behemoth. In 1990, the former deputy agriculture minister in Sierra Leone told the BBC's "Focus on Africa" program that he "won't give up his present privileged position for the sake of a multiparty system." And why should he, or any other corrupt official on the receiving end of Western largess? Such ministers oversee the disbursement of over $12 billion in annual foreign aid.

One solution is to take power away from the center, or the state, and give it back to the people (decentralization). Another is to monitor foreign aid much more closely, or to direct it only where free-market reform is a visible reality. The best solution, however, may have been expressed by Amina Ramadou, a Zairean peasant woman. "We send three sacks of angry bees to the governor and the president, and some ants which bite," she suggested. "Maybe they eat the government and solve our problems."

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INTERNATIONAL
Economic
Insights
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REPORT ON FDI

Japan and Foreign Direct Investment

by Persephone Economou and David Gold

The authors discuss the dramatic rise in the 1980s of Japan as a source of outward investment and the impact this is having on Asia. They conclude that Japan's strategy of regionally-oriented investment has given it the trade edge in fast growing Asian economies.

Between 1983 and 1990, annual worldwide flows of foreign direct investment (FDI) increased from $53 billion to a record high of $225 billion, growing at an average annual rate of 26 percent. This unprecedented growth is partly a result of the economic recovery of the last half of the 1980s, and partly due to the lowering of barriers to cross-border investments, particularly in services industries. The rapid growth of FDI also reflects strategies of transnational corporations (TNCs) from the major investing countries, which sought to re-organize on a regional basis in response to growing competition. Major policy developments, such as the Single Market program in the European Community were also a spur.

The Triad. Until the 1980s, the United States and the European Community were the main sources of FDI. The emergence of Japan as a significant outward investor changed the global pattern of FDI from bi-polar to one which may be characterized as tri-polar. The Triad (US, EC, and Japan) presently accounts for over four-fifths of FDI outflows and 70 percent of FDI inflows, indicating that the bulk of FDI stays concentrated *within* the Triad.

Indeed, developing countries have seen their share of FDI inflows decline from 25 to 17 percent of the total since 1980. Moreover, for a large number of developing countries, data on both stocks and flows of FDI collected by the United Nations and analyzed in the *World Investment Report 1992: Transnational Corporations as Engines of Growth*, show an emerging pattern of regionalization of TNC activity. Each member of the Triad has become the dominant investor (that is, accounts for more than 50 percent of total inward investment in a host country or is the largest investing country by a margin of at least 10 percentage points more than the next largest investor) in developing countries located within the same region. With some exceptions, the US is the main investor in Latin America, EC firms dominate investment in Eastern Europe and Africa, and Japanese firms are the principal source in Asia. In Asia, the East Asian NICs have followed Japan, emerging as investors in several developing countries in the region.

The rise in the value of the yen after 1985 was a major stimulent to Japanese FDI in Asia.

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Regional strategies. The regionalization of FDI appears to be closely associated with strategies pursued by TNCs from the Triad. These strategies are especially apparent among Japanese TNCs in Asia which have established networks of production facilities in different countries and are in the process of consolidating the integration of these networks on a regional basis. These networks produce complementary goods, for example, components which are then exported to a single location where the final product is assembled. Regional strategies are best-suited to manufacturing goods with discrete production processes; for example, automobiles and electronics. The rise of Japanese FDI in Asia has been accompanied by a larger proportion of intra-regional trade accounted for by Japan, much of it in the form of intra-firm trade among affiliates and between parents and affiliates of Japanese TNCs.

. . . some Japanese firms were seeking to establish similar networks . . . in the US and the EC

The rise in the value of the yen after 1985 was a major stimulant to Japanese FDI in Asia. Low costs of production and high labor skills were considered by Japanese TNCs to be the most attractive locational advantages of countries in that region. Increasingly, however, the growing affluence of Asian consumers and the strong performance of their economies, even during periods of recession in developed countries, have geared production of Japanese affiliates towards supplying the domestic markets. As a result, Japan's integrated production networks are now serving multiple and diverse markets: the home country, the other legs of the Triad and the host country and region.

The regionalization of FDI is also evident in the other legs of the Triad. While US firms are now rushing into Mexico, the integration of US and Mexican production locations began well before NAFTA. The rapid growth in US-Mexican bilateral trade accounted for by US TNCs and their Mexican affiliates in the late 1980s helped to increase integration of the two economies that is being furthered by NAFTA. Once NAFTA is a reality and if trade barriers between NAFTA members and other countries in the hemisphere continue to fall, TNCs from the US may extend their corporate networks throughout Latin America and the Caribbean. The common market being formed by Argentina, Brazil, Paraguay and Uruguay has already attracted interest from US firms, such as Monsanto, seeking to rationalize operations on a regional basis.

In Europe, regional strategies have largely been confined to the EC and EFTA countries as these nations integrate. However, a number of EC companies, including Fiat and Volkswagen, are beginning to combine Eastern European production locations with those in Western Europe to serve the entire European market.

Although formal economic integration measures contribute to the regionalization of FDI, they are not always necessary. The experience of Asia is instructive in that respect: what allowed Japanese TNCs to form networks of affiliates was the relatively low level of trade barriers among countries in the region. A high degree of openness seems necessary (though not sufficient) to induce the formation of networks and the resulting regionalization of FDI. At the same time, in the absence of formal policies, the activities of affiliates can bring about substantial integration of production or, where such policies are already in place, shape the direction of economic integration.

Many smaller and poorer countries are in danger of being further marginalized . . .

Producing in the Triad. Even as networks of foreign affiliates were integrating in Asia, some Japanese firms were seeking to establish similar networks in the other two legs of the Triad, namely the US and the EC. While cost factors were the main consideration in Asia, Japanese in-

vestments in the US and the EC followed a more defensive strategy. The desire to retain export markets in view of the growing competition in those countries, coupled with the impending economic unification among EC members and the rise of US protectionism influenced the location of production by Japanese firms. The drive to retain and expand market share for key products, such as automobiles and electronics, led Japanese TNCs to seek to become insiders in both Triad members.

One issue is whether the 1990s will witness an outflow of FDI from Japan . . . similar to the late 1980s.

Implications. The spread of regionally-oriented strategies by TNCs from the Triad raises important questions about the future. FDI outflows have fallen off in the last year as the largest investing and recipient countries have experienced slow growth. Thus, one issue is whether the 1990s will witness an outflow of FDI from Japan of a similar magnitude to that of the late 1980s, given that Japanese TNCs have already established a presence in each leg of the Triad; and whether the other members of the Triad will pursue similar regional strategies.

The formal adoption of regional integration policies could have implications for the location of FDI. In the case of NAFTA, for example, Japanese companies are beginning to invest (or expand existing investments) in Mexico. Several investments by Japanese TNCs in automobiles in Eastern Europe (Suzuki, for example) seem to have a similar objective, namely, to serve both local and European markets. With the formalization of regional integration schemes, Japanese TNCs may intensify their efforts within the cluster of countries that is centered around the US and the EC. Consequently, while FDI from Japan may not increase in the medium-term, further reorganization of affiliates within a single region might be expected to continue. Other Triad members can be expected to pursue similar strategies or risk being left out, as is evident in Mexico and Eastern Europe. A world-wide integrated production system can be envisaged for some industries but it is likely that most TNC activity will remain regional.

The Japanese lead in formulating regional strategies is partly the result of their late-comer status among the world's economic powers and their attempts to gain competitive advantages in the world's largest markets. To the extent they have been successful in the Triad, they have also brought to the fore the issue of whether a TNC can be effectively a domestic firm in more than one country. Such a development epitomized perhaps by the Triad-oriented strategies of companies such as Honda, can raise difficult policy questions for countries used to thinking of firms as national entities.

An additional issue is how these regionalization strategies affect developing countries. So far, they have been focused on developing countries with the largest domestic markets, well developed infrastructure, labor skills and open economies. Many smaller and poorer countries are in danger of being further marginalized by this process. The distribution of FDI to developing countries is highly concentrated with two-thirds of all inflows destined for 10 countries, mostly the NICs in Asia and Latin America and oil producers in Africa. Many developing countries are also concerned about the extent to which integration of production via TNC strategies ties an economy so closely to a Triad member that the host economy loses autonomy in making policy choices. Indeed, those choices may increasingly emphasize FDI and TNC issues. ■

Economou and Gold are in the transnational corporations and management division of the United Nations Department of Economic and Social Development. They were members of the team that produced the World Investment Report 1992: Transnational Corporations as Engines of Growth (New York: United Nations 1992).

The views expressed in this article are personal and do not represent the views of the United Nations or any of its subsidiary bodies.

BILATERAL ASSISTANCE

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United States Senate

WASHINGTON, DC 20510

December 1, 1992

The Honorable
Bill Clinton
President-Elect
of the United States
Presidential Transition Office
105 West Capitol Avenue
Suite 400
Little Rock, Arkansas 72201

Dear President-Elect Clinton:

The collapse of the Soviet Union has given the United States an historic opportunity to reshape its foreign policy. Throughout the Cold War, our foreign policy was centered on the desire to contain the Soviet Union. Toward that end, our foreign aid program focused mainly on keeping the Soviets from gaining the upper hand, whether in Asia, Africa, or Latin America.

Today, we face an entirely new set of political and economic circumstances, both globally and here at home. These changed conditions demand nothing short of a basic reevaluation of our foreign assistance objectives and priorities. Above all, we need to ensure that our foreign aid program focuses more on enhancing American trade and competitiveness. Without such a heightened emphasis on these economic concerns, the United States is bound to find itself less able to play a leadership role in various regions -- particularly in those developing countries that are currently experiencing the world's highest rates of economic growth.

In contrast, a greater focus on the linkages between aid and trade can ensure that three critical objectives all are satisfied: our assistance is directed toward sound economic development in the recipient countries, American firms and workers are actively engaged in those countries' development programs, and our foreign aid benefits both the recipients abroad and our own economy through expanded jobs and exports.

Toward that end, the five of us have worked together over the past two years on a modest proposal to begin this reformulation of our foreign aid priorities. Our Aid for Trade initiative, which passed the Senate last year, would require that more of our bilateral economic aid go for developmentally-sound capital projects, covering areas such as telecommunications, energy development, environmental protection, and other forms of infrastructure building, while less is provided in the form of no-strings-attached cash transfers. It would do so without infringing on our longstanding humanitarian commitment to addressing the "basic human needs," such as rural health, basic education, and family planning services, that remain so critical to the poorest aid recipients. And by providing financing that enhances the purchases of American goods and services, it would ensure that we help ourselves at the same time as we help those countries in need of our assistance.

This approach to foreign aid has several important advantages. First, it is a sounder long-term development strategy than one concentrating mainly on cash outlays. Numerous studies have documented the pressing need of more advanced developing countries, from Asia to Latin America to North Africa to Eastern Europe, for infrastructure assistance. Unrestricted cash transfers, in contrast, do nothing to ensure either sound development or a commitment to economic reforms.

Second, a greater focus on trade expansion initiatives, including additional capital project assistance, would bring the United States more into line with the approaches of our major economic competitors, including Japan. While the bulk of our aid program during the 1980's consisted of cash transfers, Japan and most European countries concentrated their assistance on infrastructure projects. By doing so, these countries helped their exporters gain a greater share of business in the recipient countries. The result was a loss to U.S. firms of up to $5 billion a year in missed export opportunities -- costing up to 100,000 American jobs. It is time to begin redressing this asymmetry, not simply through multilateral negotiations on other countries' use of "tied aid" but also through a more proactive U.S. strategy. (Although we welcomed the agreement finalized last February in the Organization for Economic Cooperation and Development that established new criteria for all aid donors, it nevertheless has several shortcomings that are certain to limit its effectiveness. In fact, to date that agreement has provided more of an excuse for the United States to unilaterally restrict our funding for capital projects than an effective restriction on other countries' activities.)

Third, greater emphasis on these forms of economic assistance will promote greater coordination among the relevant U.S. agencies concerned with both aid and trade policy, including the Agency for International Development (AID), the U.S. Export-Import Bank, the Overseas Private Investment Corporation, the Trade and Development Agency, the Office of the U.S. Trade Representative, and the Commerce Department's International Trade Administration. As you have noted, AID is badly in need of a fundamental overhaul, in part so it can work more effectively with the other agencies listed above. It is noteworthy (though perhaps not surprising) that while collaboration among these U.S. agencies has tended to be sporadic and ad hoc, Japan's equivalents of AID and the Export-Import Bank are housed in the same building and work closely together on both general policy and specific initiatives -- toward the end of opening new markets and ensuring new sales for Japanese companies.

We would be pleased to discuss our ideas in greater detail with you and your economic team at your earliest convenience. We believe that the time is right for a new approach to foreign economic assistance that better reflects our country's most pressing needs in the post-Cold War world.

Sincerely yours,

David L. Boren | Lloyd Bentsen | Robert C. Byrd

Max Baucus | Joseph I. Lieberman

cc: Robert Reich
Samuel Berger
Al From

APPROPRIATIONS

Cold War's Demise Shapes $26.3 Billion Spending Bill

President signs measure that cuts $1.1 billion from request but provides IMF funds and Israeli loan guarantees

Congress approved $12.3 billion in new financing for the International Monetary Fund (IMF) and $10 billion in loan guarantees for Israel as it sent President Bush the first foreign aid appropriations bill in nearly two years.

With minimal debate, the House on Oct. 5 adopted the conference report on the $26.3 billion spending measure (HR 5368), 312-105. The Senate approved the legislation by voice vote later that day. *(Vote 470, p. 3220)*

The president signed the measure (PL 102-391) on Oct. 6.

The bill cut about $1.1 billion from the administration's request for fiscal 1993. The final version of the legislation provides $12.5 billion more than the House-passed bill, which did not include the IMF appropriation, and $162 million less than the Senate bill.

In a number of areas, the bill marked a significant departure from foreign aid legislation enacted during the Cold War: A House-Senate conference committee on Oct. 2 moderated tough restrictions imposed by the Senate on aid to Russia — a program that did not exist the last time such a conference convened.

New controversies, reflecting the evolution of congressional foreign policy interests, replaced old ideological struggles. Over administration objections, the conferees authorized up to $50 million in U.S. military equipment for the besieged republic of Bosnia.

That represents the strongest congressional action favoring one side in the former Yugoslavia, although it does not compel Bush to provide the aid.

But the changing ideas about foreign assistance did not extend to the Middle East, where most U.S. military and economic aid continues to flow. The bill provides $3 billion in aid for Israel and $2.1 billion for Egypt, the same levels as in recent years.

By Carroll J. Doherty

BOXSCORE

Bill: HR 5368 — (H Rept 102-1011)— Fiscal 1993 foreign operations appropriations.

Latest action: President Bush signed Oct. 6 (PL 102-391).

Reference: Weekly Report, pp. 3066, 2962, 1891.

Congress has long been a wellspring of support for Israel, and the authorization of the five-year program of loan guarantees for Jerusalem — on top of the $3 billion in direct aid — made the bill more palatable for many members.

Excluding the one-time appropriation for the IMF, the measure provides $1.4 billion less than the fiscal 1991 aid bill, which was the last one to clear Congress.

That sharp reduction in spending helped ease anxiety among lawmakers about casting an election-year vote for foreign aid.

"It's a very tight bill, and we gave people some arguments to take home and defend," said Rep. David R. Obey, D-Wis., chairman of the House Appropriations Subcommittee on Foreign Operations.

Passage of the legislation also represented a qualified success for the Bush administration. The loan guarantees and the IMF appropriation — an essential component of the administration's aid initiative for the former Soviet republics — were regarded as legislative priorities by the White House.

In addition, the measure includes $417 million in economic and technical assistance for the former Soviet republics and $50 million to restructure debts owed by Latin American governments.

But the administration was forced to swallow major reductions in military aid and in Economic Support Funds (ESF), a key category of economic assistance.

The conference committee agreed to convert military assistance grants for three NATO allies — Turkey, Greece and Portugal — into low-interest loans. The bill provides $3.5 billion in military aid, a $596 million reduction from the fiscal 1992 level.

Funding for ESF, a program of cash transfers and other assistance for key U.S. allies, was cut by $498 million from fiscal 1992 to $2.7 billion.

A Russian Compromise

The conference committee faced conflicts over issues including military aid for the NATO allies, debt forgiveness and abortion.

Yet no issue took more time or effort to resolve than the stiff conditions on aid for Russia that had been attached to the Senate bill by Robert C. Byrd, D-W.Va., chairman of that chamber's Appropriations Committee.

The amendment would have prohibited aid to Russia until Moscow either withdrew its military forces from Estonia, Latvia and Lithuania, or agreed to a timetable for withdrawal. Byrd exempted humanitarian aid from his amendment.

The administration strongly opposed the provision, but decided to defer an all-out battle in order to expedite Senate passage of the measure. In an Oct. 2 letter to lawmakers, the White House warned that the amendment "would result in a cutoff of U.S.

assistance" and said that the problem was addressed by conditions in legislation (S 2532) authorizing aid to the former Soviet republics. *(Ex-Soviet aid, p. 3181)*

But Byrd was unyielding. "We have a time bomb ticking on our hands," he told the conferees, arguing that Russia's continued military presence in the Baltics could spur civil unrest.

With the proceedings dragging on — and Byrd raising the possibility of a filibuster if his amendment were stripped — Byrd, Obey and Sen. Patrick J. Leahy, D-Vt., left the conference for a private meeting. Leahy, who presided over the conference, chairs the Appropriations Subcommittee on Foreign Operations.

While the lawmakers were sequestered, Robert S. Strauss, the U.S. ambassador to Russia, called from Moscow to try to break the deadlock. But the dramatic gesture — Strauss telephoned about 5 a.m. Moscow time — went ignored as Byrd declined to leave the meeting to take the call.

Nonetheless, the three men emerged a short time later with a complicated agreement in hand. Under the compromise, only half the assistance can be provided unless the president certifies by next June that there has been "substantial progress" toward establishing a timetable for withdrawal.

If Russia still has not removed its forces by the end of next September — or has not set up a timetable to do so — further assistance will be cut off.

It is not clear how much, if any, of the $417 million in the bill for the former republics will be affected by this provision. The administration has not yet allocated the assistance among the newly independent states.

But the conditions might be less onerous than they appear because the definition of "substantial progress" is open to broad interpretation.

The White House letter noted that Russia has reached an agreement with Lithuania on withdrawal, and said there has been "considerable progress" in removing forces from the Baltic nations.

With far less controversy, the conference committee eliminated a second Senate amendment aimed at restricting aid to Russia. The amendment by Jesse Helms, R-N.C., would have barred all but humanitarian aid to Moscow until the president certified that Russia had ceased selling arms to Iran.

As the conference agreed to remove Helms' provision, Leahy declared that he "didn't have a dog in this fight."

The conferees also earmarked a substantial amount of the $417 million for specific purposes, some of which could benefit domestic interests. The legislation requires that $50 million in U.S. agricultural commodities be provided to the former republics.

Russia's failure to remove its troops from the Baltics is "a time bomb ticking on our hands."

—Sen. Robert C. Byrd, D-W.Va.

The conference committee also earmarked $50 million for scholarships and other educational exchange programs.

Cutting Military Aid

Byrd also was at the center of the dispute over military aid for Turkey and the two other countries that host NATO bases. The Appropriations chairman has been a tireless supporter of aid for Turkey.

The House and Senate were far apart on the issue. The House cut all military assistance grants for the three NATO allies — replacing them with market-based loans — but the Senate restored $540 million in grants and low-interest loans.

Byrd was the leading proponent of the Senate's position, but it seemed untenable at a time when foreign aid is so unpopular. Even if he had succeeded in conference, there would have been intense House opposition to increasing the funding in the bill by $540 million.

The conference committee essentially split the difference between the two chambers. It eliminated military grants but approved $450 million in low-interest loans for Turkey, $315 million for Greece and $90 million for Portugal. The annual interest rate on such loans is about 5 percent.

The panel attempted to assuage Turkey, an important ally in the Persian Gulf region, by providing $125 million in economic aid. Neither the House nor the Senate had included the earmark in its bill.

Despite an intense lobbying campaign by the administration and U.S. corporations, the conferees also cut $2.3 million in military training assistance that the administration requested for Indonesia.

Supporters of the aid cutoff, which was originally included in the House version of the bill, said the action was warranted because of the massacre of as many as 100 civilians last year by Indonesian forces on the island of East Timor.

But U.S. corporations operating in Indonesia feared a backlash from President Suharto's government if the provision became law. Obey, who defended the House stance, said "a number of business people have contacted various conferees with concerns about this amendment."

Opposition to the cutoff was led by Sens. Daniel K. Inouye, D-Hawaii, and Ted Stevens, R-Alaska, who proposed mild conditions in place of scrapping the aid. When it became clear that the conference would — at a minimum — impose tougher restrictions on the program, they gave up their fight.

The conference committee dropped abortion-related provisions that had triggered a veto threat. Both chambers had approved $20 million in aid for the U.N. Population Fund. The administration opposes such aid because the agency operates in China, which has been condemned for its coercive abortion policy. *(Abortion, p. 3162)*

The conferees easily reached an agreement on $50 million in funding for Latin American debt forgiveness under the administration's Enterprise for the Americas program. The House had provided no funding for debt restructuring, while the Senate had appropriated $100 million.

Middle East Dominance

Because of the cuts in the two main categories of bilateral assistance — Foreign Military Financing (FMF) and ESF — the dominant position of Israel and Egypt among aid recipients has become even more pronounced.

Congress earmarked $3.1 billion in FMF for the two allies, leaving only about $350 million for all other recipients of that assistance. Lawmakers earmarked $2 billion in ESF for Israel and Egypt, leaving only $670 million for other countries.

Foreign Aid Spending

(HR 5368, as cleared for the president, in thousands of dollars)

	Fiscal 1992 Appropriation	Fiscal 1993 Bush Request	House Bill	Senate Bill	Final Bill
Multilateral Aid					
World Bank					
Paid-in capital	$ 69,089	$ 70,126	$ 62,180	$ 62,180	$ 62,180
Limitation on callable capital	*(2,233,903)*	*(2,267,418)*	*(2,010,513)*	*(2,010,513)*	*(2,010,513)*
International Development Association	1,044,332	1,060,000	1,024,332	1,024,332	1,024,332
Global Environment Facility	—	—	—	30,000	30,000
International Finance Corp.	39,735	50,000	35,762	35,762	35,762
Inter-American Development Bank	85,053	77,889	76,738	76,738	76,738
Limit on callable capital	*(2,202,040)*	*(2,235,077)*	*(2,202,040)*	*(2,202,040)*	*(2,202,040)*
Enterprise for the Americas investment fund	—	100,000	75,000	100,000	90,000
Asian Development Bank	—	51,041	25,514	25,514	38,014
Asian Development Fund	124,979	144,474	75,000	75,000	62,500
African Development Bank	8,854	—	—	—	—
African Development Fund	103,893	135,000	103,893	103,893	103,893
European Development Bank	68,986	70,021	68,986	—	60,000
U.S. Quota, International Monetary Fund	—	12,313,857	—	12,313,857	12,313,857
State Department International programs	280,522	256,650	310,000	312,500	310,000
TOTAL, multilateral aid	**$ 1,825,443**	**$ 14,329,058**	**$ 1,857,405**	**$ 14,040,802**	**$ 14,207,276**
Bilateral Aid					
Agency for International Development (AID)					
Development assistance	1,287,945	1,265,500	1,343,480	1,387,480	1,387,480
Sub-Saharan Africa development/disaster aid	788,175	775,600	880,000	900,000	900,000
AID operating expenses	511,303	572,456	549,161	552,256	551,316
Enterprise for the Americas: debt reduction	—	202,119	—	100,000	50,000
Economic Support Fund	3,167,979	3,112,000	2,739,000	2,526,086	2,670,000
Multilateral aid for Philippines	78,522	80,000	40,000	40,000	40,000
Assistance for Eastern Europe	364,211	450,000	400,000	400,000	400,000
Assistance for ex-Soviet nations	—	350,000	417,000	417,000	417,000
Other	235,230	275,696	187,224	148,596	172,064
Subtotal, AID	**$ 6,433,365**	**$ 7,083,371**	**$ 6,555,885**	**$ 6,471,418**	**$ 6,587,860**
State Department					
International narcotics control	147,783	173,000	147,783	147,783	147,783
Migration and refugee aid	669,949	570,000	669,949	669,949	669,949
Anti-terrorism assistance	11,848	15,555	15,555	11,848	15,555
Subtotal, State Department	**$ 829,580**	**$ 758,555**	**$ 833,287**	**$ 829,580**	**$ 833,287**
Peace Corps	197,044	218,146	218,146	218,146	218,146
Overseas Private Investment Corp. *(loan levels)*	*(400,000)*	*(535,000)*	*(—)*	*(655,000)*	*(650,000)*
Other	54,511	68,303	64,938	67,598	65,793
TOTAL, bilateral aid	**$ 7,514,500**	**$ 8,128,375**	**$ 7,672,256**	**$ 7,586,742**	**$ 7,705,086**
Bilateral Military Aid					
(appropriated to the president)					
Foreign military financing (grants)	3,992,298	4,089,225	3,300,000	3,840,000	3,300,000
Estimated loan program	*(404,000)*	*(360,000)*	*(855,000)*	*(315,000)*	*(855,000)*
International military education and training	44,573	47,500	42,500	42,500	42,500
Special defense acquisition fund					
(limitation on obligations)	*(230,935)*	*(280,930)*	*(150,000)*	*(250,000)*	*(225,000)*
Other	77,734	110,498	81,596	82,806	176,366
TOTAL, military aid	**$ 4,114,605**	**$ 4,247,223**	**$ 3,424,096**	**$ 3,965,306**	**$ 3,518,866**
Export Assistance					
Export-Import Bank	640,996	682,000	778,509	786,150	786,150
Export assistance *(loan levels)*	*(11,000,000)*	*(11,385,000)*	*(—)*	*(11,000,000)*	*(15,500,000)*
Trade and development	34,483	40,000	40,000	40,000	40,000
GRAND TOTAL	**$ 14,130,027**	**$ 27,426,656**	**$ 13,772,266**	**$ 26,419,000**	**$ 26,257,378**

NOTE: The Senate Appropriations Committee approved an across-the-board cut of $118,974,000 for international financial institutions. The Enterprise for the Americas investment fund was excluded from the reduction.

SOURCE: House Appropriations Committee

As in past years, the bill also contains a host of other provisions that provide unique benefits for Israel. It is the only country that is entitled to receive its entire military and economic aid within the first 30 days of the fiscal year, enabling Jerusalem to collect interest on the assistance.

The conferees approved the guarantees that Israel has been seeking to allow it to obtain favorable interest rates on $10 billion in commercial loans to help it absorb hundreds of thousands of Jewish immigrants. The action was needed because the House had completed its bill before Bush and Israeli Prime Minister Yitzhak Rabin agreed on terms of the package.

Jerusalem has agreed to pay costs associated with the program, which for the first installment of $2 billion are expected to amount to $90 million.

Also for the Middle East, the conference committee earmarked $20 million in economic aid and $40 million in military aid for Morocco, which typically has a strong lobbying presence on Capitol Hill.

But the conferees approved a Senate amendment offered by Nancy Landon Kassebaum, R-Kan., limiting Morocco to $52 million in aid unless the president certifies the kingdom is cooperating with the U.N. peace process in the Western Sahara.

Multilateral Aid

While slashing available funds for bilateral assistance, Congress increased funding for worldwide programs that support refugees, efforts to protect the environment and family planning.

The bill provides about $670 million to aid refugees, an increase of more than $200 million since fiscal 1990. It earmarked $35 million to help refugees in Bosnia, Croatia and Slovenia.

The bill also includes $350 million for international population planning programs, a $130 million increase since fiscal 1990.

The conferees approved $650 million in funding for a number of environmental initiatives, reflecting the heightened concern in Congress over problems such as global warming.

They also approved an amendment from the Senate bill to appropriate $30 million for the World Bank's Global Environmental Facility, which backs efforts to preserve biodiversity and other environmental programs.

The legislation provides funding for several regional aid initiatives, which have emerged as alternatives to traditional bilateral assistance programs.

The bill includes $400 million to promote private-sector development and provide technical assistance for Eastern Europe and the Baltic States, $50 million less than the administration sought.

Fighting Drugs

The Senate on Oct. 7 cleared by voice vote the International Narcotics Act of 1992 (HR 6187, formerly HR 6018), aimed at streamlining the annual certification process for major drug producing countries. The House approved the measure by voice vote on Oct. 6. The bill incorporates much of the drug-control provisions from the fiscal 1992 foreign aid authorization bill (HR 2508), which died in the House last year. *(1991 Almanac, p. 471)*

The bill would allow the State Department, for the first time, to buy arms to protect its drug enforcement personnel and aircraft. It also would authorize $319.2 million in anti-narcotics aid over the next two fiscal years.

It also provides $800 million in economic development aid for sub-Saharan Africa, along with $100 million specifically allocated for emergency disaster relief in the region. The legislation earmarked $25 million in aid for war-torn Somalia, where an estimated 1.5 million people are at risk from famine.

AID and Trade

Although members from both parties have expressed frustration with continuing management problems at the Agency for International Development (AID), there is a consensus that little can be done to fix the troubled agency until after the election.

With an annual budget of more than $6 billion, AID administers most bilateral and multilateral assistance programs.

The latest embarrassment for AID occurred when the television news program "60 Minutes" broadcast a story showing AID officials attempting to induce U.S. companies to relocate in Central America.

That produced a wave of outrage on Capitol Hill. The conference committee responded by combining House and Senate language aimed at barring AID from providing any incentives to lure companies abroad.

The legislation also seeks to address persistent complaints that foreign aid is a "giveaway" program by increasing funds for export promotion activities.

The conference committee approved $757 million to back $15.5 billion in loans and financing extended by the Export Import Bank. The administration had requested $633 million for the program.

The conferees also adopted a Senate amendment requiring the administration to increase the amount of economic aid it provides in support of large-scale infrastructure projects.

Under the amendment, about 10 percent of the aid provided to the former Soviet republics, Eastern Europe and other regions must be made available for so-called capital projects.

Supporters of the proposal, such as David L. Boren, D-Okla., have long believed that U.S. companies would benefit if more aid were tied to the development of projects such as airports and telecommunications networks. *(Weekly Report p. 1351)*

The conferees also:

- Reduced the administration's request for military assistance to El Salvador from $40 million to $11 million, as both chambers had done. With a peace agreement in place, only nonlethal aid can be provided to the Salvadoran armed forces.

  The remaining $29 million was transferred to a fund established to assist the country in recovering from its 12-year civil war.

- Retained prohibitions on military assistance for Peru. The Senate bill would have allowed the president to provide the aid if President Alberto Fujimori made good on a pledge to restore constitutional democracy in the country.

- Approved an amendment, originally offered by Sen. Mark O. Hatfield, R-Ore., that will allow the president to provide some food aid and humanitarian supplies to Pakistan. Such aid has been barred since 1990 because of Islamabad's nuclear weapons program. But the conference report stipulated that Congress must agree to the aid shipments.

- Endorsed a Senate proposal authorizing the president to provide up to $15 million in U.S. military equipment for Cambodia and Laos to support their efforts to find missing American service personnel from the war in Southeast Asia. ■

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Agency in Agony

The Agency for International Development has been beset by constant criticism from Capitol Hill, shaky management, rock-bottom morale and deep internal uncertainty about its mission. Can President-elect Clinton turn it into something more than a relic of the Cold War?

BY CHRISTOPHER MADISON

On Election Day, much to the relief of some of his colleagues, Mark L. Edelman, the deputy administrator of the Agency for International Development (AID), announced that in two weeks he would finally be leaving the agency.

It was a departure long in coming. Edelman, who spent nearly a decade at AID, which administers foreign economic aid, had announced in the summer of 1991 that he would resign to pursue an unspecified business career.

But Edelman stayed put, remaining at the agency for another 16 months, drawing a salary but left out of agency decision making and management.

"He's a walking dead man," said Ted Van Dyk, a Democrat who worked in the Johnson Administration and served on the President's Commission on the Management of AID Programs, which studied the problem-plagued agency earlier this year.

But there was more to the story. Edelman, a former U.S. ambassador to Cameroon, was an AID veteran who had a good handle on what was wrong at the agency—he had been its acting administrator early in the Bush Administration—and wasn't afraid to speak his mind.

But he didn't mesh well with Ronald W. Roskens, whom President Bush had named to the top job at AID in late 1989. So Edelman told his boss that he would leave the agency as soon as a successor could be confirmed and sworn in.

Curiously, however, no successor ever arrived. AID insiders said that the White House never approved any of Roskens's proposed nominees; Edelman said that he never found another job.

So Edelman stayed on—a symbol of a dispirited and immobilized agency, an agency that was going nowhere.

Throughout the Bush Administration and even earlier, AID, which administers a $7.5 billion foreign aid budget, has been beset by constant criticism from Congress, shaky management, rock-bottom morale and deep internal uncertainty about its mission and status.

AID was created in the early 1960s to spur development in the Third World and at the same time hold the line against Communism. But Congress and succeeding Administrations have tinkered endlessly with its mission, and by 1992 it had become a Cold War relic whose role in post-Cold War U.S. foreign policy is still unclear.

That makes AID just one of the many foreign policy issues that the Clinton Administration will have to grapple with next year, despite the President-elect's pledge to concentrate on domestic economic problems.

Bill Clinton said almost nothing during his presidential campaign about foreign aid and AID, except to endorse the agency's newest mission, building democracies in the Third World, and to attack one of its more notorious missteps: using taxpayer funds to encourage U.S. firms to open plants in Central America, where labor is cheap.

Clinton eventually will be forced to address the foreign aid mess, but he'll have help. Congress, which is only too aware of the agency's problems, will try to redefine its charter and overhaul its organization next year.

Most of the agency's critics agree that AID's tarnished image of late is mostly the result of poor leadership, and they heap most of the blame not on Edelman, the incredibly invisible deputy, but on Roskens.

In fact, Roskens's harshest critics may be inside AID. "What's fundamentally wrong has been the leadership of the agency for the last three years," said a high-ranking AID official, referring to Roskens.

A former president of the University of Nebraska, Roskens had virtually no foreign policy experience when he joined the agency in early 1990. He brought an academic, management-oriented approach that largely ignored the substance of AID's mission, according to key agency officials.

"Roskens has paid attention to nothing except little management things," another source within AID said. "He was not interested in reforming foreign aid."

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Richard A. Bloom

Ted Van Dyk, who was on the President's Commission on the Management of AID Programs "AID cannot be overseas welfare. It has to meet policy objectives."

AID was already in trouble when Roskens arrived. It had been without an administrator for months and had been a bureaucratic backwater for years. Roskens, after ordering up a series of reports from consultants soon after he took office, seized on an ambitious reorganization plan.

But in retrospect, many agency officials agree that his reorganization made things worse.

Roskens did no better on Capitol Hill, where he made few allies because he often appeared unprepared and less than knowledgeable about AID's programs. "He mastered the art of saying, 'Let me get back to you with an answer for the record,' " an aide to the House Foreign Affairs Committee said.

Worst of all, AID on Roskens's watch saw a series of embarrassing scandals, with scores of employees or contractors cited for ethical violations and a few even sent to jail.

Roskens himself became entangled in a series of ethics problems involving his misuse of government travel funds and his improper acceptance of gifts during his first year. He drew a mild sanction from the White House and strong rebuke from some Democrats in Congress. (After an investigation by the White House counsel's office, Roskens repaid a college $3,580 he had received in speaking fees.)

A staff report of the House Government Operations Committee that was issued last month concluded: "Administrator Roskens's first year marked a new low in ethics at AID. While the administrator was flaunting executive orders and agency standards of conduct, white-collar crime among senior AID officials soared to new heights and staff morale plunged to new lows."

Rep. John Conyers Jr., D-Mich., the committee's chairman, recently called on Roskens to resign.

And by the tail end of the Bush Administration, Roskens had delegated the day-to-day management of the agency to a trio of aides and was spending much of his time giving speeches, by several agency accounts.

"AID," Van Dyk said, "has been on autopilot."

AN ANACHRONISTIC AGENCY?

AID's problems, however, go much deeper than poor management by Roskens, and predate his arrival. Even after Roskens and Edelman are replaced by Clinton's own team, AID's flaws—and those of the foreign aid program—will have to be fixed.

The end of the Cold War has weakened many of the underpinnings of U.S. foreign policy. Foreign aid, never a popular program, is no exception.

The program was conceived in the early 1960s, when the United States was seeking to alleviate poverty and illiteracy in the developing world while also signing up allies in its Cold War fight against Communism.

"The original rationale . . . was to help combat the spread of Communism," concluded a recent report from the Commission on Governmental Renewal, a joint project of the Carnegie Endowment for International Peace and the Institute for International Economics, which recommended reforming AID. "Even though humanitarian and other motives were always present and important, it was, above all, AID's supporting role in the Cold War that justified each annual budget request."

Communism died, the Cold War ended and solving the Third World's problems proved even more difficult than solving America's problems. By the Bush era, foreign aid had become a $7.5 billion hodgepodge of programs, ranging from massive aid to Israel and Egypt to tiny population control efforts in Africa.

Foreign aid isn't just devoted to helping developing countries. Development assistance, in fact, is only one part of the foreign aid budget.

A larger share of the foreign aid budget is doled out through AID's Economic Support Fund to U.S. allies that don't necessarily qualify as developing countries—Egypt and Israel, the Philippines and Turkey, to name a few. Other sizable

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chunks go to American schools and hospitals overseas, and for food assistance.

As a result, the amount of foreign aid actually used for development is relatively small: about $3 billion. Yet this has been the focus of the foreign aid debate.

The fierceness of feeling about AID hasn't been tempered by its relatively modest resources. "It has become patently clear to me that our international security assistance program is exhausted intellectually, conceptually and politically," said Sen. Patrick J. Leahy, D-Vt., the chairman of the Appropriations Subcommittee on Foreign Operations, which oversees foreign aid.

"Much of our foreign aid program is clearly out of step with global challenges to our national well-being, [and the program is] fast becoming a dinosaur, a relic of an era which is part of history," he wrote in a letter to Bush this summer.

Leahy is just one voice in a chorus of interest groups, congressional committees and think tanks that want to reform foreign aid.

Among those studying AID's past problems and its uncertain future are the General Accounting Office (GAO), the Office of Management and Budget, the Overseas Development Council, the President's Commission on the Management of AID Programs and several journalists.

The Bush Administration was also studying AID's future in the months leading up to the election, and the Commission on Governmental Renewal has urged Clinton to appoint "a blue-ribbon national commission to reexamine all aspects of foreign assistance."

Without exception, these study groups and committees have found persistent management problems at AID and have recommended sweeping changes.

The GAO, in a comprehensive report issued earlier this year, noted that each AID administrator brings in a new agenda and that Congress over time adds its own policy directives. The GAO, which found that AID's mission had become "too large and unfocused for its operating expense budget and staff levels," said: "The agency has no clear priorities or meaningful direction. Without a clear vision of what AID should be doing and why, [agency] efforts to reorganize, . . . focus, plan . . . may be futile."

The President's commission concluded that "AID's management problems have evolved over a period of years and are attributable to the lack of strong and consistent leadership from the administrator's office." The commission also noted that the agency's career staff has decreased while its responsibilities have increased—leading to the greater use of consultants and poorer accountability. (AID's work force has dwindled from more than 8,000 in the mid-1960s to fewer than 3,500 this year.)

"The Administration and Congress need to redefine the mission and objectives of foreign assistance and enact a new foreign assistance law," the commission said.

Departing deputy administrator Edelman agreed with many of the assessments of AID's ills. "The fundamental problem of AID is that it is being asked to do too many things by too many people at the same time," he said. But he was not sanguine that Congress or the White House would be willing to back the logical solution: to limit AID's scope, rather than continue to increase its responsibilities. "To manage AID better," Edelman said, "you have to say no."

Other AID officials suggested that Congress is part of the problem because of its penchant for widening AID's mission as well as for adding new spending programs.

John Tsui

R. Ray Randlett, AID's assistant administrator for legislation
"Foreign assistance has to serve the interests of the United States."

"Congress views AID as international pork," a veteran official of the agency said. He cited in particular congressional "earmarks" on the agency's budget, in which the Appropriations Committees will require, for example, that AID spend a certain amount for international orphans or war victims.

AID is forced to create a new program to fulfill the earmark, he said, regardless of whether its officials perceive a need or have a program in mind.

Some foreign policy analysts in the government argue that the debate over foreign aid is more sound and fury than substance. The reality is that Congress, through the appropriations process, has already begun making the adjustment to the post-Cold War era, scaling back security assistance and economic aid and protecting existing development assistance while adding aid to the former Soviet Union and Eastern Europe.

"The debate to some extent is driven by people who don't know where the money goes," a budget expert in the executive branch said. He said that despite the controversy surrounding AID's notorious management problems, many aspects of U.S. foreign assistance have widespread support.

THE FUTURE OF DEVELOPMENT AID

Whether or not they are part of the problem, Capitol Hill lawmakers with jurisdiction over AID are gearing up for action next year.

Leahy, for example, recently proposed that the leading members of the relevant committees—the two Appropriations subcommittees and the House Foreign Affairs and Senate Foreign Relations Committees—convene with the executive branch to decide on the outlines of a new foreign aid law.

Leahy hinted that absent a restructuring of foreign aid, next year's appropriation might be difficult to pass. "Without a new consensus, I do not believe the American people are willing to let foreign aid go on as it is now," he said in a letter to Bush last summer.

The Foreign Affairs Committee is also ready to tackle the foreign aid problem. Nearly three years ago, Rep. Lee H. Hamilton, D-Ind., the committee's incoming chairman, and Rep. Benjamin A. Gilman, R-N.Y., who will be the rank-

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ing Republican, co-sponsored a report that was highly critical of AID and foreign aid. Congress itself came in for some of the blame.

"Foreign assistance . . . is hamstrung by too many conflicting objectives, legislative conditions, earmarks and bureaucratic red tape," Hamilton and Gilman concluded in urging their colleagues to rewrite the law.

Their pleas went unanswered, but next year could be different now that Hamilton is chairman and the issue has become even more visible.

"We will have a lot of dance partners this time," said a committee staff member, who predicted action this year.

No formal timetable has been decided on yet at the Foreign Relations Committee, where Paul S. Sarbanes, D-Md., oversees the annual foreign aid authorization, or at the House Appropriations Subcommittee on Foreign Operations, Export Financing and Related Agencies, chaired by David R. Obey, D-Wis., which controls the appropriation.

Behind the scenes, however, Hamilton, Leahy, Obey, Sarbanes and their staffs are expected to coordinate their efforts to reform foreign aid.

"I think there is consensus that there needs to be major aid reform," said a staff member of the Foreign Relations Committee who follows the issue.

"There will be a new foreign assistance act," predicted consultant Van Dyk, who has been urging Members to act.

In theory, there is general agreement that foreign aid is supposed to encourage development in Third World countries. But in practice, of course, that consensus can get lost in the details.

The 1989 Hamilton-Gilman report, for example, listed four purposes for foreign aid: alleviating poverty, promoting economic growth, promoting democracy and protecting the global environment.

But getting agreement on the order of priorities is another matter.

As the Commission on Governmental Renewal recently noted, "It has been variously suggested that AID's primary mission should now be: to advance the spread of democracy; to promote free-market capitalism; to meet pure humanitarian and disaster relief needs; to address environmental protections and sustainable development; or to support U.S. exports. Some have argued that AID should try to do all of these things. However, the five rationales together may not add up to one compelling justification for a continued program even at today's very low aid levels."

John Eisele

Penn Kemble of Freedom House
"We still have a Cold War foreign policy structure."

The Reagan and Bush Administrations added an economic component to AID's traditional humanitarian mission. They began requiring developing countries to make economic reforms in exchange for assistance, on the theory that only by moving toward a free-market system could developing countries engineer economic growth.

The Bush Administration injected still other concerns. In response to the end of the Cold War and the spread of democracy in previously totalitarian states, AID jumped into the democracy-building business, especially in Eastern Europe and Latin America.

And with increasing pressures on U.S. firms to compete in the international arena, AID began trying to design programs that would provide markets for U.S. goods and services. It also began encouraging U.S. firms to invest in Third World countries.

"The guiding principle is that foreign assistance has to serve the interests of the United States," R. Ray Randlett, AID's assistant administrator for legislation, said. "It's a mistake to get too concerned about other factors. It's all tied into the global market. Things that help countries economically can also help the U.S. economically. Humanitarian programs can achieve [growth] and create markets for the United States."

With the change in Administrations and a chorus of calls for reform of aid, those priorities will once again be scrutinized and probably adjusted. The question is, how much?

"The real challenge is to rethink our interests in the developing world," said John W. Sewell, who's been pushing hard for aid reform in his role as the president of the Overseas Development Council, a Washington think tank that specializes in development issues.

Some development experts say that AID officials in the Reagan and Bush years skewed development policy toward commercial interests and away from humanitarian concerns.

The recent staff report from the House Government Operations Committee, for example, contended that Roskens altered AID's "primary objectives from those which benefit the poor in Third World countries to measures which promote economic growth by boosting the elite of the private sector in these nations."

The report said that "career developmentalists" at AID believe the agency has been "straying from its traditional mandate to help the poor."

Many of AID's current critics are eager to return to a more traditional approach in which "sustainable development" in the Third World is seen as serving long-term U.S. interests regardless of any direct benefits. They are likely to push their arguments with new vigor when the Clinton Administration tackles the issue. "It is in our interest for these countries to develop," said a staff member of the Foreign Affairs Committee. "If these countries are richer, they are likely to be more stable."

But a return to a purely poverty-oriented approach is unlikely, too, given tight budgets and a general disenchantment with all varieties of antipoverty programs. Van Dyk said that he hopes the pendulum will swing back from the Reagan-Bush emphasis on economic growth—but not all the way back to the basic human-needs approach.

"Aid cannot be overseas welfare," he said. "It has to meet policy objectives. It has to be used to help poor countries develop democracy and free markets and

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lift themselves up. AID doesn't have to be everywhere. Nor does everything have to be bilateral."

Another Democrat who works on development issues said: "The first and overriding issue is how to sustain political support for the effort. If the mission of AID does not seem consistent with our national interests, it won't have the support of any Members of Congress. You have to redefine AID's mission to reflect the needs of the 1990s."

That, he said, includes economic growth "that has some relationship to American jobs," in addition to promoting democracy, health, population control and environmental cleanup.

CAN AID BE SAVED?

So what should be done about AID? Should the troubled agency remain independent? Should it be folded into the State Department under a new undersecretary? Should a new development agency be created?

The debate has been around as long as AID's problems, but it gathered intensity this year when the President's Commission on the Management of AID Programs unexpectedly suggested scrapping the agency.

The commission concluded that AID didn't have sufficient clout to have an impact on U.S. foreign policy—or even to attract top-notch employees.

AID has to be part of the State Department, Van Dyk said, "if foreign assistance is to be an integral part of American foreign policy."

Van Dyk added: "It's a two-way deal. [State Department officials] look on AID as technocrats and engineers. AID is never included in meetings. AID officials, at the same time, see State as short-term political fixers."

The two should be integrated, he said, because economic and development issues "loom large" in foreign policy.

This view was beginning to take hold in the Bush Administration—acting Secretary of State Lawrence S. Eagleburger had been pushing it for some time—and also had some tentative support in Congress.

But many veterans of the development issue oppose the idea of joining AID and State. A Foreign Affairs Committee staff aide, reflecting the views of the development community, argued that State is too oriented toward short-term crisis management to think about humanitarian development. "Even in the post-Cold War world, there will be wars, and that's what State cares about," he said.

Sewell of the Overseas Development Council has suggested abolishing AID because it is discredited. "There's universal agreement that AID as an institution has run out of time," he said. But he opposes merging AID into State. Instead, Sewell has proposed a new development agency, which he calls a Sustainable Development Fund, to administer foreign aid.

"It matters whether AID is independent," Sewell said. "It's clear to most observers that a development organization has to have a problem focus rather than a country focus. The State Department has a country focus."

John Lisle

John W. Sewell, the president of the Overseas Development Council "There's universal agreement that AID as an institution has run out of time."

While the new entity concentrates on promoting development and coordinating the government's development policy, Sewell said, other agencies, including Commerce and State, could pick up other parts of AID's current portfolio, including promoting democracy and encouraging U.S. exports and investment in the Third World.

But Penn Kemble of Freedom House warns against putting the democracy-building portfolio in State. "Political development activities ought not be done under the supervision of the State Department or the embassy," he said. "People in the diplomacy end would be under too much pressure to use all the tools available [to further the embassy's goals], including political development programs."

A veteran AID official was even more dismissive of the urge to merge AID into State. "There's no problem at AID now that would be solved by putting it into the State Department," he said.

Although Clinton's impact on the foreign aid debate will be crucial, to date he has hardly weighed in on the subject.

"It's my sense that Clinton has not been thinking about these things," said Kemble, who helped to draft Clinton's foreign policy speeches during the campaign.

"It's difficult to assess what Clinton thinks," a Senate aide who follows the issue said, "because the campaign was so focused on domestic issues."

In his speeches, Clinton linked a reformed foreign aid program to the promotion of democracy but did not address AID's future.

Clinton and Vice President-elect Albert Gore Jr. have criticized AID for controversies that involve the transfer of U.S. jobs to Central America, but some Democrats suggested that their rhetoric was designed to offset Clinton's endorsement of the North American Free Trade Agreement, which labor organizations in the United States oppose.

Despite any real hints of his policy, an AID official predicted that Clinton would embrace a 1970s approach to development. "I think Clinton feels assistance should be primarily humanitarian," Randlett said. "They want to transform aid into a welfare program."

But Van Dyk predicted more of a tug-of-war within the new Administration. Clinton, he said, "will bring with him many of the humanitarian aid, ex-Peace Corps crowd. But labor will be pushing to stop the flow of jobs overseas." He declined to predict a winner.

The important step, Kemble said, is for Clinton to engage on the issue. "As Ross Perot has pointed out, we still have a Cold War foreign policy structure," he said. "And if Clinton doesn't get out in front on it, the debate will be shaped by others." ■

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The Nightmare Scenario

Future of Foreign Aid

By Anthony W. Gambino

Foreign aid is in trouble. It is likely that approximately 150 new members of the House of Representatives will arrive in Washington next January. Most of them may come to town committed to cutting foreign aid. If effective action is not taken before the election to convince them to tone down the inevitable anti-foreign aid rhetoric, many of them will be elected on domestically focussed, anti-foreign aid platforms. This outcome could be especially devastating for longer-term development assistance to reduce poverty, improve health care, foster sustainable economic growth and environmental policies, and promote family planning.

The President controls foreign policy activities and dominates the Congress in foreign affairs; in the domestic arena, power between the Executive and Legislative Branches is much more evenly balanced. President Bush has stated that he enjoys foreign policy work and dislikes domestic affairs for this reason. Both candidates for the presidency are committed internationalists, and would continue to support adequate funding for foreign assistance activities. Bush, for example, wrote the following to many Members of Congress last October:

> *Foreign aid is coming increasingly into question. More and more people wonder why the United States should engage in overseas assistance programs. However, I believe that providing food to hungry people and working to ensure all people access to a safe and nutritious food supply is a worthy goal on which all can agree.*

But do we all agree? Foreign aid is not popular in the present Congress. It has always been the favorite scapegoat for budgetary woes, despite its minuscule place in the federal budget. During a recent debate on funding priorities, one senior member of the House, Rep. Robert Roe (D-NJ) was quoted as saying: "It is time to say to the people overseas, 'Pay your own damned bills and let us spend our tax dollars with our people.'"

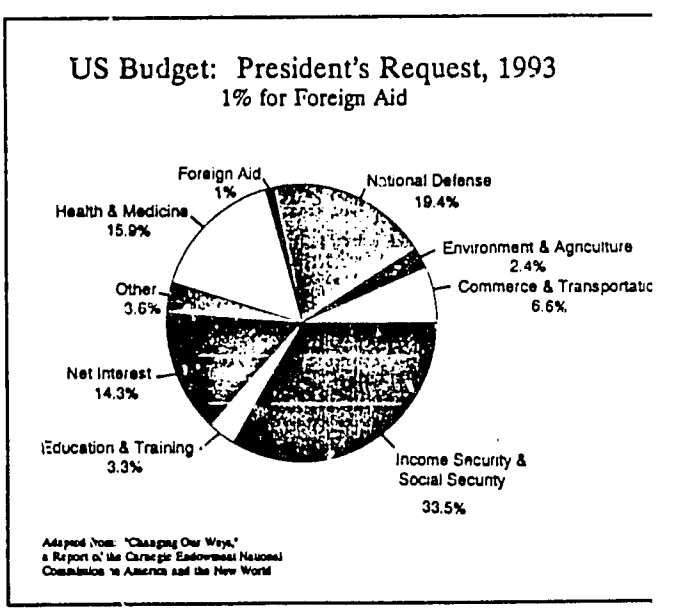
The Congress holds the purse strings: this is the essential power of the Congress in all areas, including foreign affairs.

In a $1.5 trillion budget, all foreign aid accounts for about one percent of the total. This figure includes military assistance and other activities that are not part of development activities. Humanitarian and development activities, then, account for less than one-half of one percent of the federal budget.

Unfortunately, a growing number of members of — and candidates for — Congress are using harsh neo-isolationist language similar to that quoted earlier in their campaigns. A laudable desire to focus on domestic issues is transformed into an anti-foreign aid position, which on occasion turns into an untargeted criticism of ALL so-called "foreign entanglements," including humanitarian work overseas.

This is happening even though most Americans support humanitarian work and effective poverty alleviation projects. For example, the Chicago Council on Foreign Relations examined surveys of public opinion into 1991 and stated that "combatting world hunger ... has always been seen as a top foreign policy goal among the public ..."

The foreign aid budget is an amalgam of programs, such as military assistance, economic support funds, food aid, emergency disaster assistance, aid to multilateral organizations such as UNICEF, and development assistance. Most at risk are the single largest category of these programs, the funding of which is controlled by the Foreign Operations Subcommittees ("Foreign Ops") of the House and Senate Appropriations Committees. Foreign Ops funds roughly $1 billion in multilateral and bilateral economic and developmental aid, military aid, and export assistance.



Foreign aid funding is already going down. In a recent bill passed by the House, all of these programs (and more) were funded at $13.8 billion, $1.3 billion below the Bush Administration's request. It is likely that funding for fiscal year 1993 will end up at a level even lower than $13.8 billion.

What is the problem, the "nightmare scenario," for development programs? Imagine a House of Representatives next year with one-third to one-half of its members *publicly committed* to vote against much of foreign aid? Imagine that this new, neo-isolationist House of Representatives, tells the House Foreign Operations Subcommittee that it cannot allocate $13.8 billion for foreign assistance, but, instead, it has only $10 billion.

How would this $10 billion be apportioned? Egypt and Israel will almost certainly claim their present share, $5 billion, or half the total. The Bush or Clinton Administration should be able to garner enough support to maintain military and Economic Support Fund relationships with countries like Greece, Turkey, Morocco, and some of the countries of Eastern Europe — and establish new relations with some of the new states of the former Soviet Union. This could add up to an extra $2 billion; the total becomes $7 out of the $10 billion.

Africa, I believe, will retain its claim on development assistance funds at about $800 million to $1 billion. That gets us up to $8 billion. Disaster assistance retains strong support, but continues to receive only about $50 million (the lion's share of the US disaster response continues to be in food via Title II of PL480). But a new fund for heavy infrastructure projects, the Capital Projects Fund, could become a large account funded at $1.5 billion.

That, then, would leave $500 million for non-Africa development assistance. This means only $500 million for activities like child survival (currently $250 million), population (currently over $300 million), migration and refugees (currently $620 million), environmental programs, small farmer/sustainable agriculture programs, microenterprise, and all multilateral assistance, currently $1.9 billion. Over $3 billion of programs be squeezed into a $500 million pigeonhole.

Can this "nightmare scenario" be avoided? Yes, it can, but only if enough of the new Members of the House of Representatives indicate their support for humanitarian work before Election Day. Members of Congress should be asked to indicate publicly their support for programs:

- to help end the suffering of people everywhere, including children, refugees, and migrants; and
- to help increase the well-being of people around the world through programs of economic and social development, relief, reconstruction, and environmental protection.

In its recent study, *Challenges and Priorities in the 1990s: An Alternative US International Affairs Budget, FY 1993*, the Overseas Development Council recommends nearly $7 billion in long-term bilateral and multilateral development programs. This level would represent a reasonable contribution by the US towards alleviating poverty, hunger, and ill health, and promoting sustainable economic growth around the world.

Current events — from the former Yugoslavia to Somalia — serve as gruesome reminders of the importance of international humanitarian efforts, and the key role of the United States. Will Congress give the next President $7 billion or $500 million to respond to these needs? The ability of the next President to lead in efforts to improve the lives of the billion people still hungry hangs in the balance.

The writer is public policy director for InterAction. This article also appears (in a slightly altered version) in the newsletter of the National Council for International Health.

Reforming the Post-Cold-War UN

By Lee H. Hamilton

THE United Nations is experiencing the best of times and the worst of times. The UN is now within reach of attaining the ideals of its charter. Yet never has the organization been more overburdened and underfunded. Member states are giving the UN new responsibilities, but not the resources to address them. If the UN is to carry out new tasks, it must resolve persistent management and funding problems. Both internal reform and external support will be necessary.

The end of the cold war has vastly expanded UN responsibilities. The Security Council has mandated ambitious operations in Iraq, Cambodia, the former Yugoslavia, and Somalia. The UN has launched 13 peacekeeping operations in the last five years – as many as in the 40 preceding years. It also has new environmental responsibilities after last June's Earth Summit.

UN resources have not kept pace. At the end of September, only 66 countries had fully paid their 1992 dues and unpaid dues totaled $1.47 billion. One major donor, the Soviet Union, no longer exists. This funding crisis could force the suspension of some UN operations.

What does the UN need to do? It needs to reform itself from top to bottom. It has squandered resources through mismanagement, duplication of effort, and abuse of privilege. Questionable programs in some UN agencies have undermined member nations' support. Redundant and obsolete programs need to be eliminated and jobs need to be awarded on the basis of merit, not nationality. An independent inspector-general is needed to monitor program results.

Since taking office in January, Secretary-General Boutros Boutros-Ghali has streamlined management at UN headquarters. But he is reportedly encountering resistance elsewhere in the organization from officials worried about losing jobs and perks. Developing nations worry about cuts in UN economic and social programs, which account for 90 percent of UN expenditures.

How can the United States help?

First, we should try to build a consensus in support of reform in the General Assembly, which approves major organizational changes. We need to work with the secretary-general to persuade developing countries that reform will strengthen, not weaken, economic and social programs. To gain broad support for tough management reforms, the US and other influential UN members will need to accommodate developing-country concerns.

Second, we should support an expansion of the Security Council. Expansion is necessary both to enhance the Council's legitimacy and to persuade wealthy countries to assume greater UN burdens. Permanent seats for major third-world countries from each continent should be considered. The US should also support seats for Japan and either Germany or the European Community.

Third, we need to help the UN respond better to crises. In a June report, the secretary-general recommended reviving provisions of the UN Charter that call upon member states to provide military units to the UN on short notice. We should back this proposal, which would allow us to retain a Security Council veto over proposed operations involving US forces.

In September, President Bush offered logistical and training support for UN peacekeeping forces. He pledged to train US military personnel for participation in UN operations. These are good initiatives but fall far short of meeting the secretary-general's challenge. If the UN is to extend its reach from peacekeeping to peacemaking, more US leadership is required.

Fourth, we must pay our UN dues on time and in full. We should resume paying our UN dues at the beginning of the calendar year, as we did prior to 1981. The current practice of paying dues nine months late strains UN finances. We are now paying current dues and working off arrearages, which still stand at $295 million. If we are to encourage others to pay up, we must do the same.

Fifth, we should push for a revision of UN dues assessments. The current payment scale – under which the US pays 25 percent of the UN budget and 30 percent of peacekeeping costs – no longer corresponds to economic reality. Japan, Germany, Persian Gulf states, and other prosperous members should pay a larger share.

Finally, we must explore new sources of funding for UN peacekeeping and other operations. The secretary-general has identified several funding options, including (1) a $50 million peacekeeping start-up fund; (2) a $1 billion "peace endowment" created through private and public donations; (3) charging interest on unpaid UN dues; and (4) raising funds through taxes on airline travel or arms sales.

To meet its new challenges, the UN must reform. To strengthen the UN, the US and other countries have an obligation to provide both constructive criticism and strong financial support.

■ *Rep. Lee H. Hamilton (D) of Indiana is ranking Democrat on the House Foreign Affairs Committee and chairman of the Subcommittee on Europe and the Middle East.*

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DIALOGUE:

Rights and Foreign Policy

Fight Abuses

By Aryeh Neier

When a colleague returned from Bosnia-Herzegovina, I asked what she had found. "Everything but gas chambers," she said. That catastrophe — holocaust may not be too strong a word — is just one of several facing President-elect Bill Clinton.

By rights, he should be able to rely on the international community to take responsibility for stopping the ethnic persecution also under way in Burma and the Sudan; the slaughter in Somalia, Liberia and Afghanistan, and the looming famines in Mozambique and Angola. Yet, the U.N., the European Community and the Organization of African Unity have failed miserably in these crises. If America does not take the lead, there is little prospect anyone else will rally the world to stop the carnage.

Mr. Clinton made a number of statements during the campaign and since his election that reflect a belief that the U.S. should respond effectively in places such as Bosnia and Somalia. If he is intent on transforming this belief into action, here is a 10-point program to consider.

He should declare that the U.S. has a basic interest in alleviating extreme suffering and in stopping extreme human rights violations — crimes against humanity, war crimes and genocide — anywhere.

He should denounce those responsible for extreme human rights abuses. Slobodan Milosevic, Serbia's President, is a war criminal, and the U.S. should press for his arraignment before a U.N.-sponsored tribunal.

A person of international stature should be appointed to head the State Department's Bureau of Human Rights and Humanitarian Affairs, and the post should be upgraded.

The U.S. should seek adoption of a convention that provides criminal penalties for acts already recognized in international law as crimes against humanity and that establishes a permanent criminal tribunal to try and punish those committing such crimes.

The U.S. should pay its legitimate debts to the U.N. and press for an investigation of the dismal performance of the U.N. and its specialized agencies in dealing with such humanitarian disasters as in Somalia.

Washington should express willingness to enter into the talks urged by Secretary General Boutros Boutros-Ghali over establishment of a U.N. rapid-deployment force. This permanent military force would free the U.N. from dependence on its members to contribute peacekeeping troops on an ad hoc basis. The troops would not be subject to restrictions on their duties imposed by the contributing states.

The U.S. should set an example of generous treatment of refugees fleeing human rights abuses and conflict, beginning with a new policy for dealing with the Haitian boat people.

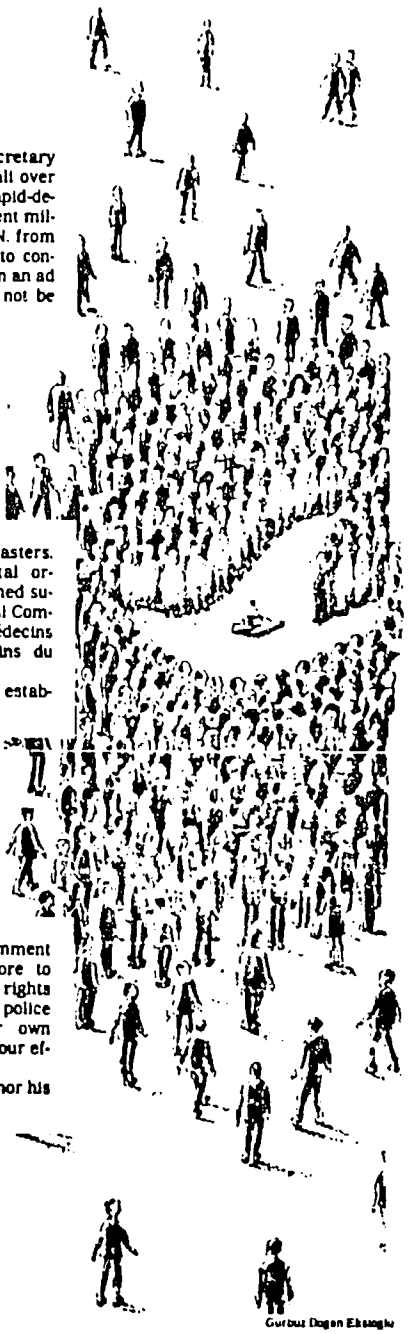
We should give priority in our foreign aid budget to responding to humanitarian disasters. International nongovernmental organizations that have performed superbly — say, the International Committee of the Red Cross, Médecins sans Frontières and Médecins du Monde — should be helped.

The Administration should establish the morality of its condemnations by denouncing perpetrators evenhandedly, whether considered friends or foes. It is appropriate to vilify Saddam Hussein, but Hafez al-Assad in Syria should not be spared. China, Indonesia, Turkey and Peru deserve sanctions for human rights abuses.

Finally, the Government should do much more to end abuses of human rights in the U.S., such as police brutality, insuring that our own shortcomings do not undercut our efforts worldwide.

Though Mr. Clinton must honor his Presidential campaign promise to give high priority to rehabilitating the domestic economy, I believe he will find near universal public support for a resolute and well-thought-through program to deal with humanitarian disasters and human rights emergencies worldwide. □

Aryeh Neier is executive director of Human Rights Watch.



Gurbuz Dogan Ekizoglu

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THE NEW YORK TIMES, November 30, 1992

Essay

WILLIAM SAFIRE

Right to Intervene

WASHINGTON

Before Larry Eagleburger and Brent Scowcroft return to Kissinger Associates, they would do their country and the world a big favor by enlisting a serious speechwriter like Anthony Snow in a great enterprise: They could help the President-unelect articulate the new international "right to intervene."

Last week, lurching to do the right thing despite the lack of policy about intervention, Mr. Bush and his advisers suddenly proposed to send a division or two of U.S. troops to end the anarchy preventing the delivery of food to the starving people of Somalia.

Bandits are in control; the tiny international force is inadequate and the U.N. cannot muster the strength of purpose needed; televised catastrophe looms. Under that impetus, our human interest superseded our national interest; the President persuaded the Joint Chiefs to go along with the political judgment of the Commander in Chief that the moment had come for a genuine "police action."

Americans now find themselves on the offering end of a secret commitment of undetermined scope (2,000 marines? Two Army infantry divisions?) with unknown allies. Through

Toward the new sovereignty.

U.N. leaks and cryptic pronouncements from White House and State Department staff, we learn of our Pentagon's requirement that our troops be under American command — if the U.N. Secretary General or Security Council will give us its blessing; or if our allies help with troops or money; or if African participation can make intervention more acceptable locally.

This is the wrong way to go about doing the right thing.

The right way is for President Bush to make his decision about how much force is necessary to intimidate into submission the bandits in Somalia, and how much aid is needed to avert mass starvation.

Then — before syndicating that troop and aid commitment among responsible nations, and before asking for a Security Council seal of approval — he should enlist support from Congressional leaders and ask for prime time on the world's networks. He'd get both.

President Bush should then explain what the need is in Somalia and how he proposes to meet it. Let's say, for argument's sake, the safest approach requires 30,000 peace-enforcing troops and $5 billion for food, medicine, a beginning to agricultural rehabilitation and troop support. Let him lay out our commitment, our expectation of military and financial support from others, and our proposal to the U.N. for the temporary governance of the pacified area.

The reaction from world leaders, President-elect Clinton, and the American public could only be supportive. Local gang leaders would assure Jane Perlez of The New York Times, whose reporting has been stunning, of their acquiescence. Nobody could rationally object to our riding massive shotgun on the humanitarian relief coach.

But Mr. Bush's address, to rival the farewell of Eisenhower's, should not end with that single rescue operation. So frequently and rightly derogated for lack of a vision, Mr. Bush should take the world to a mountaintop: as departing chief of the only standing superpower, he should deal with what George Shultz has long been calling "the new sovereignty."

When do the world's responsible powers have a right to intrude on what used to be an impenetrable sovereignty? Anarchy offers the obvious invitation to intervene, as is the case in Somalia — but what of cases of genocidal tyranny, as practiced by Iraq in its portion of Kurdistan, or by the Khmer Rouge as it plots new savagery in Cambodia, or by Serbia as it readies for the its final solution in Kosovo?

The departing American President has the standing to assert that the preservation of human life is an interest — a vital interest, to be redundant — of the world's powers. By virtue of being the superpower, we have a superinterest — and by our example, we show the way for others to accept their portion of the world's obligation to protect lives and freedoms.

Cases differ; we will not take the lead in every case; nor will we be drawn into extended military involvements alone or against our judgment. But we should be able to suggest an extension of collective security when great numbers of people are being murdered or systematically starved.

The world awaits "the new sovereignty" speech. George Bush may still have a rendezvous with history. □

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Focus on the Emerging Democracies

A Periodic Update

The following is a summary of US efforts to assist the new independent states of the former Soviet Union:

Overview

Total US Assistance: To date the US has pledged about $9.2 billion in grant assistance and credits to the new independent states of the former Soviet Union for FY 1991-93. About 63% of this total already has been obligated.

US assistance in FY 1993 will total about $3 billion. FY 1993 grant assistance is estimated to be about $1.3 billion (including $923 million in technical and humanitarian assistance and $415 million appropriated to the Department of Defense). FY 1993 credit programs are estimated to be about $1.5-$2 billion ($1 billion in Commodity Credit Corporation credits, $450-$900 million in Export-Import Bank credits, and $125 million in Overseas Private Investment Corporation (OPIC) financing).

Multilateral Financial Assistance: The US will contribute $5 billion to the $24 billion multilateral financial assistance program ($18 billion in financial support and $6-billion currency stabilization fund for Russia) as agreed by the Group of Seven industrialized countries (G-7) in April 1992.

Agricultural Credit Guarantees: The US has announced a total of $5.5 billion in export credit guarantees to the NIS, of which $4.5 billion has been committed; about 32 million tons of agricultural commodities already have been shipped.

This includes an additional $1.15 billion credit guarantee and food assistance package announced for Russia on September 14, 1992, consisting of $900 million in loan guarantees and $250 million in grant food aid. Credit guarantees of $100 million were made available immediately; $500 million more followed on October 1; and the remaining $300 million will be made available on January 1, 1993. On October 19, 1992, $200 million of credit guarantees were announced for Ukraine.

Humanitarian Assistance

Operation Provide Hope ($180 million): During Phases I and II of Operation Provide Hope, the United States delivered about 20,000 tons of Department of Defense (DOD) excess food (valued at $34 million) and 3,000 tons of excess medicines and medical supplies and equipment (valued at $112 million) to 26 cities throughout the 12 NIS. These totals do not include transportation costs.

Phase III of Operation Provide Hope has begun with the shipment of 4 million ready-to-eat meals (valued at $18 million) to 17 locations in Russia and about 10,000 tons of processed food (valued at $20 million) targeted for needy individuals and families in Russia.

US Department of Agriculture (USDA) Food Assistance ($283 million): More than 630,000 tons of food aid (valued at $283 million) has been committed to Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, and Turkmenistan.

In addition, on October 9, 1992, USDA announced a $250 million grant food aid package for Russia in FY 1993.

US Agency for International Development (USAID) Emergency Immunization Initiative ($6 million): USAID has purchased measles, tetanus, polio, and diphtheria vaccines and related medical equipment to immunize about 520,000 infants in Turkmenistan, Kyrgyzstan, Tajikistan, and Uzbekistan. In addition, Project Hope will administer a program to procure US-manufactured vaccines and immunize about 261,000 children in Ukraine and Armenia.

Emergency Medical Initiative ($14 million): The US is purchasing critically needed medicines to meet emergency needs in several republics. At least $1 million worth of medicines and supplies are being purchased for the republics of Tajikistan and Kyrgyzstan. Plans are also being developed to purchase similar amounts for the republics of Moldova, Uzbekistan, Ukraine, and Kazakhstan.

Presidential Medical Initiative ($10 million US contribution): Since February 1992, Provide Hope has delivered pharmaceuticals and medical supplies (valued at $74 million) to all NIS.

DOD Medical Supplies ($9 million): The US has shipped and installed medical supplies and equipment (valued at more than $9 million) to outfit a 1,000-bed hospital in Tbilisi, Georgia. The US also is considering providing similar assistance to Kyrgyzstan by the end of 1992.

Private Sector Contributions ($49.3 million): More than 5,000 metric tons of food (valued at $24.3 million) and 1,770 tons of medicines and medical supplies (valued at $25 million) were delivered under the authority of the Dire Emergency Supplemental legislation. According to NIS information, at least 50,000 tons of food, medicines, clothing, and other items from other private donors have been delivered.

Technical Assistance

New Technical Assistance Programs: New technical assistance programs proposed for FY 1993 include a $35-million, 3-year environment project to strengthen environmental

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management institutions and promote environmental technology, and two enterprise funds in Russia and Ukraine.

The US Government has allocated $634 million for technical assistance programs in the NIS in FY 1991-93. Examples of current programs follow:

Democratic Institution-Building

Political Party Training and Civic Education: The National Democratic Institute and International Republican Institute, as well as several other non-governmental organizations, have received grants to carry out political party training and civic education activities and to place long-term experts in the NIS.

Rule of Law: To date, the American Bar Association has placed 5 long term program directors and 7 short-term legal advisers in the NIS, provided assessments of draft legislation and constitutions, and sent about 40 US specialists to host 6 technical legal workshops on judicial restructuring.

The Department of State held seminars for senior NIS legal officials on the US legal system and is providing judicial training assistance to the Legal Academy of the Russian Ministry of Justice.

Independent Media: Internews, a non-profit media organization, is establishing an independent television news distribution system in Russia, Ukraine, and Kazakhstan and is providing journalism training for independent broadcasters throughout the NIS.

Public Administration: The US Information Agency (USIA) is sponsoring visitor programs in the US for all NIS presidential chiefs of staff and other high-level national government officials to learn about executive office organization. USIA also is sponsoring training programs for high-level city officials from Russia and Ukraine, providing a grant to Sister Cities to establish a municipal training program between partnered US and NIS cities, and publishing materials on public policy and administration for distribution in the NIS.

America Houses: USIA will begin establishing America Houses in Kiev, Ukraine, and in Alma-Ata, Kazakhstan, by November 1992, and in Vladivostok, Russia, shortly thereafter to serve as focal points for the exchange of people to and from the US and make available on-the-ground logistical and information resources for the American private sector.

Non-Governmental Organization (NGO) Assistance: Six US private voluntary organizations (PVO) have received funding to enhance the institutional capabilities of indigenous non-governmental organizations in the NIS and to undertake social service projects in Belarus, Georgia, Russia, Ukraine, and the Central Asian republics.

Economic Restructuring, Privatization, and Defense Conversion

Financial Sector Advisers: Four short-term tax policy missions have been sent to Russia since May to provide advice to the Ministry of Finance on tax policy and administration. Six short-term advisers have provided assistance on tax and currency policy and regulation in Ukraine. The Treasury Department will send a long-term tax policy adviser to Russia and a financial adviser to Belarus in November 1992, pending approval of a National Security Council directive.

Privatization: The US has provided funding to the International Financial Corporation to support NIS privatization through small-scale auctions, to distribute copies of a "how-to" manual for small privatization auctions, and to privatize the transportation sector in Nizhniy Novgorod.

The US is sponsoring auctions, modeled after those held in Nizhniy Novgorod, to privatize the retail sector in Volgograd, Russia, and Volgograd *oblast* (a regional political entity) and Lviv, Ukraine. A team also will be sent to Tomsk, Russia, shortly to begin the auction process.

The US is providing funding to the Russian State Committee on the Management of State Property to support design, implementation, and publicity for a mass voucher program, and a project to screen businesses which may serve as demonstration privatizations.

The Trade and Development Program (TDP) and OPIC have received funding to conduct investment missions and provide feasibility study financing for infrastructure projects in the NIS. The Department of Commerce has established a business information center on commercial opportunities in NIS.

Special American Business Internship Training Program (SABIT): Currently eight Russians are participating in the Commerce Department's SABIT program. An additional 86 candidates have been selected, and 33 of these are expected to arrive in the US shortly. The department has received more than 150 applications from US companies interested in hosting business or scientific interns. It expects 241 interns to participate over the next year.

Defense Conversion: The US has sent three defense conversion advisers to Nizhniy Novgorod, Russia, and two advisers to Kharkiv, Ukraine. Additional advisers are planned for Tomsk and Yekaterinburg, Russia, and Alma-Ata, Kazakhstan.

The International Executive Service Corps has completed industry restructuring projects in Saratov and St. Petersburg, Russia, and Kiev, Ukraine. It has established offices in Moscow and Kiev and expects to select long-term representatives for new offices in Yekaterinburg, Russia, and Yerevan, Armenia, by the end of 1992.

Agriculture

Farmer to Farmer: About 1,800 agribusiness volunteers in the Farmer-to-Farmer Program will be placed in private agribusinesses and/or farms in all NIS over the next 3 years. Volunteers in Overseas Cooperative Assistance (VOCA) has sent 16 volunteers to Russia and 8 volunteers to Ukraine and has identified 19 to go to Russia and 8 to go to Ukraine in the next few months. Another 15 volun-

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teers have gone to Kazakhstan and Armenia. An additional five implementing organizations received grants in late September.

USDA Programs: USDA is establishing a model farm near St. Petersburg and assisting in the development of private wholesale markets in Moscow and Kiev.

USDA also will be sending four American agribusiness executives to Russia and two to Kazakhstan to work with newly privatized food industries under its Loaned Executives Program.

In addition, USDA has selected 41 Russians and 10 Ukrainians to participate in its Cochran Fellowship program for training in agribusiness.

Grain Storage: The US recently signed a contract with North American Agricultural, Inc., to install more than 300 grain storage facilities in 80 sites (including 50 in Russia, 15 in Ukraine, and 15 in Kazakhstan) to reduce immediate grain losses and to demonstrate benefits of modern grain storage technology. Each facility, which consists of four storage bins plus grain-moving and related equipment, has a capacity to store 80,000 bushels. Most facilities will be in place by the end of 1992.

Agribusiness: All NIS will be eligible for assistance under the USAID agribusiness project that is designed to get more US agribusinesses involved in the former Soviet Union. This program will emphasize upstream and downstream agricultural activities, such as fertilizers, marketing, processing, and distribution. Proposals are under review, and grants will be awarded by late November or early December, with activities expected to begin in early spring 1993.

Energy

Nuclear Reactor Safety: The Department of Energy and the Nuclear Regulatory Commission are implementing a $25-million nuclear reactor safety program which will establish a training center in Russia and Ukraine to enhance operational safety, provide risk reduction measures for nuclear reactors, and assist regulators in developing consistent and effective safety standards and procedures.

Energy Efficiency: US technical experts have conducted energy audits in district heating plants in Kostroma and Yekaterinburg, Russia; Kiev, Ukraine; Minsk, Belarus; Yerevan, Armenia; Alma-Ata, Kazakhstan; and Bishkek, Kyrgyzstan, and are installing necessary equipment to increase energy efficiency this winter.

Coal Mine Safety: Partners in Economic Reform is providing equipment and establishing training centers to improve management and safety standards in the Kuzbass and Vorkuta regions of Russia, Donbass region of Ukraine, and Karaganda Basin in Kazakhstan.

Housing

Four of twelve long-term housing advisers are in Moscow, Novosibirsk, and Yerevan working on legal reform in the housing sector, development of a housing privatization law, and municipal management.

Health

Hospital Partnerships: Twelve hospital-to-hospital partnerships have been established in the NIS. These partnerships will create a base for technology and personnel exchanges between US and Russian hospitals. We expect to establish 20 such partnerships by the end of 1993.

Trade and Investment in Pharmaceutical Sector: TDP, OPIC, and the Department of Commerce will undertake trade and investment missions to encourage increased trade and investment in the health sector throughout the NIS.

Vaccine and Pharmaceutical Production: USAID is working with Merck & Co. and Lederle to procure equipment and spare parts to help restore production of measles, tetanus, diphtheria, and polio vaccines; provide orientation to US standard good manufacturing practices for NIS executives and scientists; and conduct feasibility studies for establishing vaccine manufacturing facilities in Russia at a level of quality comparable to that in the US. A similar program, focusing on vaccine production, will be implemented in Ukraine.

Peace Corps

The Peace Corps will place 250 volunteers in Armenia, Russia, Ukraine, and Uzbekistan by the end of 1993. Assessment visits are planned for Kyrgyzstan and Kazakhstan in October 1992, possibly to be followed by Belarus and Turkmenistan in November.

Staff arrived in Armenia in August 1992, and 40 volunteers will arrive in November.

Staff arrived in the Russian Far East in June 1992 and established a permanent office on September 14; 50 volunteers are scheduled to arrive in November to work in the Primorski, Khabarovsk, and Sakhalin *oblasts*. Fifty volunteers are scheduled to arrive in November to work in five *oblasts* in the Volga River region.

Staff arrived in Uzbekistan in September 1992. Initial negotiations on a country agreement are complete, and 50 volunteers are expected to arrive in December 1992.

Nunn-Lugar Funds

DOD appropriations for dismantlement and destruction of nuclear weapons total $400 million in FY 1992 and an additional $400 million for FY 1993. Expanded funding authorities for FY 1993 include defense conversion, nuclear safety, and export controls.

International Science and Technology Centers: The US has committed $25 million toward the establishment of an International Science and Technology Center in Russia and $10 million for a similar center in Ukraine to employ former military scientists in civilian projects in the former Soviet Union. ■

FREEDOM Support Act Signed into Law

President Bush

Statement released by the White House, Office of the Press Secretary, Washington, DC, October 25, 1992.

Today I have signed into law S. 2532, the "FREEDOM [Freedom for Russia and Emerging Eurasian Democracies and Open Markets] Support Act." This historic legislation authorizes a range of programs to support free market and democratic reforms being undertaken in Russia, Ukraine, Armenia, and the other states of the former Soviet Union. In particular, the bill endorses the $12 billion increase in the U.S. share of the International Monetary Fund (IMF) and authorizes $410 million in U.S. bilateral assistance. In addition, the bill removes a number of outdated Cold War legislative restrictions on U.S. relations with the new independent states.

I am proud that the United States has this historic opportunity to support democracy and free markets in this crucially important part of the world. While it is clear to all that the future of the new independent states of the former Soviet Union is in their own hands, passage of the FREEDOM Support Act demonstrates the commitment of the United States to support this endeavor.

Once again, the American people have united to advance the cause of freedom, to win the peace, to help transform former enemies into peaceful partners. This democratic peace will be built on the solid foundations of political and economic freedom in Russia and the other independent states. We must continue to support reformers in Russia, Ukraine, Armenia, and the other new states.

I am pleased that the bill draws our private sector, as never before, into the delivery of technical assistance to Russia and the other new states. Various provisions of this bill will call upon the specialized skills and expertise of the U.S. private sector. S. 2532 will provide support for the trade and investment activities of U.S. companies to help lay the economic and commercial foundations upon which the new democracies will rest. This is an investment in our future as well as theirs.

The IMF quota increase will ensure that the IMF has adequate resources to promote free markets in the former Soviet Union and elsewhere throughout the world. By contributing to a more prosperous world economy, the IMF will expand markets for U.S. exporters and increase jobs for American workers.

This bill will allow us to provide humanitarian assistance during the upcoming winter; to support democratic reforms and free market systems; to encourage trade and investment; to support the development of food distribution systems; to assist in health and human services programs; to help overcome problems in energy, civilian nuclear reactor safety, transportation, and telecommunications; to assist in dealing with dire environmental problems in the region; and to establish a broad range of people-to-people exchanges designed to bury forever the distrust and misunderstanding that characterized our previous relations with the former Soviet Union.

The bill also provides additional resources and authorities to support efforts to destroy nuclear and other weapons, and to convert to peaceful purposes the facilities that produce these weapons.

We undertake these programs of assistance out of a commitment to increased security for ourselves, our allies, and the peoples of the new independent states. These programs will enhance our security through demilitarization and humanitarian and technical assistance.

A number of provisions in the bill, however, raise constitutional concerns. Some provisions purport to direct me or my delegates with respect to U.S. participation in international institutions. Under our constitutional system, the President alone is responsible for such matters. I therefore will treat such provisions as advisory.

Furthermore, the bill could interfere with my supervisory power over the executive branch by giving a subordinate official in the Department of State the authority to resolve certain interagency disputes and by regulating how other agencies handle license applications by the National Aeronautics and Space Administration. I will interpret these provisions in the light of my constitutional responsibilities.

The bill also authorizes the creation of supposedly nongovernmental entities—the Democracy Corps and a foundation that will conduct scientific activities and exchanges—that would be subject to Government direction, established to carry out Government policies, and largely dependent on Government funding. As I have said before, entities that are neither clearly governmental nor clearly private undermine the principles of separation of powers and political accountability. In determining whether to exercise the authority granted by this bill, I will consider, and I direct the Director of the National Science Foundation to consider, whether these entities can be established and operate in conformity with those principles.

I also note a concern with the provision under which Freedom of Information Act litigation involving the Democracy Corps would be the "responsibility" of the Agency for International Development. This responsibility should not be understood in any way to detract from the Attorney General's plenary litigating authority. Therefore, I direct the Agency for International Development to refer all such matters to the Attorney General consistent with his current authority.

GEORGE BUSH ■

USDA Backgrounder

Roger Kunningen (202) 720-4623
Oct. 9, 1992

News Division, Office of Public Affairs, Room 404-A, U.S. Department of Agriculture, Washington, D.C. 20250

EXPORT CREDIT GUARANTEES AND FOOD AID TO RUSSIA

The U.S. Department of Agriculture today allocated $525 million in export credit guarantees and $134 million in food assistance to Russia for fiscal 1993. The guarantees, granted under USDA's Export Credit Guarantee Program (GSM-102), are available for sales of U.S. feed grains, protein meals, wheat, pork and poultry. Commodities under the $134 million aid package include rice, butter, corn, pork, wheat and wheat products, baby food, poultry, whole dry milk and peanuts.

The guarantees and food assistance are part of a $1.15 billion credit guarantee and food assistance package for Russia announced Sept. 14 by Secretary of Agriculture Edward Madigan. Of the $1.15 billion, $900 million is credit guarantees and $250 million is food aid.

Russia and the former Soviet Union represent key markets for U.S. agriculture. U.S. farm exports to Russia and other former Soviet republics have exceeded $1 billion in eight of the past 10 years. Since January 1991, the United States has granted the former Soviet Union and Russia $5.7 billion in export credits.

Export Credit Guarantees

With this announcement, $235 million in credit guarantees will be available to U.S. exporters for sales of feed grains, $40 million for protein meals, $190 million for wheat, $30 million for pork and $30 million for poultry.

With these amounts of credits, respectively, Russia will be able to purchase an estimated 80 million or more bushels of feed grains (2 million metric tons); 1[illegible],000 metric tons of protein meals (9.1 million bushels of meal on a bean equivalent); 58 million bushels of wheat (1.6 million metric tons); 23,000 metric tons of pork; and 31,000 tons of poultry.

These export credit guarantees will support 14,000 export-related jobs and nearly $1.4 billion in total economic activity in the United States.

Another $275 million in export credit guarantees will be made available to Russia about Jan. 1, 1993. Additional credits or assistance to Russia may be announced later. Exactly $100 million was made available on Sept. 14, 1992. Since January 1991, the United States has granted $5.7 billion in credit guarantees to help Russia and the former Soviet Union buy U.S. farm products.

Under the GSM-102 program, USDA guarantees repayment of credits issued in connection with sales of U.S. agricultural goods. Credits must be repaid in 3 years or less. If a purchasing country defaults on a payment, future sales under the program are immediately suspended until the debt is current. Russia has not defaulted on any payments throughout the period the program has been offered, nor has the former Soviet Union.

- more -

Food Aid

The $134 million food assistance package includes $24 million (80,000 metric tons) worth of rice, $24 million (16,800 metric tons) worth of butter, $20 million (142,000 metric tons) worth of corn, $20 million (15,500 metric tons) worth of pork (sides and quarters), $16 million (3,000 metric tons) worth of baby food, $10 million (82,000 metric tons) worth of wheat and wheat products, $8 million (3,500 metric tons) worth of whole dry milk, $8 million (8,800 metric tons) worth of chicken (legs and quarters), and $4 million (8,000 metric tons) worth of peanuts. High-value products represent more than half the commodities in the package.

The remaining $116 million of the $250 million aid package will be allocated later between commodities and freight.

The donations will be provided under several different humanitarian assistance programs operated by the U.S. Department of Agriculture. Private voluntary and cooperative organizations may handle some of the aid.

The $134 million in assistance detailed today will support roughly 3,600 export-related jobs and will generate nearly $350 million in total business activity for the United States. Roughly half this effect will occur once commodities leave the farm, through processing, packaging, shipping, merchandising and other export-related activities that add value to farm products.

During fiscal year 1992, USDA provided approximately $125 million in food aid to Russia, including $17 million worth of wheat flour, $5 million in vegetable oil, $10 million in butyryl, $8 in dry beans, peas, and lentils, $29 million in nonfat dry milk, $6 million in infant formula, $12 million in rice, $2 million in soy-fortified bulgur, $1 million in evaporated milk, and $35 million in butter.

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Make a 'New Beginning'

Below are excerpts from a 12-page memorandum to President-Elect Bill Clinton from the Joint Ministry in Africa Office of the United Church of Christ and the Christian Church (Disciples of Christ), two Protestant denominations with approximately 3 million members in the United States and Canada. "Our churches have worked in Africa for more than 150 years," the memorandum says. "We relate to a broad range of church partners in 13 countries as well as ecumenical agencies all over Africa."

We are greatly pained by the current trends of drift and neglect in U.S. policy toward Africa.

We are worried that Africa has been forgotten by the United States and that our foreign policy toward that continent seems to be rudderless and without meaning.

It is from our faith convictions that we write to you at this time. Our sense of hope tells us that your administration potentially

Dossier

augurs a new beginning in U.S. foreign policy toward Africa.

The arrival of your administration coincides with a unique period in African history. In many countries, years of dictatorship have given way to broad-based democracies. However, these democracies are fragile, weakened by economic problems and the threatening presence of the military and retired dictators on the sidelines.

Unfortunately, this is also a time of great strife and suffering. In many countries people continue to be repressed and tortured, denied their humanity and economic opportunities. It is a time of truth, which challenges us to show our true colors. Where do we stand with regard to peace, justice and freedom in this world?

What makes 1992 significant is that the Cold War is over. People around Africa are taking on the challenge of building a new democratic order without the shadow of superpower interests hanging over them. Because of the magnitude of Africa's problems, the challenges that people there are taking on require international friendship and assistance.

The United States has been a superpower player on the African scene for more than 30 years. As a nation, the United States says that it speaks for human rights, democracy and freedom. Do we really believe in these ideals?

Our government is the largest contributor to and most influential member of the International Monetary Fund (IMF) and World Bank and therefore bears considerable responsibility for the policies of these bodies. Our aid and weapons have contributed to the oppression and detention of thousands of South Africans; to civil conflicts in Angola, Liberia, Ethiopia and Somalia resulting in the deaths of more than one million people; and to the current chaos and social explosions in Zaire and Kenya.

The death toll inflicted on Africans in these conflicts is worse than the combined total of U.S. citizens killed in World Wars I and II, Korea, Vietnam, and the Persian Gulf.

There are some things you can do to change the legacies of war, dictators and neglect. In doing these things, you can help bring a new dawn to Africa. Simply by carrying through on your campaign goals and promises you can do a lot. The costs would not be great but the effects of your actions most certainly would be. Your administration would be investing in peace, democracy and development. Here are some of our thoughts – many of which are consistent with your principles – on what you could do in specific areas.

Zaire:

- Publicly distance the United States from Mobutu, stating in no uncertain terms that his rule is unacceptable in both human rights and democratic terms.
- Work with U.S. friends in Europe and with U.S. banks to freeze Mobutu's assets. The assets were meant for the Zairean people and should only be released when Mobutu is completely out of power.

Angola:

- Urge the government to release all of the Unita leaders it is holding.
- Urge both sides to come together for the sake of Angola's people.
- Upon the release of Unita's leaders, and the beginning of negotiations, recognize the Angolan government and support international reconstruction efforts.
- Stop any existing covert funding going to Unita. Resumption of any aid should be for humanitarian reasons only.
- Investigate rumors of South African government involvement in providing logistical support for Unita military actions. If these rumors are proven true, consider moving to reimpose federal sanctions on South Africa.
- Support the United Nations presence in Angola.

South Africa:

- Signal to South Africans that until their country has a fully representative and democratic government that represents the disenfranchised majority, the United States will not support the release of IMF funds for South Africa and will continue to support state and local sanctions.
- Support the recent call by South African church leaders for the convening of a multiparty conference.
- Support the church leaders' call for an election date of some time in 1993.
- Consider using the threat of reimposing federal sanctions if the currently stalled negotiations do not move forward toward legitimate rule.

Liberia:

- Support the West African peacekeeping force (Ecomog) and all diplomatic efforts to bring the different sides together.
- Support the UN ban on weapons sales to all forces except the West African peacekeeping troops.
- Investigate the role that several European companies are playing in funding one of the rebel forces.
- Provide reconstruction funds via the United Nations. The funds would be taken from military accounts and act as compensation for past U.S. policies.
- Consider developing a food for guns strategy in consultation with Ecomog and the UN.

Western Sahara:

- Use leverage to foster a fair and sovereign solution – via the United Nations – to the Western Saharan situation and to make a human rights statement about Morocco, where both Sahrawis and Moroccans languish in prison and endure other hardships for their political beliefs.

Kenya:

- Work with President Bush, the United Nations and Kenyans to ensure that effective monitoring of the December election takes place.
- Closely watch these elections and investigate other international structures that might be placed on the government in the event that the elections are not legitimate.

Mozambique:

- Support an adequate UN presence that could help move Mozambique toward a situation more akin to Namibia's peaceful and democratic transition rather than a repeat of the Angolan tragedy.
- Increase humanitarian assistance to rebuild the poorest country in the world.
- Press the South African government to stop South African citizens from providing Renamo rebels with weapons.
- Investigate reports that U.S. citizens are supplying Renamo with weapons.
- Develop an exchange program designed to provide food for guns.

Sudan:

- Call for an immediate cease-fire.
- Work with the United Nations to pressure the Sudanese government to open up relief routes in the south.
- Consider an international financial blockade on the Sudanese government in order to stop the forced relocation of people from Khartoum and the Nuba mountains.
- Work with the United Nations to develop a comprehensive humanitarian effort for Sudan. Be prepared to support this effort morally, financially and physically.

Continent-wide:

- Lead the way in checking the flow of arms and increasing relief supplies.
- Invest in people, in education, farmers, land conservation, schools, housing, and local industry to ensure that catastrophes do not repeat themselves.
- Support a debt transfer for sub-Saharan countries where these countries would stop paying interest on their debt in foreign currency and instead pay it in local currency. ■

The full text of the document is available from the United Church Board for World Ministries, 475 Riverside Drive, New York, NY 10115-0109.

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U.S. TROOPS IN SOMALIA: WHERE NEXT?

BY DAVID C. MORRISON

Thanks to President Bush's commitment of 28,000 Marines and Army troops to safeguard relief efforts in the maelstrom of starvation and lawlessness that is Somalia, President-elect Clinton has been bequeathed a military operation that is sure to drag on well beyond the cutoff point posited by the White House—Jan. 20, the date of Clinton's inauguration.

Besides the U.S. deployment in East Africa, more ominously, the next President inherits a broader question: What should the American role be in other, no-less-grave geopolitical catastrophes, especially the nightmare unfolding in Bosnia and Herzegovina?

As Defense Secretary Dick Cheney made clear at a Dec. 4 press briefing, in terms of terrain (level desert as opposed to thickly forested mountains) and the military situation on the ground (lightly armed gangs as opposed to regular and irregular army units equipped with mortar, cannon and light bombers), Somalia is a cakewalk compared with Bosnia.

But, as grisly as the reportage out of Bosnia has been this year, the picture will only dramatically worsen this winter. U.N. and CIA estimates suggest that 140,000-400,000 Bosnian Muslims could die of hunger and exposure in the months ahead if the bloody ethnic warfare sponsored by Serbia continues.

A U.S. guided-missile frigate, Coast Guard personnel and P-3 Orion maritime patrol aircraft are already participating in NATO's newly reinforced economic blockade along Serbia and Montenegro's Adriatic coast. U.S. airlifters are also flying food and medical relief into Bosnia. But the call for American forces to do much more may soon become irresistible.

"Clinton criticized Bush for being soft on Bosnia, and when winter sets in, we'll see more of that on the news," Lawrence J. Korb, an assistant Defense secretary in the Reagan Administration and now a senior fellow at the Brookings Institution, said. "We will get the—if you will—Democratic press in this country, like [*The New York Times* and *The Boston Globe*], urging him to do something. That will be a big test."

Indeed, no sooner was Bush's initiative announced than *The Times* published a column by Anthony Lewis asserting that the Somalia deployment "raises the possibility that Mr. Bush will at last take firm action on that other human and political disaster, Bosnia."

Increasingly, the old, Left-Right, Cold War divide over interventionism has been sundered. Even the leftist *In These Times* has called for U.S. military involvement. "The Left has grown so accustomed to saying no," Paul Hockenos, that Chicago weekly's European correspondent, chided in late October, "that it appears incapable of demanding positive action—be it in Bosnia, Somalia, northern or southern Iraq—when it would save lives and open space for democratic alternatives."

Despite his unexpected offer of troops for Somalia, Bush is unlikely to plunge headfirst into Bosnia at this late date. Although he supports U.S. engagement in Somalia, Army Gen. Colin L. Powell, who will serve as chairman of the Joint Chiefs of Staff through next September, has vociferously opposed any large-scale American involvement on the ground in Yugoslavia.

Clinton has praised Bush's Somalia initiative. During the campaign, Clinton also called for "urgent and appropriate action to stop the killing" in Bosnia. But, since his Nov. 3 victory, he has not fleshed out what those actions might entail.

"I think there are many options that we have in dealing with the problem in Bosnia and the potential problem in [the Albanian-populated, Serbian-dominated province of] Kosovo that are short of sending troops in, but beyond where we have been now," Clinton said on Nov. 16. "And I don't want to foreclose any of those options by anything I say now."

Rest assured, the current President and the next one do not lack for advice on the subject. Following a five-day tour of the Balkans, Sen. Dennis DeConcini, D-Ariz., co-chairman of the Commission on Security and Cooperation in Europe, and Frank McCloskey, D-Ind., a member of the House Armed Services and Foreign Affairs Committees, urged a series of steps upon Bush in a Nov. 20 letter.

Mount an air campaign against such Serbian strongholds in Bosnia as heavy artillery sites and weapons supply depots, they recommended, among other moves. And amend the current embargo on arms to the former Yugoslavia to permit Bosnian forces to rearm "in a sufficient yet controlled manner by the time the air strikes stop."

Given the caution favored by Cheney and Powell, Bush seems unlikely to follow that advice. But another much-debated option toward which Bush *does* seem to be moving is enforcing a U.N. resolution that bars flights by Serbian warplanes

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over Bosnia. Britain and France have feared Serbian retaliation against their peacekeeping forces in Bosnia and Croatia if the United States starts downing Serbian planes that violate this "no-fly zone." But Britain, at least, is shifting toward a tougher stance.

But not as muscular as the position staked out by George D. Kenney, a Yugoslav specialist who resigned from the State Department last August in protest over Bush Administration "appeasement" of Serbia, and Gen. Michael J. Dugan, the former Air Force chief of staff fired in late 1990 for talking too freely with the news media about Persian Gulf war plans. In a Nov. 29 *New York Times* op-ed piece, they urged an ambitious Operation Balkan Storm.

In coalition with Great Britain, France and Italy—and eventually even Russia—the United States should arm and train Bosnian Muslim forces, Kenney and Dugan wrote. Air-drop food and supplies on "safe havens" in Bosnia, stymieing Serbian efforts to "ethnically cleanse" the region. And then, using air bases in Italy and an aircraft carrier afloat in the Adriatic Sea, "neutralize" Serbian artillery and armored units with precision-guided bombs. Finally, if necessary, wield light bombers and Tomahawk cruise missiles to destroy "centers of gravity"—troop concentrations, petroleum storage tanks, electrical and communications grids—in Serbia itself.

Perhaps the most sweeping and entangling proposal for dealing with the Balkan crisis, however, is that tendered by retired Army Lt. Gen. William E. Odom, the former chief of the National Security Agency who now directs national security studies at the Hudson Institute.

"The idea that you can have this kind of killing and civil war going on down there and TV pictures appearing every day and night in Western Europe without some kind of effect on the political morality of those regimes, to me, is the height of fantasy," he said in an interview.

Odom, a Clinton supporter, thus urges NATO to take up the "neat challenge" of ending the Yugoslav war. "I do not think you can go in with small forces for a short time," he said. "You have to go in with big forces. Admit that you can't stop all of the violence, but that you can stop the major violence. And ensure that nobody keeps land that he gained through ethnic cleansing."

But, Odom added, "you must be prepared to sit there for 10-15 years while a negotiation proceeds. When you say that's impossible or absurd, I ask you: What did we do in Korea? What did we do in Germany after World War II?"

On the other hand, Michael G. Roskin, a foreign policy professor and a Yugoslav expert at the U.S. Army War College in Carlisle, Pa., argues that directly injecting American military forces into Bosnia would be "dangerous and wrongheaded."

"There may be after the success in Desert Storm a little too much emphasis on the efficacy of air power," Roskin said in an interview. "This is not an air war. It is an artillery war. But to silence artillery, you'd want to do it from the ground. And I can't imagine how you'd mount such an effort. There seems to be a lack of awareness of how any direct intervention in Bosnia could become open-ended. I know Bosnia pretty well. I've climbed mountains there and it is arguably the most rugged terrain in Europe."

But something must be done, he argues in the winter 1992-93 issue of *Parameters*, the War College's quarterly journal, to contain the crisis and keep Serbia's expansionism from inspiring other irredentist states in Europe. Encourage Serbia to back off, Roskin argues, by supplying limited military and diplomatic support to bordering nations—Albania, Bulgaria and Hungary—that could become involved if the Yugoslav pot boils over.

"A lot of this would be signaling, but it could not be bluff," Roskin said. "But there is something [to be done] between all and nothing."

By the time Clinton comes to power, Bosnia may well already be lost. It that's the case, the focus will shift to Serbian designs on Kosovo and Macedonia. In any event, it will be up to the incoming commander in chief to decide what the "something to be done" should be. ■

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PERSPECTIVE ON SOMALIA

Using Force to Help a Gentle People

Once U.S. troops secure the aid lines, the people in the hardest-hit area are capable of resuming productive, orderly lives.

By MOHAMMED SAHNOUN

PARIS—The Rahanwein people of southwest Somalia are facing the same threat of genocide by massacre and starvation that confronts the Muslims in Sarajevo. Their situation has grown extremely grave over the past five weeks, as order has completely broken down in the area where they live between the Shebelle and Jubba rivers.

Unless there is an urgent deployment of sufficient international forces to ensure the delivery of food and to protect relief workers and civilians, these gentle farming people, caught in the cross-fire of a civil war between outside factions, may disappear from the face of the Earth.

As a result of my very recent experience as the U.N. envoy, I know that the situation in southwest Somalia is far less complex than in Bosnia-Herzegovina. Indeed, I believe that the humanitarian aspect of the crisis in Somalia can be stabilized within a matter of weeks—if a forceful military presence from outside is organized.

Troops should be deployed to, in effect, occupy the southwest region of the country stretching in a quadrant from Mogadishu to Kismaayo to Bardera to Baidoa, where the worst starvation is taking place. Their task must be to protect relief-agency workers and ensure the delivery of food, as well as to promote a local structure of law and order. These troops should remain in control until people can be regularly fed and are better able to care for themselves.

This fertile land between two rivers is not, after all, a poor region. It is an agricultural area with viable farms. If they are protected, people are ready to go to work to feed themselves as soon as they are physically able.

A large-scale troop deployment can-

ISAAC, Bulletin Today, Manila

not, of course, resolve the fundamental problem in Somalia. It can only create the preconditions for pursuing efforts at national reconciliation.

Once each tribal group is stabilized within its own territory—something which the faction leaders now agree should be done—then most of the multinational troops can leave. Beyond the troubled southwest area of the country, where tribes from outside are fighting on Rahanwein territory, most of Somalia is already more or less stabilized. When this is accomplished in the southwest as well, a national conference can establish a sort of coordinating commission to administer the country.

Tribal divisions will remain so strong, however, that I doubt that one united Somalia is any longer possible. A more likely solution, following the world trend, will be a federation that will enable each community to control its own territory.

The main reason Somalia has been so readily engulfed by famine and tribal war is that civil society was extremely weak after years of dictatorship by Mohamed Siad Barre, whose fall from power two years ago created the vacuum filled by today's chaos.

Although most of their leaders are now in hiding, there are many women's associations (and women are very powerful in Somali society because they often control the marketplaces), youth groups, business organizations and intellectuals prepared to actively build a civil foundation. These groups know that, if they cannot offer an alternative to young men carrying guns, there is little hope for the future.

During the past several weeks, the United Nations has lost control of the situation in Somalia. To regain it, the United Nations must swiftly accept and implement the generous U.S. offer to send its troops, and accompany those troops by others under a Security Council umbrella. The survival of the Rahanwein people is at stake.

Mohammed Sahnoun, an Algerian diplomat, was U.N. special representative for Somalia until October, when he resigned after charging that the U.N. effort in Somalia had been ineffective.

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THE LOS ANGELES TIMES, December 1, 1992

PERSPECTIVE ON SOMALIA

When America Talks, Thugs Listen

Getting relief supplies to the starving countryside will take military force, which is beyond the scope of the U.N.

By JOHN GERARD RUGGIE

Somali strongman Gen. Mohammed Farrah Aidid and Interim President Ali Mahdi Mohamed have just taught the international community an important lesson. Will it be learned?

Three months ago, the United Nations proposed sending 3,500 peacekeeping troops to Somalia to secure the relief effort. Aidid threatened to send them home in body bags. Only 500 Pakistani soldiers have been dispatched to date and, thanks to Aidid, they are under siege at Mogadishu's airport.

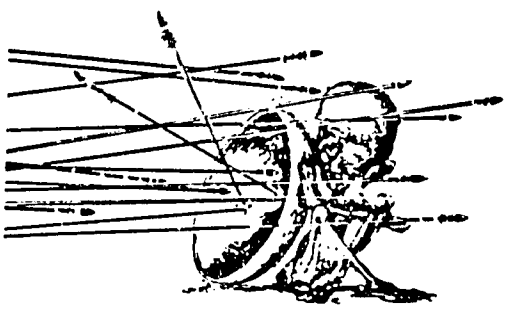
Hundreds of Somalis a day continue to die of starvation and diseases induced by malnutrition. Barely 20% of international food relief is reaching the needy, the rest being lost to armed thugs.

Last week, the United States offered to commit up to 30,000 U.S. troops to Somalia as part of a U.N.-authorized multinational force. Aidid welcomed the American initiative and promised support. Mahdi followed suit.

The lesson is clear: Where anarchy prevails, as in Somalia, only the threat of superior force can restore a semblance of order. What is not yet clear is whether international relief agencies and the United Nations fully appreciate the implications of the lesson. Both have expressed initial reluctance to embrace the U.S. offer, for perverse reasons.

International relief agencies fear retribution against their representatives in Somalia, who number about 400, if U.S.-led coalition forces engage Somali gangs. These agencies thereby put the safety of the hundreds of their workers ahead of the thousands of Somalis who face death. This might carry weight if they were successful in delivering food, medical and other assistance to more than a fraction of the population. But they are not.

Even worse, the major source of hard currency for the armed factions in Somalia is the food and medicine they plunder and the funds they extort from these agencies. And a major use of this currency is to import yet more arms from abroad. Under present circumstances, therefore, international relief agencies in Somalia are part of the problem, not the solution. Accordingly, they should be the first to welcome effective armed intervention.



CUMMINGS, Winnipeg Free Press, Winnipeg, Canada

Reluctance by the United Nations stems from fear that its authority and prestige would be diminished by ceding operational control of a multinational force to the United States, as the Pentagon insists. But the United Nations lacks the ability to field large-scale fighting forces. And despite pleas by U.N. Secretary General Boutros Boutros-Ghali, governments have shown no signs of granting the United Nations such powers. Hence, this is a phantom loss, in return for a real gain.

The longer-term implication of the Somali warlords' acquiescence is that a clearer division of labor should be established between multinational forces and the United Nations in responding to humanitarian crises.

Where large-scale troop deployments are required, there is no substitute for national forces, combined in multinational coalitions. They should be requested and sanctioned by the Security Council. But it is asking too much now to place them under an integrated multinational command, as many U.N. officials and supporters urge. In all of modern history, there is only one successful instance of large-scale standing forces organized in this manner: NATO. Mutual affinity and trust in global politics may have improved in the past few years, but they are not yet of the same order as in the Atlantic alliance during the Cold War. Even the European Community has barely begun to move in this direction via a planned Franco-German army corps.

Other than to authorize multinational forces and thereby endow them with collective legitimacy, the U.N. should focus on its peacekeeping and peacemaking roles. History shows that the world body derives its strength from its impartiality, the interpositionary character of peacekeeping forces and their provision of support services to peoples under stress. In recent years, these missions have expanded to include human-rights monitoring, administering public agencies, providing police contingents and supervising electoral politics. All will be required in Somalia. But all would be risked by U.N. insistence to field fighting forces.

John Gerard Ruggie is dean of the School of International and Public Affairs at Columbia University.

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Colman McCarthy

Why Abolish the Hunger Committee?

In running for reelection, Rep. Tony Hall, a seven-term Dayton, Ohio, Democrat, had a Republican challenger, Pete Davis, who thought he'd uncovered the kind of dirt that would arouse voters. Davis featured in his campaign literature the scandalous and outrageous fact that Hall cares about feeding the world's starving and hungry. The incumbent, said Davis, "gives more than 80 percent of his professional time" to the House Select Committee on Hunger.

Take that.

The grubby, small-minded attack by the Republican flopped. Hall, who chairs the hunger committee, won convincingly, 60-40. Aside from my admiration for Hall, a self-giving congressman free of guile and totally committed to advocacy for the hungriest and poorest people of the world, I had an extra interest in this race. Davis took the quotation—"he gives more than 80 percent of his professional time" to the hunger committee—from a column I wrote last year about Hall.

I can understand Davis's desperation to get the goods on his opponent. Hall is so well-regarded in Dayton—he has organized four food programs in his district, he opposed the gulf war as unjust, he is strong on constituent service and has no bounced checks—that Republicans didn't run anyone against him in several previous elections.

Since 1989, Hall has chaired the Select Committee on Hunger, a group that has the lowest budget ($661,000) of the House's 27 permanent or select committees. He has traveled three times to refugee and hunger camps in Somalia, Ethiopia and Sudan, and has also held hearings on domestic hunger in Appalachia and on tribal reservations. Hall sees his committee work as an extension of the moral commitment he made to serving poor people when volunteering for the Peace Corps in Thailand in 1966-67.

Having overcome a baseless attack from a Republican, the reelected Hall must now survive his own Democrats. The Select Committee on Hunger, along with similar panels on aging, children, youth and families, and narcotics abuse and control, has been marked for elimination by reform-minded House Democratic leaders. If the death warrant is carried out, it will come in early December when the House Democratic Caucus votes on whether or not to close out four of the five select committees, Intelligence excepted. A second vote—on the House floor—is scheduled for the first days of the new Congress in January.

Disposing of the hunger committee, which was created in 1984, would mean silencing the voice of the voiceless. Last week, Rep. Bill Emerson, a Missouri Republican and the committee's ranking minority leader, returned from Somalia, carrying back the cries of the hungry enduring mass starvation. An estimated 60 percent of Somalia's children are facing—or dying from—severe malnutrition. Emerson's mission was one of dozens in recent years in which the smallest committee in Congress persists in finding solutions to the planet's largest waste of human life, global hunger.

The United States, as the committee keeps saying, is not exempt. Eighteen million Americans received food stamps in 1989. By July 1992, the number was 25.7 million.

Attacking the hunger committee is an exercise in misguided reform. Do-nothing or make-work subcommittees, which are the fungi of Congress and hang on year after year like parasites on the body politic, could be eliminated at minimal loss to anyone. Is the public getting its mail delivered more efficiently because the House Post Office and Civil Service Committee has the subcommittee on investigations, the subcommittee on the civil service, the subcommittee on postal operations and services, the subcommittee on compensation and employee benefits, the subcommittee on census and population, the subcommittee on human resources and the subcommittee on postal personnel and modernization? All that's lacking is the subcommittee for "This Window Closed."

And how are citizens better off because the $5.6 million House Government Operations Committee and the $4 million House Administration Committee have a combined 14 subcommittees?

Slice into those and other legislative tubs of lard for genuine reform. Abuses aren't to be found in the hunger committee. If anything, the opposite is true. Its work has been consistently praised by such groups as CARE, Catholic Relief Services, the U.S. Conference on Mayors and Bread for the World. Hall himself has received two awards in recent weeks—from Oxfam America and the United Nations.

Should the committee be voted out of existence in the fever of reform now gripping Congress, the message will be one of regression, not reform. The hunger committee ought to be promoted as a model for the future. Instead of examining it and taking aim, reformers should honor it and take comfort.

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US Refugee Policy Faulted

Eligibilty rules stretched to benefit some applicants

By Don Barnett

IN the recent debate about who is a political refugee and who is an economic migrant, very little is said about the slide of United States refugee policy into politics.

Immigration from the former Soviet Union illustrates the uses and limits of US refugee policy. A refugee, according to the Refugee Act of 1980 is an individual who has been persecuted or who has "well-founded fear of persecution on account of race, religion, nationality, membership in a particular social group, or political opinion." The act empowers the US to respond quickly and with flexibility when a need arises to provide refuge to those in imminent danger at home and have nowhere else to go.

The United Nations High Commissioner for Refugees (UNHCR) now places 16 million to 17 million people in that category worldwide. For 1992 the US will fund the admission of about 122,000 refugees. Of these, 61,000 will be admitted as refugees from the Commonwealth of Independent States.

Refugees enjoy some important advantages over regular immigrants, like a cash allotment and an interest-free loan for transportation to the US. The federal portion of the bill for refugee resettlement is $709.3 million dollars for fiscal year 1992. Focusing on the federal portion of resettlement costs ignores expenditures on social services required after the initial settlement period of eight months.

Most of the true cost of refugee absorption is borne outside refugee-specific budget items, at the federal, state, and local levels. The National Governors Association says state and local expenditures on refugee support are "conservatively" estimated at $620 million for the first year of refugee support alone.

According to an unpublished 1991 US Department of Health and Human Services study, about 44 percent of refugees from the commonwealth are receiving public cash assistance a year after arrival, well after federal refugee assistance has run out.

The actual welfare dependency rate is higher, since the study excluded all individuals 65 or over (1 1/3 percent of recent arrivals) and those receiving only non-cash assistance. Refugees are actively encouraged to use Medicaid and other programs like food stamps and public housing; those of retirement age receive SSI/Medicare.

According to the UNHCR, almost no one emigrating from the commonwealth today is a refugee. Nevertheless, the Lautenberg Amendment of 1989 was recently extended for two more years, defining entire groups in the commonwealth as subject to persecution and thus entitled to refugee status under US law. Accordingly, "once an individual asserts that he is a member of the covered class and asserts that he has been persecuted or has a fear of persecution, that individual shall be deemed a refugee." With a perfunctory assertion of persecution, the applicant learns that dissimulation is as important for getting by in America as it was at home in the old USSR.

Eighty percent of the refugee quota goes to Jewish applicants. Most of the balance is awarded to evangelicals. Among these, it is reported, there has been a wave of dubious conversions. These two groups together are a minority of those who have applied to leave the commonwealth. Yet, as these things go, opportunity to emigrate to the US is virtually foreclosed to those outside the covered group.

BECAUSE of the great numbers with automatic eligibility, Russian refugees of today, besides belonging to "Lautenberg" categories, must have relatives in America – themselves recent beneficiaries of the resettlement program. Since citizenship is not required of the "anchor" relative, it is, more precisely, an accelerated version of that process, minus the requirement that the visa-holder be an individual unlikely to become a public charge.

We don't know how many of the 300,000 we have accepted since 1975 have been here long enough to be citizens and thus could serve as "anchor" relatives for normal immigration. This year less than 3,000 will be admitted as immigrants from the commonwealth. Refugee status is the designation of choice for those immigrating to America and for those in America who would otherwise have to help with the costs.

Processing immigrants as refugees sets the stage for special-interest group infighting for privileged admission status and transfers the costs of resettlement from the sponsor and the immigrant to the taxpayer. It weakens the necessary link to an established community and the need for integration into the culture, language and economy.

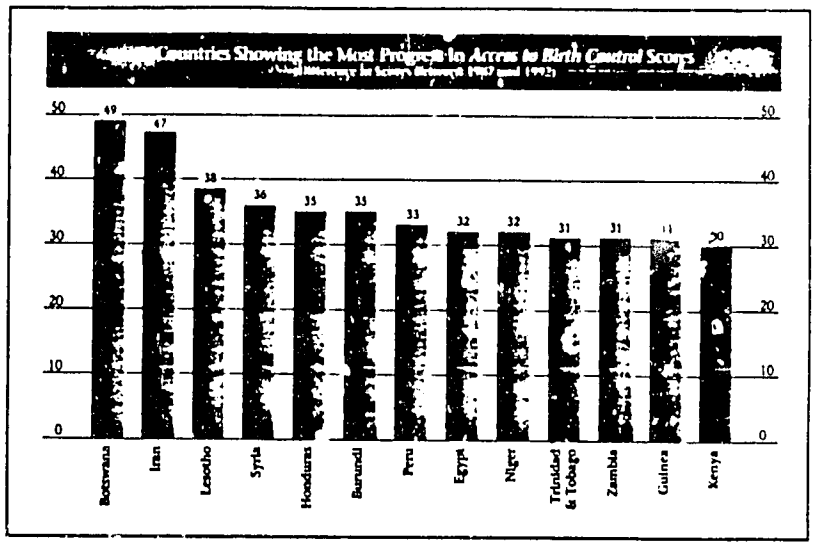
While the US has defined broad legal categories for refugee admission, it has, paradoxically, surrendered all control over the selection of individuals who enter the US; that decision is the prerogative of the would-be immigrant and can be made with little sacrifice or regard for economic conditions in the host country.

Our refugee policy has outlived its historical mission; and discussion about its future must be premised on the privatization of immigration for the former Soviet Union. Today, immigration from the commonwealth is politicized in the extreme. Indeed, only in a place like the old Soviet Union would it come as no surprise that a policy which began with a humanitarian concern has ended so thoroughly in politics.

■ *Don Barnett lived and worked in the former Soviet Union for almost two years and is also a former USIA staffer.*

PCC Documents Progress in World Access to Birth Control

The availability of family planning services and information in developing countries has improved dramatically, especially in Africa, according to a newly updated study released last week by the Population Crisis Committee, an InterAction member. The study, *World Access to Birth Control*, ranks 124 countries — including 95 developing countries — according to the strength of their family planning programs.



First published by PCC in 1987, the updated study finds significant progress taking place in more than one-third of the 87 developing countries included in both editions; in Africa that proportion goes up to more than one-half: 21 of 39 countries show significant improvement. A comparison of the two editions finds Botswana making the most progress, to become the only sub-Saharan African country in the top-ranked "Good" category. Iran made the most progress among Middle Eastern countries, reflecting dramatic changes in government policy in the late 1980s. In all, a total of 57 developing countries show measurable improvement in the strength of their family planning efforts.

"Few things can make a greater impact on the health of women and children and on the future of our shared planet than the expansion of high-quality family planning programs," says Sharon L. Camp, PhD, senior vice president of PCC and editor of the study. "Our 1992 report shows how quickly progress can occur when the financial resources and political will are forthcoming.

World Access to Birth Control ranks the 124 countries on a 100-point scale that measures the strength of family planning efforts in three areas: the degree of access to different birth control methods, including abortion; the competence of care providers; and the number of channels through which women and men can get either contraceptive supplies or family planning information.

Among the 95 developing countries included in the study, the highest ranked countries are Taiwan (94 points), South Korea (93), China (90), Thailand (90), Mexico (88), and Trinidad and Tobago (88 points). Average family size in these countries, except for Mexico, is less than three children.

Seven countries received a score of zero (0) for availability of family planning services and information — Somalia, Saudi Arabia, Libya, Liberia, Kuwait, Iraq and Gabon. Except for Kuwait, women in these countries have an average of more than five children.

Botswana (75 points) and Iran (73 points) showed the biggest gains in *Access to Birth Control* scores — 49 and 48 points, respectively. Another 11 developing countries improved their scores by 30 to 40 points, including Kenya, Syria, Honduras, and Niger. Of the 87 developing countries common to both editions of *World Access to Birth Control*, 57 improved their scores by 10 points or more.

On a different and separate scale for developed countries, the United States ranks fourteenth, well behind Denmark (97 points), the Netherlands (95), Sweden (95), Norway (93) and Australia (88). The low US score — 75 points, in contrast to Denmark's 97 — is due to the narrower range of contraceptive methods readily available in the US, the restrictions on contraceptive advertising, the weakness of programs for adolescents, and the unwillingness of many health insurers to pay for family planing services.

Ireland (40 points), Japan (43), Romania (51), Poland (51) and Bulgaria (54) received lowest marks among developed countries included in *World Access to Birth Control.*

"We find it somewhat alarming that, at a time when developing countries are moving forward in providing access to family planning for men and women, some of the most developed countries continue to limit reproductive choice," says Dr. Camp. "Women in the United States, as well as in Japan, Poland and other Eastern European countries, are

being denied access to a full range of family planning options — with serious consequences for their physical health and economic well-being."

The 1992 *World Access to Birth Control* study is the third in PCC's series on *World Progress Towards Population Stabilization* and includes data for 95 percent of the world population.

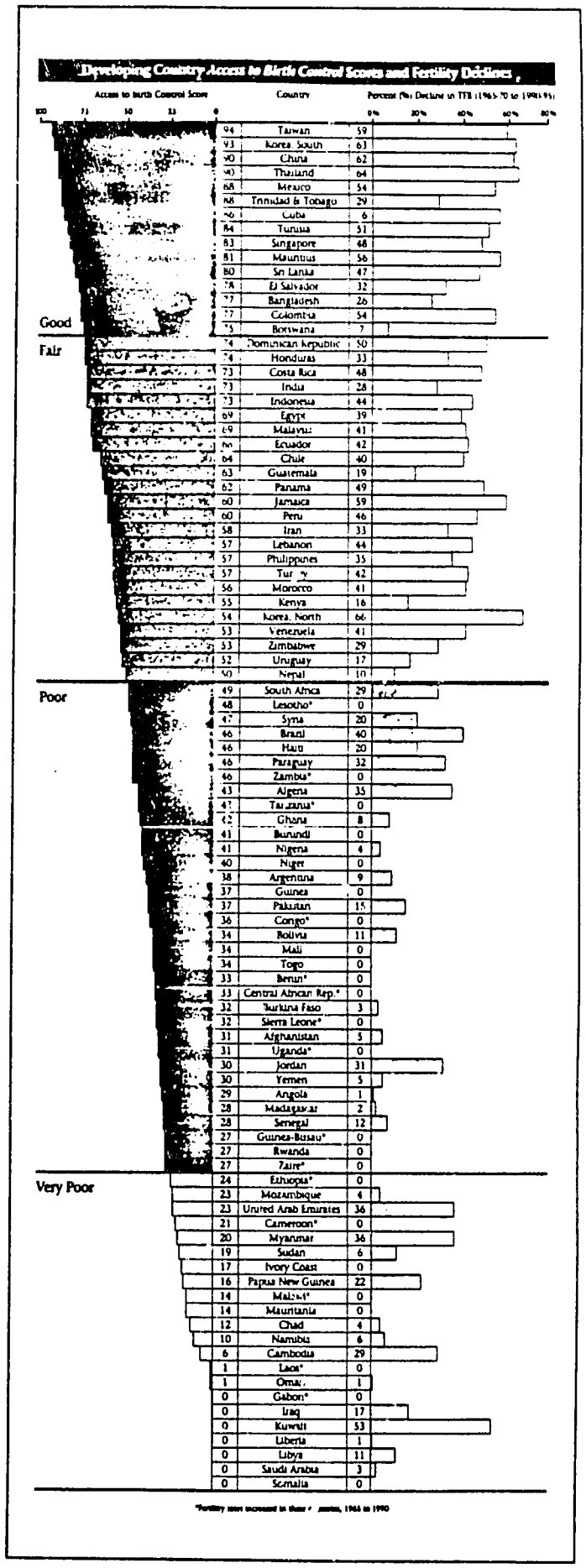
World Access to Birth Control assigns each country a score from 0 to 100 and places each county in one of four categories reflecting the availability of family planning services and information — Good, Fair, Poor or Very Very Poor. The 100-point scale uses 10 indicators, which give priority to measures related to: the range of birth control choices available; the competence of those providing family planning service; and the convenience of services and the amount of information available to contraceptive users.

"Our study confirms the findings of other recent research," says PCC president J. Joseph Speidel, MD, MPH. "Good programs backed up by strong political leadership can work in almost any economic setting, but when reinforced by a growing and productive economy, the results can be astounding. Today's challenge, however, is to provide this kind of access to family planning and economic opportunity for the hundreds of millions who don't have it."

According to the PCC study, there are still tremendous gaps in the availability of family planning services and information. More than half the 95 developing countries studied fall into the POOR or VERY POOR category with scores below 50. Most of the lowest ranked countries are in the Middle East and Africa, where family planning programs are still relatively young. Yet these countries still face continued rapid growth in the number of childbearing-age couples. Through the end of the 1990s, an average of 18 million couples needing family planning services will be added each year to the reproductive-age population. And while 50 percent of couples now use a method of contraception, that proportion will need to increase to 75 percent in order for the lengthy process of stabilizing world population to begin.

"The task we face is a formidable one," says Dr. Camp. "But our study ... holds the promise of success, if we can build on the kind of progress made in recent years."

For further information, contact the Population Crisis Committee, 1120 19th Street NW, Suite 550, Washington, DC 20036; 202/659-1833.



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SAVING FAILED STATES

by Gerald B. Helman and Steven R. Ratner

From Haiti in the Western Hemisphere to the remnants of Yugoslavia in Europe, from Somalia, Sudan, and Liberia in Africa to Cambodia in Southeast Asia, a disturbing new phenomenon is emerging: the failed nation-state, utterly incapable of sustaining itself as a member of the international community. Civil strife, government breakdown, and economic privation are creating more and more modern *debellatios*, the term used in describing the destroyed German state after World War II. As those states descend into violence and anarchy—imperiling their own citizens and threatening their neighbors through refugee flows, political instability, and random warfare—it is becoming clear that something must be done. The massive abuses of human rights—including that most basic of rights, the right to life—are distressing enough, but the need to help those states is made more critical by the evidence that their problems tend to spread. Although alleviating the developing world's suffering has long been a major task, saving failed states will prove a new—and in many ways different—challenge.

The current collapse has its roots in the vast proliferation of nation-states, especially in Africa and Asia, since the end of World War II. When the United Nations Charter was signed in 1945, it had 50 signatories. Since that time, membership has more than tripled, reflecting the momentous transformation of the pre-war colonial world to a globe composed of independent states. During that period, now nearing its conclusion following the independence of Namibia in 1990, the U.N. and its member states

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made the "self-determination of peoples"—a right enshrined in the U.N. Charter—a primary goal.

Self-determination, in fact, was given more attention than long-term survivability. All agreed that the new states needed economic assistance, and the U.N. encouraged institutions like the World Bank and the United Nations Development Programme (UNDP) to help them. But fundamental to the notion of decolonization was the idea that peoples could best govern themselves when free from the shackles, or even the influences, of foreigners. The idea, then, that states could fail—that they could be simply unable to function as independent entities—was anathema to the raison d'être of decolonization and offensive to the notion of self-determination. New states might be poor, it was thought, but they would hold their own by virtue of being independent.

While it lasted, the Cold War prolonged the viability of some of the newly independent and other Third World states. Countries with seriously underdeveloped economies and governments received hefty infusions of aid from their former colonial masters as well as from the two superpowers. The systemic corruption that characterized many of the new states did not stop the superpowers from sending foreign aid as they sought to buttress a potential ally in the Cold War. Thus the Philippines, South Vietnam, Zaire, and post-1977 Somalia profited immensely from U.S. aid, while Afghanistan, Cuba, post-1974 Ethiopia, and several of the front-line African states benefited from Soviet aid. Granted, most of the foreign aid recipients were not wholly dependent on it. Many—most countries of the Association of Southeast Asian Nations, for example—have become thriving independent states. But clearly foreign aid was critical in sustaining a number of states, based on their real or imagined strategic significance in the Cold War.

Over time, however, the hurdles faced by some young countries have proven overwhelming, and the assistance cuts that began in the late 1980s brought home the full weight of their shortcomings. In states like Somalia, Sudan, and Zaire, discredited regimes are being challenged by powerful insurgencies. The resulting civil strife is disrupting essential governmental services, destroying food supplies and distribution networks, and bringing economies to a virtual standstill; corrupt and criminal public officials only exacerbate the human misery. In Somalia and Sudan, natural disasters have compounded the suffering, killing large portions of the populations and forcing many others to migrate to already overcrowded urban areas or to refugee centers abroad. In Cambodia, 20 years of conflict have left the country in ruins, littered with land mines, and still suffering from the Khmer Rouge's genocidal rule. Afghanistan's civil war appears stuck in a stalemate and the country may not be able to hold together. Of course, most states that have suffered economic hardships have not faced governmental collapse. Most governments have been able to muddle through, although they have been heavily burdened by a stagnant standard of living.

Third World countries are not the only ones that could fail. The disintegration of the Soviet Union and Yugoslavia over the last two and a half years has created almost 20 new states, most of which have no tradition of statehood or practice in self-government. One hopes that most will succeed, but lack of experience in government, weak civic institutions, limited economic prospects, and ethnic strife will inevitably reduce some to helplessness—a condition in which Bosnia, with its civil war, now finds itself. The world's changing political, economic, and cultural configurations are testing the unity—and the borders—of many other countries. It is impossible to be certain that the political boundaries created under colonialism will, in the end, prove sustainable.

Thus, there are three groups of states whose survival is threatened: First, there are the failed states like Bosnia, Cambodia, Liberia, and Somalia, a small group whose governmental structures have been overwhelmed by circumstances. Second, there are the failing states like Ethiopia, Georgia, and Zaire, where collapse is not imminent but could occur within several years. And third, there are some newly independent states in the territories formerly known as Yugoslavia and the Soviet Union, whose viability is difficult to assess. All three groups merit

close attention, and all three will require innovative policies.

Traditional Approaches

The international community's traditional response to states or territories in need of development assistance has fallen into several patterns. For some non-self-governing territories, the U.N. Charter—and the Covenant of the League of Nations before it—created a system of trusteeship under which member states or even the international organization itself was charged with promoting the political, economic, social, cultural, and educational well-being of the inhabitants. The Charter regarded the obligation to advance those interests as a "sacred trust." In a few cases, the United Nations took on a direct role. During 1962 and 1963, for example, at the request of the Netherlands and Indonesia, the United Nations governed Irian Jaya (the western half of the island of New Guinea) during that territory's brief transition from Dutch to Indonesian rule. Plans for other U.N. administrations, such as a separate legal regime for Jerusalem (envisaged in the 1947 Palestine partition plan) or the U.N. Council for Namibia (created after the termination of South Africa's League mandate over Namibia), never resulted in effective U.N. control. The Council for Namibia did, however, help lay the groundwork for the Western members of the Security Council to draft an independence plan, which was finally implemented in 1988–89. The Western Sahara may constitute another example of the U.N.'s midwifing the creation of a new state.

For independent states, the world community has employed conventional remedies to promote the political and economic development of people in distress. The grandfather of all postwar programs, the Marshall Plan, provided more than $16 billion, about $114 billion in 1992 dollars, in bilateral economic assistance to the countries of Western Europe, which were so ravaged by war as to constitute failing states. The United States undertook not only to restore the economies of its defeated enemies, but to reorganize the Italian, Japanese, and West German political systems along democratic lines. The result was the restoration of states

that have proven to be economically productive, politically stable, and strongly supportive of a peaceful international system.

Since that time, the revived states of Europe, the other countries of the Organization for Economic Cooperation and Development (OECD), and the former Soviet bloc have contributed large amounts of bilateral aid to the developing world. Donor groups have pooled resources for a particular country and donated humanitarian assistance in response to crises. And the United Nations, through the UNDP and various specialized and technical agencies, has furnished training to officials in developing countries and project funding. The World Bank offers grants and loans for specific projects in developing countries, and the International Monetary Fund (IMF) supplies credit on easy terms. The U.N. High Commissioner for Refugees (UNHCR) assists in relief operations, as do the World Food Programme and the United Nations International Children's Emergency Fund (UNICEF).

Unfortunately, those methods have met with scant success in failing states, and they will prove wholly inadequate in those that have collapsed. Western aid cannot reach its intended recipients because of violence, irreconcilable political divisions, or the absence of an economic infrastructure. Somalia provides a dismaying example. An IMF program is not possible where there is in effect no government. Grants of money, uncoordinated technical assistance programs, and occasional visits by humanitarian and relief organizations have not been enough to bring states such as Bosnia and Somalia back from the brink of death. Although international organizations deserve much credit for responding to distress, the emergence of additional failed states suggests the need for a more systematic and intrusive approach.

Recent U.N. activities have begun to reflect that need. In his landmark June 1992 report, *An Agenda for Peace*, Secretary-General Boutros Boutros-Ghali set forth the concept of "post-conflict peace-building" as a new priority for the United Nations. Boutros-Ghali argued forcefully for "action to identify and support structures which will tend to strengthen and solidify peace in order to avoid a relapse into

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conflict." To prevent future conflict, the international community must create a new political, economic, and social environment for states riven by war. That would include strengthening governmental institutions, protecting human rights, pursuing bilateral cooperation projects, and encouraging demilitarization. Existing U.N. agencies would provide most of the assistance, requiring member states to increase their financial contributions.

Boutros-Ghali largely sought to base his case for assistance on the responsibility of the United Nations under its Charter to "maintain international peace and security." Certainly the argument is a strong one. The demise of a state is often marked by violence and widespread human rights violations that affect other states. Civil strife, the breakdown of food and health systems, and economic collapse force refugees to flee to adjacent countries. Neighboring states may also be burdened with illicit arms traffic, solidarity activities by related ethnic groups, and armed bands seeking to establish a safe haven. As is evident in the Balkans, there is a tangible risk that such conflicts will spill over into other countries.

The need to safeguard international peace and security has already prompted specific U.N. action aimed, at least partly, at rescuing failing states through direct involvement in their internal affairs. The massive U.N. plan to restore peace to Cambodia—with civil administration, peacekeeping, and supervised elections—is meant not only to rebuild Cambodia internally, but to eliminate a great source of regional tension in Southeast Asia. In Central America, too, the United Nations has used nation building as a means of preserving the peace. Its close monitoring of elections in Nicaragua and of the democratization programs in El Salvador has shown the U.N.'s willingness to become involved in the domestic affairs of its members in order to preserve international peace and security. Any future U.N. effort in the Balkans—moving from its peacekeeping and humanitarian assistance programs to creating a long-term peace on the ground—will likely be done under the same rubric.

The U.N.'s responsibility for international peace and security is not, however, a sufficient

basis for its action to resurrect all failed or failing states. Not all failing states pose true dangers to the peace. Haiti's tragedy has been borne by the Haitians themselves, and Liberia's disintegration only minimally imperils international security, apart from the modest impact of refugee flows from both states on neighbors. In such cases, U.N. members are more reluctant to support multilateral involvement.

That reluctance has both legal and political origins. From a legal standpoint, Article 2(7) of the U.N. Charter states that the organization is not authorized under the Charter to intervene "in matters which are essentially within the domestic jurisdiction of any state," except when the Security Council is enforcing its will under Chapter VII (the same part relied upon for sanctions against Iraq, Libya, and Serbia). The United Nations, then, is explicitly not authorized to interfere in purely domestic issues except to support Security Council resolutions, or with the consent of the concerned state.

The international community should now be prepared to consider a novel, expansive—and desperately needed—effort by the U.N. to undertake nation-saving responsibilities.

More important, deeply rooted political obstacles have tended to prevent extensive U.N. direction of a country's internal matters and even stifled debate about the appropriateness of such involvement. Those barriers stem from the talisman of "sovereignty." That ill-defined and amorphous notion of international law has been used to denote everything from a state's political independence—its separate existence as a political unit on the world scene—to the more extreme view that all the internal affairs of a state are beyond the scrutiny of the international community. The states that achieved independence after 1945 attach great—almost exaggerated—importance to the concept of sovereignty. Those countries, organized regionally or as the Group of 77 (now numbering over 120 countries), are quick to resist perceived threats to sovereignty—whether as hu-

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manitarian assistance or U.N. peacekeeping in civil conflicts such as the one in Bosnia. They view an unqualified doctrine of sovereignty as a protection against the predatory designs of stronger states.

Many states, especially China in recent years, have sought to hide behind "sovereignty" to shield themselves from international criticism of their abysmal human rights records. Their position endures despite the emerging consensus over the past 40 years—codified in the Charter, the Universal Declaration of Human Rights, and numerous U.N. conventions, and institutionalized through the U.N. Human Rights Commission—that human rights are of international concern and that the world community has a right and a duty to promote the basic human dignity of persons in all countries. Sovereignty has been invoked to block international involvement in other issues as well, like pollution, public health, and narcotics.

But the tide is slowly changing, or, as Boutros-Ghali has put it, perhaps the tide was never as far out as some proponents of sovereignty would have it. In his June 1992 report, he observed that "the time of absolute and exclusive sovereignty . . . has passed; its theory was never matched by reality." He called for "a balance between the needs of good internal governance and the requirements of an ever more interdependent world." That the theory was never matched by reality is well documented, especially in ways that the world community has aided states in distress.

Many economic assistance programs, for example, require the recipient state to undertake policies of a wholly domestic nature. Such "conditionality" is widely accepted, despite the occasional objection from target states. Some conditions relate to the use of the money, such as ensuring that it is spent on a specific project. Others link aid to the recipient's policies on other matters, such as human rights practices, expropriation policy, or, more recently, democratization efforts. The IMF mandates recipients of credit to enter into detailed agreements that require the country to reform, and perhaps even restructure, its economy. The IMF sets targets for inflation, money supply, and foreign exchange reserves, and the recipient has little

choice but to comply if it wants to retain acce to IMF credit and bank loans. It is therefor unpersuasive to contend that absolute sover eignty—in the sense of full freedom over dc mestic policy—is undiminished when countrie choose to accept such conditioned internation assistance.

Also, humanitarian assistance has often bee delivered regardless of whether host govern ments have given formal assent to all the opera tions. When the UNHCR is given authority t enter a country to care for refugees, it normall works with the host government to accomplis its purpose. The International Committee fc the Red Cross, in exchange for its vow of se crecy, is granted access to persons in prisor and can conduct other humanitarian activitie such as exchanges of prisoners in countrie experiencing civil strife. Even when govern ments have officially denied permission—as i Afghanistan, Ethiopia, and Sudan over the pa decade—humanitarian entities have deliberatel found ways to circumvent official policy. Th United Nations itself, in a June 1992 Gener Assembly resolution on humanitarian involve ment, set forth a somewhat remarkable princ ple governing such efforts. It noted that hu manitarian assistance "*should* [not "shall"] b provided with the consent of the affected *cour try* [not "state" or "government"] and *in princ ple* on the basis of an appeal by the affecte country" (italics added).

In a similar fashion, the problems of th environment overwhelm traditional concepts c national sovereignty. The effects c desertification, global warming, destruction c the ozone layer, and acid rain know no nation boundaries. Solutions to such problems wi require international regimes that constrain dc mestic activities, like the emission of ozone depleting gases.

The long-term acceptance of limitations o absolute sovereignty, the emerging views e pressed by the world community regarding th propriety and legality of humanitarian assistanc to countries in distress, and member state increased willingness to entrust more authori to the U.N. all point to new alternatives fc responding to the phenomenon of failed state The international community should now b

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prepared to consider a novel, expansive—and desperately needed—effort by the U.N. to undertake nation-saving responsibilities.

United Nations Conservatorship

The conceptual basis for the effort should lie in the idea of conservatorship. In domestic systems when the polity confronts persons who are utterly incapable of functioning on their own, the law often provides some regime whereby the community itself manages the affairs of the victim. Forms of guardianship or trusteeship are a common response to broken families, serious mental or physical illness, or economic destitution. The hapless individual is placed under the responsibility of a trustee or guardian, who is charged to look out for the best interests of that person. In a commercial context, bankruptcy codes accomplish a similar purpose, providing a transitional period under which those unable to conduct business relations are given a second chance at economic viability.

It is time that the United Nations consider such a response to the plight of failed states. The undertaking would flow logically from its historical efforts in non-self-governing territories as well as from the tradition of conditioning aid and credits on certain behavior. Limiting the U.N.'s conservatorship role to the formal Trust Territories (of which only the tiny islands of Palau remain) is much like limiting legal guardianship to minors, or bankruptcy to new companies. Such a qualification stems from an incorrect premise—that only territories not yet fully independent require U.N. protection and oversight—and fails to promote the central Charter values: human rights for all and stability in international relations. The Charter also entrusts the United Nations with achieving "international cooperation in solving international problems of an economic, social, cultural, or humanitarian character, and in promoting and encouraging respect for human rights." Conservatorship would fulfill that goal.

The traditional view of sovereignty has so decayed that all should recognize the appropriateness of U.N. measures inside member states to save them from self-destruction. At the same time, though, the United Nations cannot simply begin to involve itself in the affairs of member states as if they were suddenly part of the trusteeship system. The irreducible minimum of sovereignty requires some form of consent from the host state. Whether that consent must be a formal invitation or simply the absence of opposition would seem to depend upon the circumstances. The only exception to the principle ought to be rare situations involving major violations of human rights or the prospect of regional conflict where warring factions oppose an international presence. Cambodia under the Khmer Rouge might well have merited such an extraordinary form of forcible conservatorship, to prevent completion of the "auto-genocide" the Khmer Rouge started.

Three models for a U.N. guardianship role are suggested here: governance assistance, delegation of governmental authority, and direct U.N. trusteeship. Each builds upon multilateral assistance efforts of the past. Each seeks to seize the moment offered by newly evolving conceptions of sovereignty.

Where the target state still maintains some type of minimal governmental structure—where the state is failing, but not yet failed—the U.N. should provide aid through what is best described as "governance assistance." That alternative assumes the existence of a regime that is both effective to some degree—in that it maintains some control over the instruments of state power—and internationally recognized (even if not democratically chosen). Examples of such states might include Georgia, Zaire, and possibly a handful of other states in Africa and Asia. They have experienced economic breakdown or political unrest but not complete civil destruction. The governance assistance would build upon existing technical assistance programs but be far more expansive. Instead of merely offering advice or training, the U.N. would assign personnel to work directly with governmental officials on the country's most pressing needs. U.N. personnel would help administer the state, although the final decision-making authority would remain with the government. Conditions for providing such assistance and intervention might include not only economic change, but modification of the political structure and process where those have a bearing on

the health of the state.

The technical training of the sort now funded by the UNDP would of course continue. But because the goal of conservatorship is to enable the state to get on its feet again, the aid should be directed at those sectors least equipped to respond to the country's needs, whether they be law enforcement, the military, transportation, or health services. The United Nations should also foster democratic institutions and help build elements of a civil society. Thus, it might help draft a constitution, organize free elections, or encourage NGOs that are working to strengthen civic institutions, including political parties and judicial systems. NGOs have performed such functions in Eastern Europe and in the states of the former Soviet Union. Obviously, the U.N. will have an even more delicate task when the incumbent government is corrupt; the line between reforming it and undermining it may be thin, and close coordination with nongovernmental actors will be needed to ensure that the overall interests of the country are paramount.

For those states that have already failed, a second, more intrusive form of conservatorship would be appropriate. Here, the state could actually delegate certain governmental functions to the U.N. That process is already underway, at least in theory, in Cambodia, which clearly qualifies as a failed state: Twenty years of civil war, invasions, outside arms supplies, gross violations of human rights, massive dislocations of its population, and destruction of its infrastructure have rendered the country incapable of governing itself. When peace efforts aimed at a reconciliation of four warring factions met with no success, the five permanent members of the Security Council developed a formula, ultimately endorsed by those factions, for a U.N. operation: the United Nations Transitional Authority in Cambodia (UNTAC). It exercises oversight over the country until the elections. The unparalleled authority given to the U.N. includes aspects of civil administration. It controls five ministries, supervises others, has access to all documents, can issue binding directives, and may replace personnel, all to create a neutral environment for elections.

UNTAC's broad powers are fully consistent

with Cambodia's status as an independent state because its authority was delegated to it by the warring factions. The Cambodians agreed to create a Supreme National Council (SNC) composed of representatives of the four factions and acting as the "unique . . . source of authority" and embodiment of Cambodian sovereignty. Under the 1991 Paris Agreements, the SNC delegated to the United Nations all the authority needed to ensure that the accords would be successfully implemented. However, the United Nations must follow the instructions of the SNC when that body adopts positions unanimously or when Prince Norodom Sihanouk, the country's hereditary monarch and the president of the SNC, chooses to speak on its behalf and its views are consistent, in the U.N.'s opinion, with the agreements. That arrangement ensures that Cambodia retains its "sovereignty." At the same time, the U.N.'s role certainly means that Cambodia lacks full freedom to manage its internal affairs.

It seems appropriate to modernize and reorient U.N. programs to cover the "newly non-self-governing territories."

Whether the reality of the Cambodia experience will match the promise of the Paris Agreements remains to be seen, but the "Cambodia model" has the advantage that it is fully consistent with the Charter while allowing for an extensive U.N. role. It also preserves a modicum of authority for local elites by requiring the U.N. to consider fully their advice when they can all agree. Moreover, if the country actually has a government of some kind that can delegate authority, the conservatorship need not create anything like a Supreme National Council. The Cambodian precedent may well represent the limit to which the international community is willing to consider guardianship for member states. It may also prove the best model for solving Bosnia's woes. If a committee authoritatively representing Croats, Muslims, and Serbs—and their militias—could agree to delegate certain functions to the U.N., pending elections, then there might be a way through

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Bosnia's seemingly intractable ethnic conflict.

Finally, there is the most radical option: direct U.N. trusteeship. Such a plan would resurrect the old trusteeship system and apply it to failed states. For now, though, the U.N. Charter would preclude that kind of trusteeship: Under Articles 77 and 78, the International Trusteeship system applies only to former League mandates, territories captured during World War II, and other areas placed under trusteeship by their administering states. It does "not apply to territories which have become Members of the United Nations."

Those limitations reflect the colonial situation and priorities of U.N. members at the close of the Second World War. Many areas under League mandates needed a similar status under the new United Nations and newly occupied lands might require a transition to independence. In 1945, the relatively few independent states were generally well-established, if not always wealthy, members of the international community; their failure seemed inconceivable. Moreover, creating a trusteeship out of a member state would have been viewed as inconsistent with the premise that the U.N. was to be based upon "the principle of the sovereign equality of all Members," and that it would not interfere in their internal affairs.

Today, however, if the forces in a country cannot agree upon the basic components of a political settlement—such as free and fair elections—and accept administration by an impartial outside authority pending elections, then the U.N. Charter should provide a mechanism for direct international trusteeship. Although no state should be the unwilling object of a U.N. trusteeship, states could voluntarily relinquish control over their internal and external affairs for a defined period. The trusteeship plan would go further than the Cambodia model; local authorities would turn over power to the United Nations and follow its orders, rather than retaining a veto.

In general, the United Nations would act as the administering authority, although a group of states might also perform that function, such as the European Community with respect to Bosnia. In any case, the U.N. and the affected state would negotiate a trusteeship agreement,

which would contain the essential elements upon which the state authorities could agree. Because creating trusteeships would require amending the U.N. Charter, the obstacles should not be underestimated. Objections to amending the Charter are well known, and a successful amendment process would no doubt require a carefully constructed political consensus.

Any of the three types of conservatorship outlined above—and especially formal trusteeships—are bound to bring objections. Placing member states, many would argue, under intrusive U.N. supervision would undermine basic notions of sovereignty and violate the "sovereign equality" of members enshrined in Article 2(1). On a more practical level, the U.N. has never itself administered a territory, except for the brief experience in Irian Jaya; administering trusteeships may prove beyond its capacity and will certainly prove costly.

Those arguments are not decisive. Sovereignty, even as touted by many developing states, is consistent with the idea of conservatorships because the purpose of conservatorship is to enable the state to resume responsibility for itself. Failed states are self-governing only in the narrowest sense. Though not under the control of a colonial power, they hardly govern themselves. It seems appropriate to modernize and reorient U.N. programs to cover the "newly non-self-governing territories." The entire Cambodia operation, for example, is organized toward permitting the Cambodian people to exercise their self-determination, the same goal the Charter posits for the trusteeship system. Thus, U.N. assistance—whether in the form of intrusive oversight or outright trusteeship—furthers sovereignty in the long run Moreover, notions of sovereignty are changing. The world community's responsibility to promote human rights in failed states suggests that the old notions of sovereignty should not block conservatorships. Such arrangements would advance popular sovereignty in the long run.

Finally, with respect to the U.N.'s lack of experience, its supervision of Namibian independence and conduct of ever more complex peacekeeping functions in Central America and the former Yugoslavia bode well for its ability

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to adapt to the more complex demands of conservatorship. The results of the Cambodia operation will also prove important. Clearly, though, performing those conservatorship tasks will require significant new resources.

Practical Considerations

Any conception of conservatorship will also require some limiting principles and organized procedures. First, conservatorships must not become another form of wealth transfer from developed to developing states—a "watering trough' for poorer countries. States in difficult economic straits, but with functioning political and economic institutions, should not qualify for U.N. conservatorship. They should be directed to the usual institutions for providing foreign assistance. The U.N. will have to develop criteria for determining when a state is near failure based on sustained political, economic, and human rights distress. Perhaps a state could, in effect, declare bankruptcy and ask for one of the above forms of expanded relief, involving varying degrees of relinquishment of authority to the United Nations. The standards need not prove difficult to apply; states would be reluctant to surrender so much authority to the U.N. unless their situation were nearly hopeless. Of course, resource constraints are certain to limit to a handful the number of states that could be accommodated at any one time.

Second, an organ of the United Nations will have to be assigned overall responsibility for conservatorships, including the power to initiate and terminate them. Existing U.N. organs fall short of what may be needed. The General Assembly is too large and unwieldy for effective oversight, especially when urgent action is needed. The Economic and Social Council, with its 54 members, is also too large. The Trusteeship Council might suffice, although it would require a Charter amendment to reconstitute its functions. Currently, the Security Council is the most efficient organ available, and it could probably handle the political and peacekeeping elements of conservatorship, but it has little experience with economic and social matters. The Security Council could establish a subgroup—not all of whose members need be

on the council—to oversee each conservatorship on the basis of a resolution adopted by the council and a budget approved by the General Assembly. Thus, the Security Council might set up a board of trustees for Somalia by resolution, specifying the terms of the plan, and appoint five countries (perhaps three from Africa on the recommendation of the Africa Group) as members. That procedure would be consistent with the precedent set by the General Assembly in creating the U.N. Council for Namibia, which originally had only 11 members.

Third, the U.N. Secretariat would need to develop a management facility. A central agency of the United Nations would administer and coordinate the conservatorship and provide relief. Some of those functions now belong to the Under-Secretary-General for Peace-keeping Operations; others lie with the Under-Secretary-General for Humanitarian Affairs; and still others are assumed by specialized and technical U.N. agencies. The central bureau within the Secretariat could commandeer the expertise and resources of the U.N. system, much as the secretary-general's special representative for Cambodia, Ambassador Yasushi Akashi of Japan, is given that authority in the Cambodia operation.

Fourth, conservatorships should not devolve into long-term custody. If a program fails to show serious progress after, for example, three years, then the Security Council or General Assembly should reassess the state's political viability. It is even conceivable that a better solution might be a referendum by the citizens of the state on partition or union with a neighbor.

Lastly, no discussion of an expanded U.N. role can take place without serious attention to the financial aspects. The Cambodia operation, the closest case to U.N. management of a sovereign state, is expected to cost more than $1.6 billion during its two-year duration. For a country greater in population (Cambodia has only 7.8 million people), the resources will necessarily be larger, depending on the kinds of civilian and peacekeeping activities required. Few countries are likely to suffer worse devastation than Cambodia. That means sizable new

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contributions from member states at a time when many, especially the United States, are turning to domestic priorities. But the long-term costs of ignoring failed states—in human misery, economic terms, and political instability—are enormous compared to the up-front expenses of a U.N. rescue operation.

Failing states promise to become a familiar facet of international life. They will necessarily exact heavy tolls on their own people and on all countries. Even if the international community were to continue its current ad hoc approach, it would find itself facing mounting costs—for peacekeeping troops, humanitarian aid, and coping with refugees. The real challenge to U.N. members is to address the problem directly, by creating a conceptual and juridical basis for dealing with failed states as a special category, and by forming institutions to succor them. The international community needs a cost-effective way to respond to growing national instability and human misery. Properly conceived, managed, and funded, a regime of conservatorship could be the answer.

Help the UN Live Up to Its Charter

By Nancy Landon Kassebaum

THERE is perhaps no stronger example of the importance of a post-cold-war United Nations than its presence in Somalia. In that country, once so symbolic of the cold-war rivalry, the UN is fulfilling the promise of its 1945 charter. The Security Council has not been paralyzed by a veto, security forces have been approved to protect relief supplies, the UN flag is flying, and relief is arriving on a scale that only an international institution could provide.

I had the opportunity this past July in Somalia to see first hand how UN relief workers, among others on the front lines, were the only vestige of hope for a devastated people. Women and children too weak to stand and too weak to cry waited patiently for relief workers.

Yet, the problems the UN has faced in Somalia are also representative of the UN's new challenges in the wake of the cold war. The UN relief effort has been late and the scale of suffering has been magnified because of the delayed attention by the UN member states and the lack of coordination and inefficiency of a bloated UN bureaucracy. While relief is arriving, the scope of the tragedy could well have been avoided had the UN acted sooner and more effectively.

The UN is being called upon to prevent war, to end conflict, to stop the spread of armaments, to alleviate human suffering, and to improve the environment, among other mandates. In the past four years, 13 peacekeeping operations have been initiated, as many as during the entire period from 1945-1987.

An institution long distorted by the United States/Soviet Union rivalry is now being called upon to be a forum for constructive action. This transformation is not an easy task. But the international community must not squander the UN's second, and perhaps best, chance to fulfill its charter.

Whether the UN can meet the challenges of the next century depends on two critical elements: a commitment by member states to fully support collective diplomacy and security, and a restructuring of the bureaucracy.

First and foremost, the Security Council needs to be restructured to reflect the realities of the post-cold-war era. Along with this change should come a more equitable distribution of the funding of UN operations. Currently, the US pays 25 percent of UN-assessed budgets, 21 percent of voluntary budgets, and 30 percent of peacekeeping costs.

UN members also face the critical task of defining the organization's role in peacemaking and peacekeeping. Secretary-General Boutros Boutros-Ghali has provided an ambitious plan that includes arrangements for standby forces and suggestions for funding them.

For the UN to meet its new demands, such arrangements need full consideration by the membership. I welcome President Bush's recent call for a special meeting of the UN Security Council to discuss the secretary general's proposals. The president also committed the US to increased participation in peacekeeping activities and training efforts.

Whether it is peacekeeping or humanitarian efforts, however, more needs to be done by the UN itself in order to instill confidence among members that it can perform effectively. Most important, it needs to streamline a bloated, competitive bureaucracy and provide more accountability for how money is spent. Mr. Boutros-Ghali has begun to tackle this problem.

But his efforts are only the beginning of a difficult job. Even with his reforms, the Secretariat, for example, would retain 36 undersecretaries general and assistant secretaries general.

As the author of the 1985 UN budgeting amendment which gave the UN's largest contributors more input into the budget process, I continue to believe that strengthening accountability will strengthen the UN. I also continue to believe that increased demands on the UN need not automatically translate into a need for significantly larger resources from member states.

It is important to acknowledge, however, that increased demand for peacekeeping forces resulted in a rise in peacekeeping costs over the past five years from $233 million to $2.7 billion. But UN priorities need to change; then substantial savings can be found. For example, I have felt for some time that conference center projects, such as the one planned for Addis Adaba, Ethiopia, which is projected to cost over $100 million, are a waste of money. Furthermore, a more streamlined UN bureaucracy would also be able to provide savings, as well as work more efficiently.

If the promises of 1945 are to be fulfilled, the UN must boldly address the challenges of the 21st century. Boutros-Ghali has set that course. It is up to member states to commit themselves fully to collective security and to providing the impetus for reform of this very important organization.

■ *Sen. Nancy Landon Kassebaum (R) of Kansas is the 1992 United Nations Day Chair, appointed by the United Nations Association of the USA.*

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THE ENVIRONMENTAL EFFECTS OF STABILIZATION AND STRUCTURAL ADJUSTMENT PROGRAMS: THE PHILIPPINES CASE

by Wilfrido Cruz and Robert Repetto

Throughout Africa, Latin America, and the formerly socialist countries of Eastern Europe and Asia, economies are undergoing dramatic transformations, undoing decades of state intervention and market distortion. Although the impetus behind these structural reforms is the unsatisfactory record of stagnation and indebtedness of the 1980s, the problems of transition are formidable. Inflation, unemployment, and recession threaten the viability of economic reforms in many countries. The international community is being called upon, largely through the agencies of the World Bank and the International Monetary Fund, to support structural adjustment and stabilization programs with policy advice and capital flows.

How economic reforms should be designed to ensure a successful transition to sustainable economic progress is a matter of urgent concern and discussion. However, one vital aspect, environmental sustainability, has been inadequately considered. In all these regions now undergoing structural reforms, environmental degradation has been as obvious a symptom of the failure of the previous policies as economic collapse. Uncontrolled pollution, excessive environmental hazards, and overexploitation of natural resources have accompanied the decline of living standards.

However, the links between macroeconomic policy and environmental degradation have rarely been investigated and are poorly understood. Until now, although project lending by multilateral development banks has received much critical scrutiny, little attention has been paid to the possible environmental implications of structural adjustment and stabilization programs, or of macroeconomic policies in general. For example, the most recent progress report of the World Bank to its Board of Governors on its environmental work stated that "Adjustment lending has not, until recently, paid explicit attention to environmental issues." This would apply even more emphatically to macroeconomic policy analysis carried out by the International Monetary Fund, the Inter-American Development Bank and other regional development banks, most bilateral development assistance agencies, and by developing country governments. Indeed, the macroeconomic accounting frameworks and analytical models used by such agencies generally assume away any possible environmental effects of macroeconomic policy instruments.

This case study helps to fill this gap by analyzing the environmental implications of previous macroeconomic policies in the Philippines and of more recent economic stabilization and structural adjustment programs. The analysis examines the macroeconomic policies that led to the Philippines debt crisis in the early 1980s, and it evaluates the environmental implications of structural adjustment and stabilization policies recommended as countermeasures to the debt crisis. It identifies alternative structural adjustment policies that would better address the objectives of economic recovery and resource conservation.

The effects of macroeconomic policies can be traced along three dimensions that represent effects on current versus future consumption and income, effects on different industries and the mix of inputs used in production, and effects on the distribution of wealth and income. On the intertemporal axis, economic policies in the Philippines encouraged the immediate consumption of natural resources while the economy was piling up debt, thereby dimming future economic prospects. On the intersectoral axis, materials and energy-intensive industries were encouraged to grow and cluster around the Metropolitan Manila area, exacerbating pollution. On the

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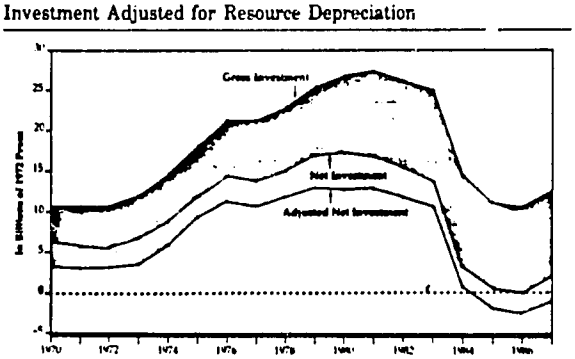
interpersonal axis, policies that perpetuated severe income inequalities and poverty pushed tens of millions of low-income and landless households into small-scale coastal fishing or shifting cultivation in upland forests, overtaxing those fragile natural resources.

INTERTEMPORAL EFFECTS: RESOURCE DEPLETION AND FOREIGN DEBT

Philippine development strategy led to a shortfall in savings, low returns on investments, and rising external debt. Macroeconomic policies depressed the returns to private investors who held onto or improved their natural resource assets, but inflated returns to industrial investment. This led to resource extraction and disinvestment in the primary production sector, reducing sustainable yields from such natural resources as forests or fisheries.

From 1970 to 1987, the country's balance sheet deteriorated more from depreciation of natural resources than from foreign borrowing: depreciation in just three sectors—forests, soils, and coastal fisheries—averaged more than 4 percent of gross domestic product (GDP) per year, 0.8 percent higher than the annual rise of external debt as a percentage of GDP. Both kinds of depreciation stemmed from the macroeconomic bias toward present consumption at the expense of future income, and both contributed to the ensuing economic crisis. Unlike the highly publicized debt problem, however, resource depletion went unmeasured and unnoticed because the national accounts, the framework for macroeconomic analysis, fail to keep track of changes in natural resource assets. For example, capital formation, which actually became negative during the early 1980s, was greatly overstated because the national accounts ignored resource depletion. *(See Figure.)*

Investment Adjusted for Resource Depreciation



Note: Net Investment is Gross Investment less Capital Consumption Allowance. Adjusted Net Investment is Net Investment less forestry, soil and fishery resource depreciation from Part II. Investment data are from *Philippine Statistical Yearbook* (1989).

Declining natural resources and growing external debt can be consistent with sustainable development for a time, but only if the process results in new productive assets. In the Philippines' case, it did not. Capital investments in an excessively protected and inefficient industrial sector had low real rates of economic return and failed to provide adequate alternative sources of growth. The capital required to produce a unit of output grew by more than 50 percent from 1970 to 1982—and another 50 percent between 1983 and 1988. In short, productive natural resource capital was sacrificed to acquire industrial white elephants.

INTERSECTORAL AND INTERREGIONAL RESOURCE ALLOCATIONS

Tariff and exchange rate policies discouraged investment in the primary sector (i.e., forests, agriculture, and mining) and promoted the progressive decapitalization of primary industries. These policies also kept the prices of industrial raw materials and intermediate inputs such as energy relatively low. As a result, from the mid-1950s through the mid-1980s, industrial use of intermediate inputs increased faster than industrial output did. In response to distorted price signals, Philippine industry became more materials-intensive, which led to rapidly rising pollution and resource waste. This process was reinforced by fiscal policies that heavily subsidized such pollution-prone and energy-intensive sectors as pulp and paper, mining, chemicals, and petroleum products. Industrial pollution became even worse in the 1980s when the economic crisis led to cuts in government spending that undermined environmental regulation and waste collection and treatment.

Government policies favoring industries closely tied to consumer markets also led to a pronounced concentration of industry in the Metro Manila region. By the 1980s, two thirds of all manufacturing and 7 million households crowded the region, resulting in severe environmental degradation, particularly in air and water quality.

Energy policy allowed rising world oil prices to pass through into domestic energy prices, promoting energy conservation and the development of indigenous energy sources. But this policy was blunted by macroeconomic policies that allowed the exchange rate to appreciate in the wake of both oil shocks. Between 1962 and 1988, the peso was overvalued by from 14 to 24 percent, which artificially lowered the cost of imported oil and contributed to industry's rising energy-intensity—a trend further encouraged by low electricity prices.

INTERPERSONAL EFFECTS: POVERTY AND POPULATION PRESSURE

Over the past three decades, the Philippine population has more than doubled to 62.4 million, expanding both the demand for agricultural staples

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and the labor supply. Industrial employment grew too slowly to absorb the rapidly growing workforce. As the Green Revolution in the lowlands lost momentum, rural households began migrating into artisanal fisheries and into the uplands, where the combination of steep slopes and twice yearly monsoons make farming an ecologically risky venture.

Macroeconomic policies intensified these trends by favoring capital-intensive industries, retarding job creation, and penalizing agriculture with implicit output taxes as high as 20 percent. At the same time, credit was rationed in ways that funnelled financing to industrialists and large farmers, and regressive taxation aggravated income disparities. Timber concessionaires and large ranchers were granted use rights to most of the public lands. Only logged-over forest lands, mangroves, and fisheries in the public domain were available to the rapidly growing pool of landless workers.

Stabilization policies that sharply increased poverty and unemployment sharply accelerated rural-to-rural migration into upland watersheds and coastal regions, intensifying deforestation and erosion of upland watersheds and the overexploitation of coastal fisheries and mangroves. By 1985, 12 percent of the workforce was unemployed, and more than one in three workers could find only part-time work. Real wages fell more than 20 percent between 1983 and 1985, leaving 58 percent of the population below the poverty line.

Low wages "pushed" households out of overcrowded, poverty-stricken areas, while the prospects of gaining access to land "pulled" them into the newly opened uplands or coastal areas. Early settlers in the uplands may have been able to improve their lot for a time, but their hopes for a better life were dashed as succeeding waves of migrants spilled into the area—2.5 million of them in the first half of the 1980s alone. With each harvest, the eroded soils yielded less, and more migrants competed for land. Poverty drove agricultural workers from crowded lowland rice farms, but poverty also awaited them in the fragile uplands.

During the 1970s, the number of fishermen nearly tripled to more than a million, who were compelled to expend ever more effort to get an ever smaller catch—a classic sign that fisheries are being overexploited. By 1985, some 72 percent of fishing households were below the poverty line.

ENVIRONMENTAL IMPACTS OF STABILIZATION AND ADJUSTMENT PROGRAMS

Contrary to the conventional view that the debt crisis stepped up natural resource exports, the massive economic contraction associated with the collapse of world commodity prices and restrictive stabilization policies actually reduced the country's production of timber, minerals, and most other resource-based products. But the resources of the uplands and coastal areas nonetheless deteriorated because a stabilization program designed and executed without regard for environmental costs triggered vast migrations into these open access areas.

These findings notwithstanding, the full environmental consequences of macroeconomic policy changes can be analyzed only in a general equilibrium framework that shows how interrelated changes in relative prices and income levels affect demand for natural resources. A computable general equilibrium (CGE) model of the Philippine economy was adapted so that the effects of actual structural adjustment policies on such resource-dependent sectors as logging, fishing, upland agriculture, mining, and energy production could be compared with the effects of hypothetical alternative policies.

Most neoclassical macroeconomic models incorporate only capital and labor inputs into production. This CGE model incorporated natural resources into the analysis of structural adjustment programs by recognizing land as a productive input. Its simulations showed that the adjustment programs prescribed for the Philippines economy could indeed improve income and the balance of payments, but unless accompanied by safeguards against resource overexploitation, they would do so at the cost of additional environmental deterioration.

An alternative set of policies could have promoted growth, employment, and income distribution while reducing resource degradation. To take pressure off marginal natural resources, income and employment opportunities must increase elsewhere in an economy. In the Philippines, this would have required policies that stimulated growth in lowland agriculture and tree cropping, rather than logging, mining, and upland cropping. Changes in land tenure and property rights could have mitigated rural environmental degradation by giving the poor a greater stake in resource management. Reforming the regressive tax structure and taxing land and resources more intensively, through timber and mineral royalties, for example, could have made for a more equitable distribution of income, more jobs, and a better balance of payments. Besides reducing environmental damage and poverty, programs designed along these lines could also promote fiscal balance and economic efficiency. Had these opportunities not been missed, policy changes could have helped put the Philippine economy on a more sustainable growth path.

MAKING MACROECONOMIC POLICIES WORK *FOR*, NOT AGAINST, SUSTAINABLE DEVELOPMENT

Adjustment and stabilization policies in the developing world determine production, trade, invest-

ment, and income distribution patterns for good or ill, so they inevitably affect how natural resources are used. It is crucial that these policies focus not just on immediate crises, but also on the long-term requirements of sustainable development. This broader focus is unlikely as long as macroeconomic analyses exclude environmental impacts, allowing governments and international agencies to adhere to myopic policies.

As the main purveyors of macroeconomic policy reform in the developing world, the World Bank and the International Monetary Fund should promote new analytical approaches that simultaneously address structural reform and environmental needs. In cooperation with all their clients, these institutions should carry out comprehensive studies on how to craft macroeconomic policies that recognize the linkages between sustained economic recovery and natural resource conservation—and address both needs with equal urgency. The International Monetary Fund sees stabilizing short-term economic imbalances as its mandate, but the programs it prescribed in the Philippines had significant and long-lasting social and environmental costs. Working with national authorities, the IMF must develop analytical methods that predict these costs if future stabilization programs are not to impose them.

The World Bank's structural adjustment program for the Philippines did not adequately incorporate environmental concerns either. Simulations suggest that had these reforms been fully implemented, they would have intensified environmental deterioration. In order to ensure that structural adjustment programs that support trade liberalization and market reform lead countries toward sustainable development, the programs must also address issues of property rights, natural resource management and environmental protection. There are ways to improve resource management while contributing to other objectives of economic adjustment—for instance, by increasing rent and property taxation and by strengthening tenurial rights of small farmers. The World Bank should pay more attention to such linkages in future structural adjustment programs.

Environmental advocacy groups have a vital role to play in this sphere too. They should scrutinize macroeconomic policies and structural reform programs as closely as they have traditionally examined particular development decisions and sectoral policies. Their positions on such policies and programs should be informed by a deeper understanding of the direct and indirect workings of macroeconomics, lest they oversimplify complex issues. This need should be regarded as a challenge to become involved, not an excuse to stand aside.

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POPULATION GROWTH, POVERTY, AND ENVIRONMENTAL STRESS: FRONTIER MIGRATION IN THE PHILIPPINES AND COSTA RICA

by Maria Concepcion Cruz, Carrie A. Meyer, Robert Repetto, and Richard Woodward

After decades of debate, the relationship of population growth to environmental stress remains an unresolved issue of intense concern. The impact of the human population on the global environment was clearly demonstrated by the stratospheric ozone depletion, greenhouse gas accumulation, tropical deforestation, and marine pollution that became so apparent in the 1980s. During the same period—a period of economic stagnation in developing countries—the pace of fertility decline slowed down. Forecasts of the date when the human population will eventually stabilize were pushed up to 2150, and estimates of its ultimate size increased to 11.6 billion—more than double the current population.

The debate over population and resources, carried on with the fervor of theological conviction, concerns nothing less than the fate of the world. One side holds that the press of growing numbers on finite resources dooms the world to impoverishment and ecological collapse. The other holds that all resource constraints can be overcome through technological and social innovation. Both sides point selectively to current events to bolster their prophesies.

Neither position, however, goes very far toward unravelling the tangled interactions between population changes and the human use of the natural environment. The conflicts that arise between population growth and the environment are local as well as global, and they are influenced by a host of factors that may reinforce or alleviate the tension. Legal systems, economic policies, technology, consumption patterns, and the distribution of wealth all affect a population's use of, and impact on, the natural environment. But human society co-evolves with its natural environment, and its institutions, cultures, laws, and economic pursuits are also shaped by its ecological setting.

A better understanding of the linkages between population growth, poverty, and environmental degradation can help direct policy for sustainable development. Although many have recognized that such linkages exist, few have examined the key mechanisms. *Population Growth, Poverty, and Environmental Stress* breaks new ground by focusing on a demographic process with an environmental outcome: frontier migration.

During the past decade, tens of millions of impoverished people have moved into fragile ecosystems in a desperate search for sustenance. Using the cases of the Philippines and Costa Rica, this study shows how poverty and ill-designed tenure policies can increase migration to unguarded frontier areas, exacerbating the environmental damage inflicted by population growth.

The study's authors examine how population increases have stressed the frontier environment in the two countries—and then explore the crucial role that poverty and tenure policies play in this relationship. Although population pressure and poverty are more severe in the Philippines, and land management and tenure policies in the two countries differ, in both a rapidly growing population is migrating out onto easily degraded forest slopes. And in both countries, poverty and landlessness among the migrant population and the invadable conditions of the marginal lands to which they flee promote rapid migration.

The research findings show that in countries already experiencing population pressure on resources, increases in poverty induce increased migration to those frontier lands where property rights are vague or poorly enforced. Both Costa Rica and the Philippines suffered severe recessions after oil prices rose sharply in 1979, world interest rates subsequently began rising in 1980, and lending contracted sharply, precipitating a debt crisis throughout most of the developing world in the early 1980s. Using new data from population censuses carried out in both countries in the mid-1980s,

researchers compared migration patterns in the early 1980s with historical migration patterns. Despite the many differences between the two countries, both saw the rural-to-urban migration flows of the 1970s change course during the early 1980s. Migration to urban areas declined, as employment and real wages fell. Frontier migration increased, which intensified pressure on forest resources during the recessionary period.

POLICIES FOR PEOPLE AND THE ENVIRONMENT

Studies of both Costa Rica and the Philippines demonstrate that in the face of poverty, rapid population growth has detrimental effects on publicly-owned or easily invaded natural resources. Exactly how much causality should be assigned to population growth, poverty, and resource management is not the issue since these various determinants of environmental degradation are so interconnected that the effects of one cannot be isolated from those of the others. Nor can a single strategic point of policy intervention that would break into the process of population growth, impoverishment, and environmental degradation be identified. Rather, there are multiple points of intervention.

Conventionally, these interventions have been classified as "population" or "economic" or "resource" policies, but these distinctions are artificial. Tenurial policies *are* population policies when they allow uncontrolled land use in frontier areas, thus inviting large-scale in-migration. Economic policies that depress real wages and employment can also have significant demographic consequences. And failure to address rapid population growth should be regarded as a resource policy with tremendous long-term environmental consequences.

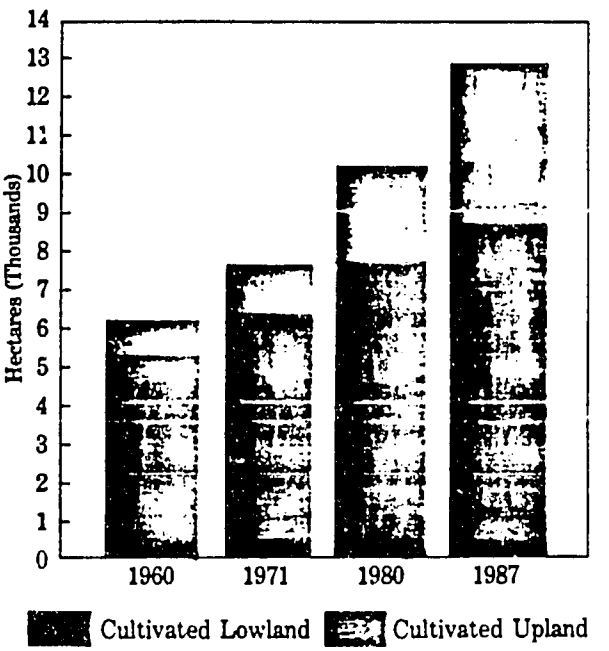
Policies to address poverty, population growth, and resource degradation can thus be highly complementary. Economic policies that accelerate the creation of jobs for both men and women reduce poverty and accelerate the decline of fertility rates. Similarly, government policies that ensure wide access to basic education and health services can encourage economic growth and reduce both infant mortality and fertility rates. Tenurial policies that increase the security of individual or communal tenure in forested areas both alleviate poverty and encourage improvements in resource management. The close linkages among population growth, poverty, and environmental degradation mean that, like a troika, they can be driven by the same forces.

THE PHILIPPINES CASE STUDY

The Philippines supports a very large and rapidly growing population on a fragile land base. In 1990, the population stood at 62.4 million people, and the population is likely to at least double before it stabilizes. Over 200 people per km² put it among the world's most densely populated countries. The strong influence of the Catholic church has contributed to a lack of consistency in government commitment to family planning programs. Although education and economic opportunities are available to women, government expenditures on health care are very low and health and family planning services often do not reach the poor or those in rural areas.

Pressure on resources for arable land and fuelwood is intense in the Philippines. Between 1960 and 1987, cultivated land more than doubled: an additional 6 [illegible] million hectares—22 percent of the country's [illegible] area—were brought under cultivation. *(See Figure 1.)* Most of this farmland was in the uplands, where cultivation has resulted in serious soil erosion and deforestation.

Figure 1. Cultivated Lowland and Upland in the Philippines, 1960-67



The detrimental effects of the growing population on the land base are exacerbated by the poverty of the population and the insecurity of tenure for forest lands. Fifty-seven percent of the Philippine population lives below the poverty line. To these people, the unprotected forest lands hold the promise of some form of subsistence income. The uplands—those lands with slopes of over 18 percent—include over half of the land area of the country. Although few remain forested, these lands are officially called "forest lands" and are part of the public domain. However, this claim is not officially enforced since a sizable portion of forest lands has been declared "alienable and disposable"

and titled to support 6.7 million people. Another 11 million—both indigenous peoples and migrants—live there without benefit of legal title. The indigenous populations hold traditional rights to land that are recognized by law, but since they have not received titles, their lands are continually invaded. At least 5.7 million migrants have so far illegally encroached on land that the government pretends to protect for the public domain. Without title, agriculturalists have little incentive to maintain the land, and almost inevitably degradation occurs.

Timber concession policies have helped "pull" migrants onto Philippine forest lands. Commercial logging companies build roads, making it easier for migrants to move in and plant crops in the logged areas. In 1985, 62 percent of the total upland population resided in timber concession areas.

Managing the debt crisis that hit the Philippines and most of the developing world in the early 1980s caused increased economic hardship. Real wages and employment began falling in 1981 and the stagnation persisted until 1987. The resulting economic crises coincided with dramatic changes in demographic movements, and an intensification of upland migration was recorded in the census of 1985.

Upland migration was already on an upward trend: positive net migration into the uplands increased from 0.4 million in the years 1970–75 to 1.4 million in 1975–80. But with the increase in poverty and unemployment in the 1980s, net in-migration surged to 2.6 million in the period 1980–85. Rural-to-urban migration was very strong in the 1970s, with rural lowland areas experiencing net losses. These flows exceeded the movements to the uplands, particularly in the early 1970s. In the early 1980s, however, upland migration increased significantly, dominating the urban-ward flows. This shift in the pace and direction of migration aptly demonstrates the interplay of economic conditions, demographic change, and environmental degradation.

THE COSTA RICAN CASE STUDY

Costa Rica has a small population—approximately 3 million people in 1990—and its population density of roughly 60 people per km² is only one third that of the Philippines. The government has only recently come to regard the population growth rate as excessive despite a rapid rate of 2.5 percent per year. Contraceptive use and health care are widespread in Costa Rica and Costa Rica's crude birth rate, 25 per thousand, is the lowest in Central America, but the pace of fertility decline has slowed. Lack of economic opportunity for women may be at fault. The ratio of women to men in the Costa Rican workforce is only 28 to 100—almost half that of the developing country average. Basic educational opportunities (also linked to declines in fertility) are about equal for men and women as reflected in high literacy rates and secondary school enrollments.

Land and forest resources are threatened in Costa Rica by expanding cattle pastures rather than large increases in cropped areas. Between 1963 and 1984, cropped area increased by less than 10 percent. (An additional 42 thousand hectares were cultivated— less than 1 percent of the total land area.) During this same period, pasture land almost doubled to encompass over 50 percent of the land area of the country. Only about 10 percent of the country's land area, however, is considered suitable for pasture, so forests were squandered and soil resources washed away as the pastures moved on to steep and fragile slopes.

Land tenure policies in Costa Rica invite the poor and landless to invade marginal forested areas, but the mechanism differs from that in the Philippines. The government of Costa Rica, instead of trying unsuccessfully to keep migrants out of the forest, has granted squatters provisional rights to any under-utilized public or private land that they occupy. Squatters can receive provisional rights to land that they have partially cleared after occupying the land for only a year. Then they can sell the land to a speculator or cattle rancher who can receive full title to the land. Government incentives for cattle ranching in the past have buoyed demand for land in Costa Rica and have given professional squatters a compelling opportunity to make a business out of clearing land merely to sell their "improvements" and move on to repeat the process. As a result, the average migrant in Costa Rica deforests a much greater area than the average Philippine migrant does.

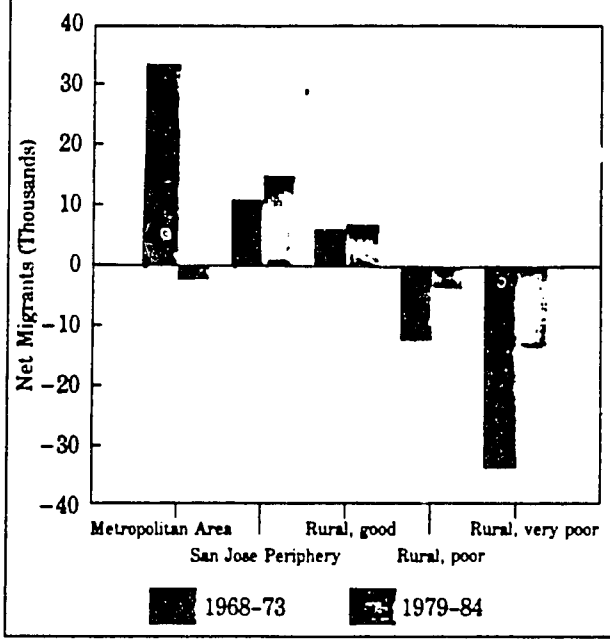
Migration patterns in Costa Rica also changed dramatically as unemployment grew and wages fell during the debt crisis in the early 1980s, which was shorter than in the Philippines but also more severe. In just two years—1981 and 1982—real wages dropped by 30 percent and unemployment doubled. Rural areas became the refuge for those with nowhere else to turn.

Net in-migration made up 6.9 percent of the San José Metropolitan Area population in 1973, but during the 5-year period up to 1984—which included the two years of deep recession—migrants leaving the metropolitan area exceeded those entering. *(See Figure 2.)* At the same time, net out-migration from rural areas with poor or very poor land resources dropped dramatically. Four times as many squatters received rights to land in the period of economic crisis as did in the 1968–73 period. The vast majority of these—85 percent in 1979–84, or 13.7 thousand individuals—settled in districts of poor or very poor lands that were not suitable for agriculture.

RECOMMENDED ACTION

Recognizing the interconnectedness of population growth, poverty, and resource policies can make for improved policy intervention. Economic policies that help alleviate poverty in developing countries can have important environmental benefits. Land tenure policies

Figure 2. Net Migration in Costa Rica 1968-73 and 1979-84



are also powerful instruments of environmental policy. Health and family planning programs that reduce birth and death rates can promote sustainable development. Successful intervention will require attention to a broad range of issues.

In Costa Rica, even though incentives to cattle-ranching have apparently been removed, the granting of rights to squatters who fell trees remains a deeply ingrained institution that must be broken. Economic policies should stimulate broad-based growth to reduce poverty and provide economic opportunity, especially to women, who are under-represented in the Costa Rican workforce. Fertility rates are still high for a country with good health and family planning services. Government's recent recognition of the need to lower population growth rates must be translated into action.

Although in the Philippines the task is more daunting, changes in policy can alleviate poverty and environmental stress and bring population growth rates down. Extending enforceable property rights to indigenous agriculturalists is a necessary first step, making a reality of their constitutionally recognized rights. Since most of the Philippine population lives in poverty, economic growth that generates employment must be a priority. And finally, the scope for improving health and family planning services is very large. Fertility rates cannot be expected to come down until these basic services are available to the poor and in rural areas.

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news release

Inter-American Development Bank
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FOR IMMEDIATE RELEASE

August 28, 1992
NR-93/92

BICYCLES: AN OLD IDEA THAT KEEPS GETTING BETTER

Nonmototized transport can provide sustainable mobility

Ask a citizen of a developing country to imagine the transportation system of a modern city, and the image most likely to come to mind is a metropolis crisscrossed with roads and belted with highways.

Ask how he or she would personally prefer to travel around, and the answer is likely to be: "In a car."

According to an article in the current issue of the Bank's monthly publication The IDB, such ideas, while widespread, are both unrealistic and ill conceived as guides for sustainable transportation systems in the developing world. They reflect what a growing number of development specialists see as a "cultura of motorized developmentalism" that serves the interests of a small elite of car owners, while leaving the transportation needs of the vast majority unmet.

Millions of working people in developing countries have discovered a far better transportation alternative on their own: the bicycle. In "The Cycle Solution," The IDB presents the findings of experts from around the world gathered for a conference on nonmotorized transport at Bank headquarters in Washington, D.C. They described how bicycles and other forms of nonmotorized transport provide an inexpensive and efficient means of mobility that is virtually nonpolluting. The article suggests how planners and development agencies can support this appropriate technology solution to the developing — and to a significant degree, the developed — world's transportation needs.

Bikes are better. Fewer than 1 percent of people in developing countries can afford their own automobile. By contrast, bicycles and other forms of nonmotorized transport are within the reach of millions of the working poor. In fact, nonmotorized transport today accounts for the majority of person-trips around the world, as well as a large percentage of the transport of goods.

The environmental benefits of bicycles are perhaps their greatest advantage. A person traveling ten miles on a bicycle expends barely 350 calories, while the same trip by car consumes 18,600 calories (in a half-gallon of gas), or more than 50 times the energy, while also contributing to air and noise pollution.

Urban and transportation planners in developing countries have yet to grasp fully the importance of nonmotorized transport, instead concentrating on building roads for motor traffic. This has created a situation in which "mobility for a minority reduces the quality of life for the majority by diverting resources from other social priorities and by degrading the environment," according to Ricardo Neves, of the Institute of Technology for the Citizen, in Rio de Janeiro, Brazil.

What can be done to encourage the use of bicycles and other forms of

nonmotorized transport? The article suggests the following:

- Raise awareness among transportation planners and development experts of the value of nonmotorized transport. Provide bicycle safety education.
- Integrate motorized with nonmotorized forms of transport by including bike lanes, public racks, and other facilities in transportation systems. • Encourage land-use patterns that reduce the demand for motor transport.
- Remove government and development agency subsidies to motor transport. Reduce tariffs on imports of bicycles and bicycle parts.
- Establish credit programs for lower income people to purchase bicycles, and support microenterprises that make or repair bicycles and parts.

Other stories in The IDB's August issue:

- Ecuadorans turn barren landscapes into tree plantations.
- Chile launches a joint government-private sector effort to help the hard-to-employ enter the labor force.
- An NGO in the Dominican Republic is helping to finance thousands of local microentrepreneurs.
- Uruguay announces the region's first comprehensive environmental plan.

For more information, or to obtain photographs, call:
Donna Eberwine (202) 623-2319

THE FINANCIAL TIMES, September 30, 1992

India's dam-busters

Environmental concerns threaten the future of a $3bn World Bank development project, writes **Stefan Wagstyl**

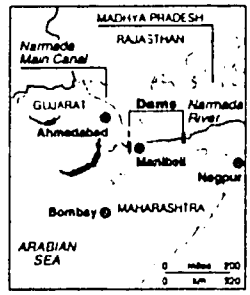
Manibeli, a village of thatched huts, muddy river banks and an ancient stone temple, will tomorrow top the agenda at a World Bank meeting in Washington. The bank's directors are due to debate the future of one of the bank's most controversial large-scale development projects – the construction of a huge dam across the Narmada River in north-western India.

The $3bn (£1.73bn) project will supply drinking water to about 30m people through a 75,000km network of canals, the world's largest, and generate torrents of electricity. However, it will also flood – partly or completely – land belonging to some 240,000 of India's poorest people. They include tribal villagers, such as the inhabitants of Manibeli, which is located on the Narmada in Maharashtra state.

Most of the 230 families of Manibeli have already moved out to resettlement sites purchased by the dam authorities. But most of the 30 or so who remain say they are ready to drown rather than move from their land or the surrounding forests which provide them with food, firewood and medicinal herbs. Mr Narayan, the 45-year-old headman, says: "We will not leave; our parents are buried here."

The villagers' stand has brought to a head the long running battle over the dam's construction. Critics, led by environmental lobbyists, want it stopped on the grounds that too little consideration has been paid to the protection of local communities or the environment. Supporters – including the World Bank – say the benefits outweigh the costs and that displaced villagers are being resettled on better terms than in previous schemes.

The project was first discussed as long ago as 1946 and the foundation stone was laid by Jawaharlal Nehru, India's first prime minister,



in 1961. However, the scheme was delayed by protracted disputes between the three states through which the Narmada flows – Gujarat, Maharashtra and Madhya Pradesh. It was 1979 before they were resolved and 1985 before the World Bank approved a $450m loan.

By then, environmental lobbyists, both in India and elsewhere, were winning public support for their concerns about large-scale construction schemes. In 1986, Mr Rajiv Gandhi, the late prime minister, acknowledged that India's big dams had failed to deliver the promised benefits. "Perhaps we can safely say that almost no benefit has come to the people from these projects."

Mr Gandhi and the World Bank saw the Narmada scheme as a chance to learn from past mistakes. They insisted the three states leading the scheme compensate displaced villagers in ways which safeguarded their economic and social well-being. They also demanded a detailed environmental master plan.

However, even though large-scale construction started in 1989, the three states failed to meet the conditions imposed upon them. A trickle of complaints from environmental activists became a flood, and last year the World Bank ordered an unprecedented independent review by Mr Bradford Morse, a US development aid administrator.

Mr Morse's report, delivered this summer, shocked the bank. He concluded that most of the environmental lobbyists' complaints were justified. "The projects as they stand are flawed, resettlement and rehabilitation of all those displaced by the projects is not possible under prevailing circumstances, and the environmental impacts of the projects have not been properly considered or adequately addressed," Mr Morse wrote.

He expressed particular concern about compensation for those villagers whose rights to land had never been recorded and about the continuing absence of any environmental master plan. Mr Morse stopped just short of recommending abandoning the project.

World Bank experts accept many of Mr Morse's criticisms, but argue there is time to make improvements before the main dam's completion in 2000. The three states make the same point, adding, belligerently, that the dam will be built with or without the World Bank.

The bank's directors are unlikely to abandon the main dam and canals when they met on Thursday. But they could well refrain from funding other dams the states plan along the Narmada. And they could insist that Mr Morse's objections are met before more bank money is spent on the scheme.

That will not entirely satisfy the Manibeli villagers. But they will have the comfort of knowing they have secured better compensation than they might have thought possible even a year ago. Moreover, they will have helped to force a wholesale reappraisal of the project – and, by extension, of the value of large-scale irrigation schemes everywhere. As a World Bank official in India says: "We have learnt some important lessons here."

1992 Called the Year of Population at the ADB

Africa's population is called its most valuable resource. But it has also been referred to as an impediment to sustainable development, as the continent's poor economic performance over the last two decades has barely matched its population growth rate. Last year, a population growth rate of slightly more than 3 percent—the highest in the world—outstripped the continent's real GDP growth rate of 2.4 percent. With Africa's population of over 640 million expected to swell to 1.6 billion by the year 2025, demographic issues will pose a challenge to African policy-makers into the next century.

Margaret A. Novicki

ADB President Babacar Ndiaye

While such issues have grown in importance to African governments and donor agencies since the mid-1980s, the only African multilateral lending institution—the African Development Bank (ADB)—has not had a population policy. But in line with the Bank's growing commitment over the last few years to assisting people-centered development, this is about to change.

"1992 may rightly be called the year of population in the African Development Bank," the institution's president, Babacar Ndiaye, told development experts who assembled on the 18th floor of the Bank's headquarters in Abidjan on September 1 to kick off a three-day conference on "Population Growth and Sustainable Development." The institution had indeed been examining population issues throughout the year. The Bank's board of governors held a symposium during their annual meeting in May to "exchange views on population growth and its implications on the development prospects of the region," and the focus of the ADB's 1992 African Development Report was on population issues. The conference itself brought a wide array of experts to the Bank, including participants from NGOs, the research community, and African youth, as well as representatives from multilateral and bilateral agencies.

Ndiaye also noted that the ADB had benefitted from the treatment of population issues in Agenda 21, the plan of action for cleaning the environment adopted at the Rio de Janeiro Conference on Environment and Development in June. The Bank will gain further exposure on population issues in December at the All-Africa Population Conference in Senegal, which will bring together African government representatives. The Bank president said, "All this exposure, experience, and reflection will provide us with a clear sense of direction in establishing the Bank's policy on population." The ADB expects to have completed a population policy paper by the end of the year, and a sector policy paper outlining the Bank's criteria for funding projects related to population is also in the works.

Africa's population explosion began in the 1960s because rapidly decreasing mortality rates—due to drastic improvements in health care—were not met by significant changes in fertility rates. Despite the burgeoning population, the prevailing view among African government representatives who met in 1974 at the World Population Conference in Bucharest was that "development is the best contraceptive," and little was done to actively address the issue. But by the 1984 Second African Population Conference in Arusha, the poor economic performance of the continent had led many policy-makers to assert that Africa's rapidly growing population was compounding the continent's economic woes. The conference issued recommendations to integrate population into development planning, and adopted the Kilimanjaro Program of Action on Population, which called on governments to ensure the availability of family planning services. Many African countries still remain at the formulation stage of population policy.

External assistance to African nations pursuing population policies has grown in the last 10 years in the context of the donor community's embrace of "development with a human face." The multilaterals leading this assistance have been the United Nations Fund for Population Activities (UNFPA) and the World Bank. By far, the leading bilateral actor in population activities has been the U.S. Agency for International Development, and several foundations and NGOs have also been involved.

The Bank believes that it is crucial to tailor its role to the major actors already active in population issues and recently signed a working agreement with UNFPA. The chief of the ADB's environment and social policy divisions, Lual Deng, who organized the Bank's population conference, told *Africa Report*, "We are not trying to invent the wheel. There are already people there—donors—who are doing well in population. They know how to design and implement policy and we're going to rely on that."

But the Bank also feels that it can contribute to existing policy. It has focused considerable attention on developing the multi-sectoral approach to population policy. Indeed, this was a main theme of the Bank's population conference and was cited by Norway as one of the main reasons that it contributed $500,000 to co-fund the event. Norway's chargé d'affaires in Abidjan, Erling Skjønsberg, said, "For a number of African countries, it is urgent to elaborate effective comprehensive population policies that can be integrated with social, environmental, and economic aspects of development...This forum will have a considerable impact on development if it succeeds in contributing to the elaboration and implementation of [such] policies."

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The Bank plans to hinge its population policy on three core sectors: education, health, and development. In articulating the Bank's envisioned policy at the start of the conference, Ndiaye said, "The focus of the Bank on these three sectors emanates from the fundamental reality that there are linkages between the dynamic factors of population growth and the dominant cultural values: education, health, poverty, status of women, environment, and the state of development of social services."

He added that the Bank believes that "a well-articulated population policy would ensure that population activities are formulated and executed within the framework of a national development strategy that combines economic growth with poverty reduction, and the protection of the environment."

When pressed to name a priority sector in the context of population policy—the ADB is adamant about taking an integrated approach to the issue—more than one Bank official surmised that the most efficient sector to assist is education. Ndiaye pointed out that "the education of women is a priority concern in addressing population issues such as family planning and nutrition." Some demographers at the conference noted, however, that the link between fertility rates and the level of woman's education was not a linear one, with women who have had only a few years of education frequently having higher fertility rates than women with no education at all. Nonetheless, virtually all participants agreed that improved access to education at the secondary school level for women is the most effective means to reduce fertility.

The Bank's virtually all-male leadership came under some good-natured scrutiny when Wagaki Mwangi, editor of the Kenyan publication, *Econews Africa*, read from a list of recommendations for an ADB population policy made by a working group which examined population and women in development. She said, "We...need to ensure that women are in key decision-making levels to influence...policy—for example, having women at the ministerial level or for that matter in the leadership of the ADB!"

Mwangi, in her twenties and at the conference as a representative of Africa's youth, said that very few people at the conference were discussing the involvement of the youth in the formulation of population policy, even though they are the main target of this policy. One of the most striking features of Africa's demographic breakdown—and one of the biggest challenges facing policy-makers—is that 45 percent of the continent's people are under age 15.

At the conclusion of the conference, the Bank was expected to incorporate many of the participants' recommendations into its comprehensive document on population issues, strategies, and policy measures, and consider them in finalizing its sector policy paper. A Bank official also said the conference proceedings could be offered as an input to the December All-Africa Population Conference.

The ADB's strides in articulating a comprehensive population policy over the last year have been impressive, but as environment and social policy divisions chief Deng stressed, "The implementation will be the problem, not the policy." Responding to assertions that Africans were particularly resistant to population policy, the president of the International Planned Parenthood Federation, Dr. Fred Sai, pointed out that implementation is also difficult in Europe where governments have been unable to boost fertility rates. Given the limited resources of African countries, a Bank official said there is still a lack of appreciation that population policies should be a priority.

The ADB recognizes that it must increase its assistance to the social sector within the context of its integrated approach to development. The ADB Group (which includes the Bank, the African Development Fund and the Nigeria Trust Fund) reports cumulative lending to this sector of slightly over $2 billion during 1967-91, which is roughly 9 percent of its lending during the period. An important step toward the Bank's goal of increasing its assistance in a comprehensive way will be the completion of its population sector policy paper.

The ADB's 1992 African Development Report suggests that the Bank may initially concentrate on giving assistance to countries which have explicit population policies, but are not currently receiving a high level of donor assistance.

While donors express interest in funding the social side of Africa's development, population experts have expressed concern that this will be done without participation at the grass-roots level and as a result may prove ineffective. In addition, virtually all population experts recognize the need for better data on Africa's demographic trends. But Ethiopian Almaz Eshete, who presented a paper to the ADB conference, said the available data "is adequate for starting."

Ethiopian Almaz Eshete said the demographic data "is adequate for starting."

Eshete's view is shared by donors, many of whom have said that they are offering resources now for projects which they feel will work. Deng added to this argument that "policy is flexible and subject to review," noting that in three to five years the Bank will adjust its population policy.

Donors have responded to calls for participation of the people they are assisting by presenting population policies which stress self-determination. One of the guiding principles of the British Overseas Development Administration's approach to population in development is the recognition that "countries whose governments establish a climate within which couples can exercise reproductive choice should eventually attain population growth rates that are in balance with their economic and natural resources."

But Professor Charles Westoff, director of the office of population research at Princeton University, brought up the point that "if unmet demand [for contraception in Africa] were to be satisfied, the total fertility rate...would come down by about 20 percent." He noted that this would still leave the fertility rate at about

Continued on page 11

Population *Continued*

five, far in excess of its replacement level of 2.1 births per woman.

Westoff said this presented a need "to motivate people to be interested in smaller families...whether the motivation be cast in terms of infant or maternal health or economic self-interest."

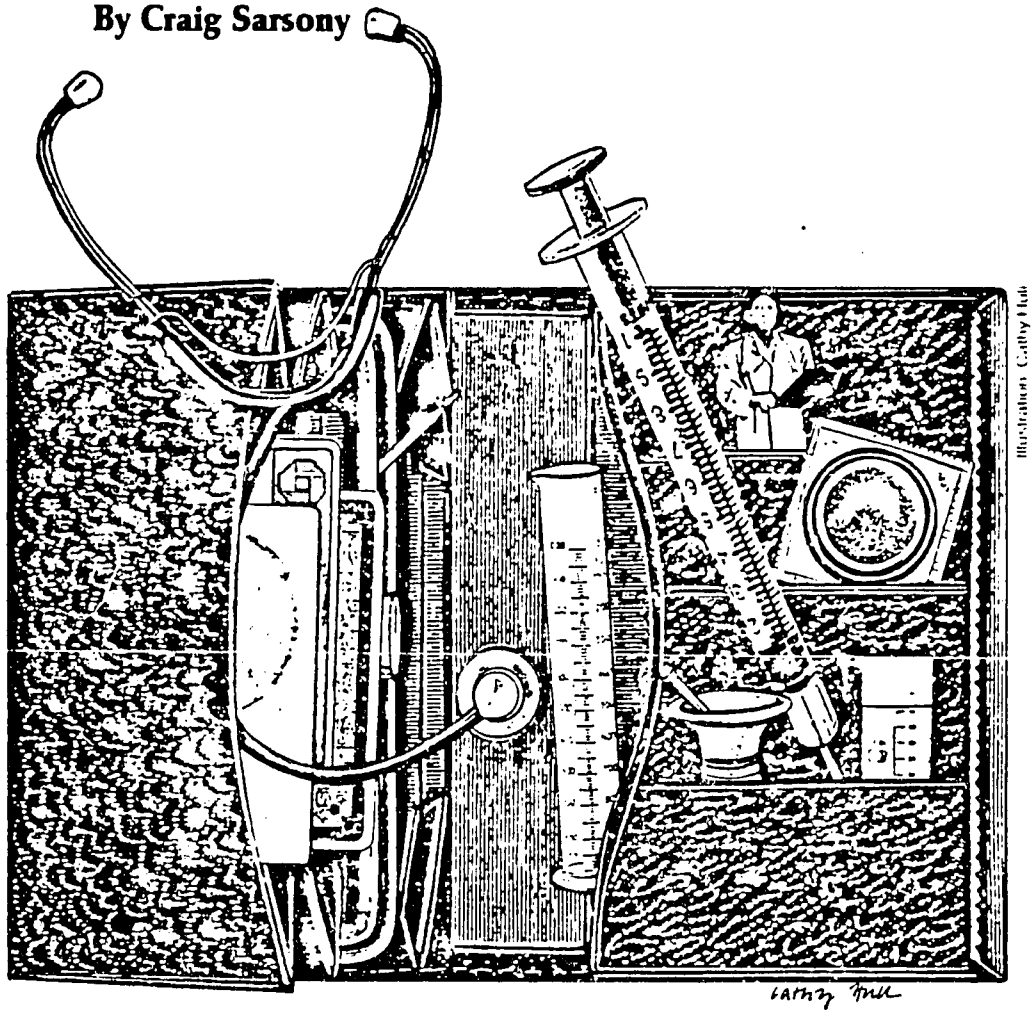
The underlying goal of the Bank's multi-sectoral approach to population policy is to increase the demand for smaller families, which essentially means to decrease fertility. The All-Africa Population Conference in Dakar will give the Bank and other population policy actors a better idea of how dedicated African countries are to implementing integrated development policies. The decisions made at the conference might not be implemented for two to three years, and the effects on African populations themselves might not be seen for 10 to 15 years. In the meantime, Africa's population—fueled by the continent's greatest asset, its youth—may continue to grow at the highest rate in the world. ■

V I E W P O I N T

Debt Swaps for AIDS

By Craig Sarsony

Through debt conversions, countries hard-hit by HIV/AIDS could expand national health programmes aimed at curtailing the epidemic.



AIDS is not affecting all nations equally. Worldwide, an estimated two-thirds of reported HIV infections are in countries of the developing world. By 2010, according to the World Health Organization (WHO), this share could go as high as 90 per cent. Hit hardest by AIDS, developing countries can least afford to confront it.

While the majority of HIV infections among adults is currently in sub-Saharan Africa, experts warn that the incidence of HIV/AIDS in South and Southeast Asia is growing at a pace reminiscent of sub-Saharan Africa in the early 1980s. Similarly, in Latin America and the Caribbean, HIV/AIDS is expected to spread dramatically over the next two decades.

As the human toll of HIV/AIDS escalates, so does the devastation wrought on local economies. A shrinking work force means shrinking productivity, markets and investment. Add to this the burgeoning health costs associated with the disease and the result is a major threat to the development prospects of many countries. Faced with this spectre, governments are looking for creative ways to

step up prevention and control programmes and meet skyrocketing medical costs.

One strategy that merits close attention is a financing mechanism involving debt swaps that has already proven successful in areas such as the environment, child survival, education and agriculture. The same approach could be employed to help developing countries raise much needed cash in the fight against AIDS.

Under a debt conversion, a development organization first purchases a debtor nation's unpaid loan from a commercial bank at a discount. The debtor government then repays the buyer (the development institution) at an amount greater than the purchase price, with the agreement that all of the funds be spent on development. The funds put up by the developing country are in local currency, thereby eliminating currency conversion costs. The developing country benefits in two ways: by ridding itself of an unpaid loan while at the same time helping finance a necessary but otherwise unaffordable development programme.

This creative approach to development financing has grown in popularity in recent years, as commercial banks have become more willing to sell overdue developing-country loans for less than their face value. A 1987 agreement between Conservation International and the Government of Bolivia to cooperate in a US$650,000 debt-for-nature swap, and another valued at $1 million between the World Wildlife Federation and Ecuador, are two of the earliest examples of debt conversions that have set the stage for others to follow. Debts of $500 million to $750 million have since been converted through this mechanism to provide funding for development and conservation programmes in Africa, Latin America and Asia. Debt conversions that have been completed in Ecuador, Mexico, Nigeria and the Philippines have boosted project funding by 25 per cent to 100 per cent in some cases.

One current example is an agreement being negotiated between the Government of Nigeria and the River Blindness Foundation (RBF). The debt swap will provide about $500,000 needed for the mass distribution of Ivermectin, a drug used to combat onchocerciasis, or river blindness, which is provided free by its US manufacturer, Merck & Co. Under the transaction, RBF will purchase a $1 million Nigerian debt from a commercial bank at about 40 per cent of its face value, or $400,000. The Central Bank of Nigeria will then pay the Foundation 50 per cent of the original debt in Nigerian naira, which will help fund the national Ivermectin drive. By using the debt conversion mechanism, the number of Nigerians receiving this important drug will increase significantly. The government will clear its books of an outstanding obligation and the commercial bank will recoup part of a loan that was not being serviced.

Debt swaps to raise funds for the prevention and control of HIV/AIDS would work in much the same way as the RBF initiative. Through debt conversions, countries hard-hit by HIV/AIDS could afford to expand national health programmes aimed at curtailing the epidemic. This could lead to increased numbers of clean blood units, improved treatment facilities and more widespread and effective prevention campaigns.

Debt swaps have grown in popularity in recent years as commercial banks have become more willing to sell overdue developing-country loans for less than their face value.

There are excellent debt conversion opportunities in many countries at risk of HIV/AIDS, including Ecuador, Mexico, Nigeria, the Philippines, Tanzania and Zambia. Development organizations operating in these and other countries should explore expanding their resources for HIV/AIDS programming through this approach. Governments in countries which do not yet have debt conversion programmes may want to consider the value of this strategy in mobilizing funds for HIV/AIDS campaigns as well as other priority areas. ■

Craig Sarsony, MBA, MPH, is senior manager of transactions at the Debt-for-Development Coalition, Inc. in Washington, DC, a non-profit organization specializing in debt conversions. Mr. Sarsony looks for new strategies to finance public health programmes.

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Gender Differences in Refugee Health

Sarah E. Moten, Deputy Assistant Secretary for International Refugee Assistance

Address before the Institute of Medicine's annual meeting, Washington, DC, October 20, 1992

It is truly a pleasure for me to be with you today, despite the early hour of the morning. Many thanks to Dr. Cassells and other members of the Committee on Health and Human Rights here at IOM [Institute of Medicine] for putting together the workshop this morning. Although it's almost too early to talk shop, I am always happy to discuss a group of people who are near to my heart: refugee women. From the day I began my tenure in [Department of State's Bureau for] Refugee Programs over 3 years ago, I have tried to be an advocate and a voice for millions of refugee women. I am continually impressed with the power, dignity, and strength that the refugee women I've met on monitoring trips to Africa, South Asia, the Middle East, and Southeast Asia have demonstrated in efforts to empower themselves under very difficult circumstances.

The subject chosen for today's panel—gender differences in refugee health—is certainly timely. Because of the number and scale of emergencies worldwide that have forced individuals, families, and, in some cases, whole communities to flee to safety, I would like to focus on the health needs of refugee women in emergency situations—although please keep in mind that many of the principles that I will discuss with you today go beyond emergencies and should be applied to longer-term refugee assistance programs.

I'm sure that you all have been reading the gruesome details of what has happened to the people of the former Yugoslavia and of the conflict and starvation that has devastated Somalia. Hundreds of thousands of refugees have been forced to flee to neighboring countries in the Horn of Africa. I'd like to tell you about a lesser-known refugee emergency. Although it has not graced the front pages of the newspapers for months, it deserves our attention for efforts by the UNHCR [UN High Commissioner for Refugees] and the asylum government to provide appropriate and accessible health care services, particularly to women.

Early this year, a flood of approximately 265,000 Rohingya Muslims, many of them women, crossed the Burmese border into Bangladesh to seek refuge from persecution by the Burmese military. Unfortunately, despite efforts by UNHCR, non-governmental organizations, and the Government of Bangladesh to provide health care to the refugees, UNHCR officials learned 3 months into the crisis that twice as many women were dying as men. In contrast, health data collected also indicated that outpatient visits to camp health clinics were much higher for men than for women. Relief officials had not focused on the particular needs of refugee women. Attention to the health needs of refugee women is so important in an emergency situation. Let us return to the Bangladesh example in a few minutes. First, let me tell you about health considerations for refugee women as target beneficiaries.

Assistance affects the health of refugee women in a number of ways. Take, for example, food distribution systems. If the food distribution system and the food basket are not constructed with the needs of refugee women in mind, malnutrition can become a serious problem, especially for pregnant or lactating women—particularly since, in many cultures, women are responsible for preparing, cooking, and allocating food in the household. Certain cultural practices, specifically those in which men eat first [and] women eat last, can also be a problem. To mitigate these problems, food rations should be distributed directly to refugee women, who in most societies are responsible for feeding the family. Male food networks have, in too many refugee situations, been responsible for the diversion of food to resistance forces or the black market.

The availability, location, and quality of water supplies can also affect the health of refugee women. Contaminated water supplies can lead to a number of water-borne diseases which affect refugee women more than the rest of the refugee community owing to the time they spend gathering water, washing clothes, and bathing children. Water must be conveniently located to minimize the risks taken by refugee women while undertaking daily chores. Water supplies located too far from refugee homes may discourage women from collecting an adequate supply of water for their families or can cause health problems for women who have to carry water for long distances.

Finally, the accessibility to health services is especially important for refugee women. Owing to cultural reasons, some women may be reluctant to seek health care from male providers. If the health care services are not easily accessible, women may hesitate before bringing themselves or their children to seek medical attention. Since 80% of the world's refugees are women and children, providing a sufficient number of female health workers, adequate clinic hours, and convenient health services is crucial to the health of the entire refugee family. Another important aspect of health care for refugee women is mental health. Refugee women have often fled unspeakable circumstances in their home countries. Along with traditional health concerns of women, mental health services in refugee camps and settlements need to be established to handle the number of cases of emotional trauma associated with fleeing persecution, social disruption, physical violence, and lack of [a] traditional support system.

In short, the full and effective participation of refugee women in food, water, and heath care services is absolutely necessary.

Let's return to the Bangladesh example. The Rohingyas fled to Bangladesh for a number of reasons. Religious sites were desecrated, men were taken for forced conscription, and an unusually large number of women reported having been raped. Although, by and large, the refugees report that they left Burma for several reasons, a significant number of families said that they left because the sanctity of the family had been destroyed with the abuse and torture that many women suffered. UNHCR was asked by the Government of Bangladesh in mid-February to assist in coordinating the relief operation to provide aid to the thousands of refugees who were entering Bangladesh each day. After undertaking an initial needs assessment, UNHCR enlisted the support of several international and national non-governmental organizations to implement, among other things, health, nutrition, and sanitation programs. The goal was for UNHCR to bring the international community's attention and resources into Bangladesh, thereby supporting a country which is already overpopulated and has limited resources of its own to contribute.

Since we are focusing on health issues in this workshop, I'd like to talk a little bit about the way health care was provided to the Burmese refugee women. When I was in Bangladesh last April, there were approximately 12 refugee camps. (There are a few more now.) In each camp, the Government of Bangladesh's Ministry of Health operated an outpatient health clinic (in some camps, several beds were held for in-patient care) which provided basic curative care—for example, diagnosed ailments, distributed pharmaceuticals, as well as other limited services. In addition, UNHCR assigned at least one non-governmental organization to each camp to fill in the gaps left by the government health care services. At the beginning of the emergency, the non-governmental organizations focused on child immunizations, supplementary feeding, and limited curative services. Some non-governmental organizations had a more community development/primary health care approach. Health care workers made home visits.

In Bangladesh, in the early months of the emergency, the primary causes of death were malnutrition, diarrhea, acute respiratory infection, and malaria—all of which are easily treatable and, in most cases, preventable. UNHCR worked to provide adequate food rations to families, widespread immunization of children under 10 years of age, clean and plentiful water supplies, adequate sanitation in the camps, and proper shelter for all refugees.

Owing to cultural considerations, women were reluctant to visit clinics staffed primarily by male health workers. The central location of the health facilities in the camps were inappropriate for women whose time was consumed by collecting water, preparing meals, caring for children, and multiple other tasks, particularly for female-headed households. Time was not available to go to the clinic either for treatment or to collect information to prevent disease.

UNHCR identified the urgent need for more community-based health care. Preventive and curative health services were expanded rapidly in order to identify ill patients quickly and to provide health education. Satellite health posts were created throughout the camps from which outreach teams would visit sheds and provide routine care and health education. Emphasis was placed on massively increasing the number of female health care workers. The government and non-governmental organizations were encouraged to designate at least 1 day per week for women to seek care and provide maternal/child health care services. Although refugee participation in assistance programs was prohibited by the government, relief officials made a concerted effort to involve refugee women in decision-making, particularly decisions concerning expanded health care facilities. Women were asked why they were reluctant to seek medical attention. Time, distance, and cultural barriers were most often provided as the reason that women were not visiting the clinics in the same numbers as men. Community-based health services were viewed as the answer to decreasing mortality rates for women.

To some extent, UNHCR has successfully used this approach to reduce morbidity and mortality rates in the Burmese refugee camps in Bangladesh. But there is at least one lesson to be learned from this emergency. If we knew the characteristics of the refugee population from the needs-assessment stage of the emergency, we would have been better able to provide adequate and appropriate health care services from the beginning. UNHCR's needs-assessment team estimated the demographic breakdown of the refugee population not from concrete information collected from registration forms, independent calculation, or information from camp officials but based on the "typical" refugee population breakdown. Neither the actual demographic breakdown of the population nor cultural considerations were taken into account in [the] programming, budgeting, or planning exercise. It is imperative in any emergency that we know who our target beneficiaries are.

In many ways, the relief operation in Bangladesh has been deemed a success, largely owing to the efforts to UNHCR. However, it's disappointing from a donor's point of view that simple programming tools like the demograph breakdown of the refugee popul ion, the early participation of refugee women in the planning of health service programs, or cultural factors gleaned from other refugee situations are still not utilized. For example, from its genesis, UNHCR's programs in Pakistan have used a community outreach program with female health workers. Knowing that the population crossing into Bangladesh was also Muslim, could UNHCR not have implemented a similar program there? While we compliment UNHCR for an aggressive campaign to decentralize the health services and focus on preventive health care in the Burmese refugee camps, there is room for improvement. We hope that for the next emergency, lessons learned can be applied.

Thank you very much for inviting me to speak with you today. I've enjoyed it and hope that you have many questions, so that we can talk further about refugee women and health. This is a particularly important issue since the number of emergencies worldwide are increasing and along with them the number of refugees are also growing. ■

Zambia

Women clean up shanties

Heaps of rotting domestic garbage pile up at the edges of shanty compounds, often impeding access and drainage. Potholes on roads, so many that you have to be drunk to drive in a straight line. Communal water collection points, more like flooded refuse dumps covered with slime. Broken sewerage systems, spewing effluent around homesteads and down roads.

Photographic images like these are familiar in many a developing country, but this montage is one of the dreary and dusty, sometimes muddy shanties that have mushroomed in Zambia's major cities and towns. At least 1.5 million people live in the slum settlements, many underemployed or unemployed.

Zambia is the most urbanized country in Africa, with most of its eight million people living in the major cities. Once one of the most prosperous countries in Sub-Saharan Africa, Zambia is today one of the world's most impoverished nations. Nowhere is the poverty more evident than in the shanties, where the majority of urban dwellers live.

Kanyama, Misisi, Chawama, Mtendere, Kalikiliki, Chipulukusu — the list of settlements appears endless. These shanties have no surface-water drainage or adequate sanitation. When it rains, yards and roads become muddy, making them ideal breeding grounds for cholera, malaria, dysentery and other waterborne diseases. Such diseases are taking a heavy toll among Zambians, particularly the poor, as outbreaks become more frequent.

In Chipulukusu, a slum in Ndola, Zambia's economic heartland, more than one hundred cases of cholera were reported between January and March of this year. At least 800 people in Zambia have died from the disease in the last few months.

WFP/Francis Mwanza

Behind a "road works ahead" sign there are usually men working but in Chiupulukusu shanty town, Ndola, it is the women who are mending the roads.

Effects of structural adjustment

In a determined effort to put the brakes on the economic decline and address socioeconomic problems, Zambia has embarked on a structural adjustment programme backed by the International Monetary Fund and the World Bank.

The agreement involves heavy cuts in Government expenditure; elimination of subsidies on the price of maize, the staple food; and the privatization of Government-controlled companies

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aimed to revitalize growth and employment.

But in the short-term, the required measures have fallen heavily upon the poor, especially households headed by women. There has been a heavy reduction in formal employment, as both the public and private sector companies trim their staff. As subsidies have been removed, the price of basic food has increased more than tenfold, while real incomes have tumbled.

There is also an upsurge in infant deaths and malnutrition among children under the age of five. Although exact figures are difficult to obtain, the number of households below the poverty line has dramatically increased.

With worsening revenues and budget cuts, Government support for the maintenance of existing infrastructure and for the provision of services has been considerably reduced, adding another blow to the poor. The situation is most acute in the capital, Lusaka, where more than half of the 1.2 million population lives in unplanned, often illegal shanties.

Helping the poor

To mitigate the short-term negative effects of the economic adjustment programme, a unique coalition of aid organizations is backing Project Urban Self-help (PUSH). A brainchild of the World Food Programme, PUSH combines WFP food aid with funds and technical assistance from UNDP, ILO, UNCHS, non-governmental organizations, and the Governments of Australia, Canada, Switzerland, Sweden, the United Kingdom, the United States, the Netherlands and Norway.

The project was designed to help the Government upgrade basic infrastructure and improve sanitary conditions in the neglected shanty towns, as well as to provide temporary employment for the poor, particularly women.

PUSH started operating in October 1990, building on community work established by a local NGO, the Human Settlement of Zambia (HUZA), in the Bauleni shanty compound of Lusaka. Work then started clearing refuse and unblocking drainage ditches and culverts in the Mtendere and Kanyama areas.

"Community work through PUSH aims at improving roads, drainage and sanitation," said Vicki Mambwe, a Zambian sociologist in charge of the project. "Improving such infrastructures will benefit all the residents of the shanty compounds in which we are operating and should improve the health and surroundings of over half a million people."

PUSH is unlike many other development projects in that all decisions on which projects to undertake, whether road construction, drainage or sanitation, are made by the community itself.

"PUSH presents a viable method of developing urban slums using the skills and energy of the residents themselves," says Tony Momement, WFP Director of Operations in Lusaka. "The project has created a strong community spirit amongst the women as they work together. As they are in charge, they will ensure that their drains, their roads, and their latrines are maintained in the future."

The project has a strong training element, with 12 expatriate and five

WFP/Francis Mwanza

In Kanyama roads are often impassable, especially during the rainy season, due to flooding or the accumulation of garbage. These women, many with their children on their backs, are improving the drains.

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Zambian civil engineers advising on drainage and construction techniques, and training the local technicians and the participants. "These skills ensure that the work produced will last and the knowledge gained gives the participants the self-confidence in their abilities to initiate other community projects," says Tony Momement.

Targeting women

"The project targets the most needy," says Vicki Mambwe. "Only the poor are prepared to undertake manual work in return for basic family food rations."

PUSH has so far created employment for more than 3,000 women, who are paid in daily food rations. "It is better to pay the women with food rather than cash, as the men tend to use cash for beer," said Vicki Mambwe. A common sight near worksites is to see women working while unemployed men are "elbow raising" — drinking beer at the roadside pubs.

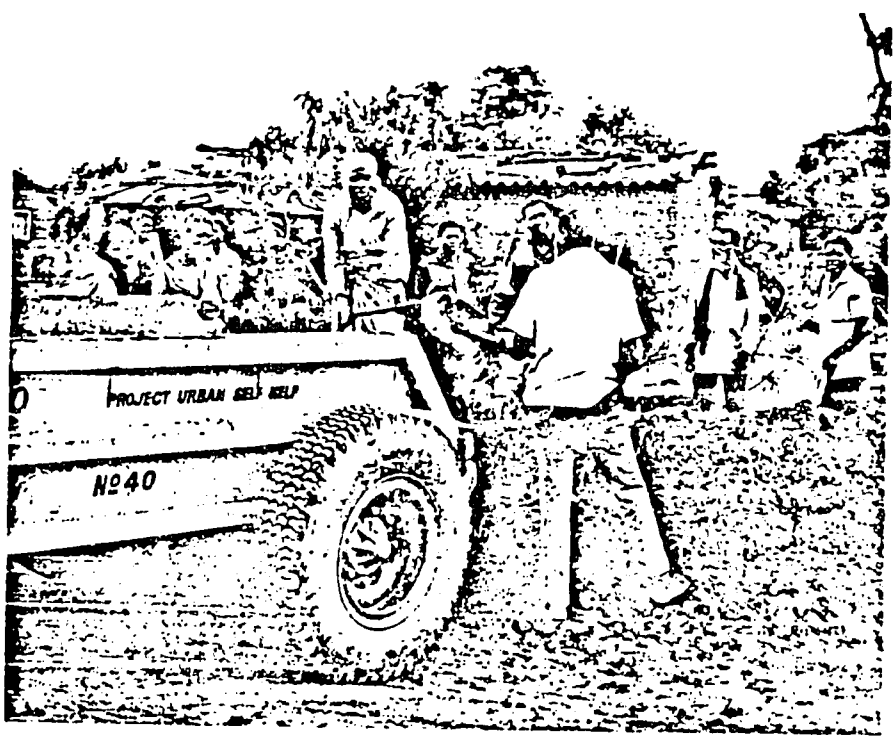
Martha Phiri of Mtendere said that, thanks to the project, she now has adequate food supplies in the home, which previously she could not afford. "My family no longer suffers from food shortages."

The shanties are now a flurry of development activities. Women of all ages, some with babies strapped on their backs, can be seen constructing roads.

"As you can see, the women here do all the road construction — levelling, cambering and constructing culverts," explains Agnes Banda of Lusaka's Kanyama shanty compound, one of the handful of women trained by the project in basic road construction.

Women also remove refuse from their communities, a job that the city councils, hamstrung by a shortage of funds and equipment, have failed to perform. Drains have also been dug to syphon off potential breeding pools for mosquitoes and as a result malaria cases have significantly decreased.

"The more the women see the results of their work the keener they become in participating in the project," said Sarah House, a UNV civil engineer working in Bauleni.



WFP/Francis Mwanza

Most of the participants in the PUSH project are women, but some men help as well.

Improving sanitation

The major cause of cholera and other infectious diseases in the shanties is contamination of surface water by sewage. According to available figures, only 20 to 30 per cent of households have their own pit latrine.

Vicki Mambwe explained that the project will help shanty dwellers construct more than 5,000 pit latrines. "But unlike roads and drainage, which directly benefit the whole community, latrines tend to be private assets. Rather than make an outright gift, we help families to construct pit latrines by providing technical advice on design, loaning tools and providing food rations as compensation for labour and time diverted from their normal money-making activities."

Roads repaired, rubbish removed, ditches dug; a new picture is developing in Zambian shanties — thanks to the women.

by Francis Mwanza

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Assessing adjustment's social impact

Russia's recent tangle with the International Monetary Fund (IMF) has put into the world's headlines — and onto the agenda of Western leaders — what has already been a lengthy debate in Africa on the nature of adjustment policies. The modest returns in the region from a decade or more of tough economic reforms has produced a strong critique of the practice of adjustment and, while the general thrust of IMF/World Bank reforms remains constant, there have been steady modifications to the mix of policies expected from governments.

World Bank

Workers in the informal sector in Côte d'Ivoire. Incomes have been hit as laid-off workers from the formal sector join their ranks.

For Africa, the social costs of adjustment have been one of the most critical areas of this debate and one which is seeing some of the more significant shifts in policy. Two recent studies — one by a US-based, independent research organization, the Alexis de Tocqueville Institution, the other by the Development Centre of the Organization for Economic Cooperation and Development (OECD) — throw new light on the social impact of adjustment and provide suggestions for policies.

The de Tocqueville study, *IMF Conditionality, 1980-91*, discovered a disturbing correlation between undertaking adjustment programmes and a fall in spending on the social sector. In 42 IMF programmes undertaken between 1986-90, the project found that in over 90 per cent there was reduced spending in at least one of the three areas monitored — housing, health, and services such as training, income supplements and social security. In two-thirds of the cases there was an overall reduction in combined spending on the three — measured as a share of gross national/domestic product (GNP/GDP) — and in nearly 30 per cent of the cases the reduction was in excess of 20 per cent. Overall, social welfare spending in the three programme areas fell from a combined country average of 11.1 per cent of either GNP or GDP to 10.2 per cent.

In their primary concern to restore fiscal balances, the IMF advocates measures to both raise revenue and cut expenditure. But a recent IMF publication, *The Fiscal Dimensions of Adjustment in Low-Income Countries*, concluded that governments have generally found it easier to cut expenditure than raise revenues. Although governments generally have the power to choose where to cut, the IMF can play a more active role in targeting areas, particularly in countries undergoing what is termed enhanced surveillance. The study observed that the Fund tended to cut government programmes which it felt transferred services, such as food subsidies, either inefficiently or indiscriminately to poor and not-so-poor groups. Subsidies and housing programmes, because of their usually large costs, have been a favourite for cuts. In contrast, less than 5 per cent of programmes involved any reduced spending for health. Cases such as Ghana, Mozambique and Togo, where social welfare spending was targeted to rise, were relatively rare.

The study also explored the relationship between military and social welfare spending. In 20 countries with extensive conditionality, spending on the military between 1982 and 1990 rose relative to that on social welfare. The record for African countries was mixed, with three out of seven — Ghana, Kenya and Morocco — showing a reverse trend.

Reducing poverty

The study observed that reduced social welfare spending does not necessarily translate into worsening poverty. This can be either because cuts are linked to more efficient and targeted delivery systems, as Fund officials would argue, or through a general improvement in the economy. For programmes undertaken since 1985, the survey found that countries adhering to Fund targets experienced faster growth, from 2 per cent a year to 4.1 per cent. Those that failed to meet targets saw annual growth rates improve only minimally — from 1.1 to 1.4 per cent.

Focusing on social indicators, the study found that food production and consumption per capita, life expectancy and literacy all improved in adjusting countries, though at a slower rate than for developing countries as a whole. But in the area of infant mortality, adjusting countries did even better than the developing country average. This suggests the Fund was able to condition programme support in an area of social welfare "it deemed of exceptional importance."

This also reinforces arguments that adjustment programmes can — and increasingly do — protect social welfare without jeopardizing wider economic goals. Where this might conflict with the Fund's broader macro-economic and fiscal targets, countries could draw on separate funding to meet targets, the study suggested. It also leads to the question of what is the precise mix of adjustment policies which best safeguards the social sector and the interests of the poorest groups. This has been the focus of an OECD study of adjustment and equity in seven countries, including Côte d'Ivoire, Ghana and Morocco. An overview of the main findings from these studies has recently been published in the OECD's *Adjustment and Equity in Developing Countries: A New Approach*.

The social impact of adjustment has been mixed, the overview concluded, with rural areas generally benefitting from adjustment, but not the urban poor. Family living standards improved in rural areas in Ghana and Morocco, the OECD said, though it conceded that the statistical base for this assertion for Ghana was weak. Even the landless benefitted in rural areas of Morocco, the OECD said,

though not in Côte d'Ivoire.

But in urban areas of Morocco and in Côte d'Ivoire adjustment had a generally adverse effect. Unemployment rose sharply in both countries — in Morocco, by 60 per cent between 1982-84. In Côte d'Ivoire, mass lay-offs in the formal sector swelled the ranks of the informal sector. Without this fallback, the study said, the number of unemployed would have tripled and the official unemployment rate would have been 42 per cent rather than 29 per cent.

However, the increase in numbers in the informal sector only put a sharp downward pressure on already low incomes. This was a general trend, the OECD observed: "in every case...average income in the informal sector drops during the adjustment period."

Social services

The OECD studies found that adjustment widely affected public services: some food subsidies were reduced, while per capita expenditure on education and health declined. But the record was usually mixed, the OECD argued, adding that only in Côte d'Ivoire was there an overall fall in public services or transfers.

"In these conditions, family living standards do not necessarily fall during adjustment," the OECD concluded. Instead, individual country circumstances and the mix of policies were the crucial factors. The one structural adjustment measure that had a large social cost, the OECD argued, was reorganizing the public sector. This had often led to a great number of lay-offs, with consequent knock-on effects on the informal sector. When combined with a stabilization programme, this could "create explosive conditions in cities," the OECD observed. Much better, the OECD suggested, was a system for moderate cuts in public sector wages — though many analysts claim these are already too low — or failing that, a system of compensation payments and re-training as in Ghana's Programme of Actions to Mitigate the Social Costs of Adjustment (PAMSCAD).

By helping to fund programmes such as PAMSCAD — which, however, has had a number of problems in implementation — donors could help reduce the social costs of adjustment. But the OECD warned that "the most equitable programme is not always feasible politically." Even the best programmes would involve some social costs, the OECD said, and compensation payments to fully meet these could amount to 1-4 per cent of a country's GDP. Donors "must become involved financially" if this "not negligible" cost is to be met, it concluded. ■

Venezuela: Learn From Mexico

By GEORGE W. GRAYSON

Venezuela's President Carlos Andres Perez — now limping through a second term — could profit from Mexico's example as tension mounts following the Nov. 27 coup attempt, the second abortive putsch by disgruntled officers and enlisted men this year.

Although four times more populous, Mexico has a great deal in common with Venezuela. Both nations are major oil exporters. They boast per-capita income levels that are among the highest in the Third World from which they seek to escape.

Both countries' leaders are impelling market-oriented reforms to spur investment and growth, while diminishing government intrusion into once-hugely statist economies. And corruption abounds in Caracas and Mexico City, as do the poor who live as rag-pickers at the base of distended social pyramids.

These similarities aside, the 70-year-old Mr. Perez's standing in public opinion polls hovers around 9%, while Mexico's chief executive, Carlos Salinas de Gortari, enjoys a 70%-plus approval rating.

What accounts for this difference? Why is Venezuela, which boasts one of Latin America's longest periods of civilian rule, vulnerable to a military takeover at a time when Mexico stands as the region's political Rock of Gibraltar?

To begin with, Mexico's 135,000-member armed forces submits rather than subverts. Thanks to a series of moves — training abroad, rotating commands, purges, budget-cutting and creating a broad-based official party, the PRI — Mexico defanged the huge army that sprang up during the 1910-1917 revolution.

In contrast, Venezuelan presidents, beginning with Romulo Betancourt (1959-64), the father of his country's 33-year-long democracy, have propitiated the military with weapons and money. Venezuela devotes twice as much of its gross domestic product (1.1%) to defense as does Mexico (.5%).

The result is that many army and air force junior officers feel emboldened to challenge civil authority.

Equally important in understanding Venezuela's instability is the treatment accorded its poor, who constitute one-quarter of the country's 21 million inhabitants. Even while achieving a 9% growth rate this year, Mr. Perez has failed — like his predecessors — to use petroleum earnings to uplift his country's have-nots, who live in the fetid slums of Caracas, Maracaibo, Valencia and other cities.

One priest called the situation "a moral problem."

"Venezuelans," he stated, "want a change. It's not just the president but the entire government. They have not honored their promises to help the poor and offer programs for social development."

Not only has President Salinas fought the blatant corruption that alienates less powerful sectors in his country and Venezuela, he has addressed the pressing needs of the poor, who make up 40% of Mexico's 85 million people.

His anti-poverty initiative, for which there is no Venezuelan counterpart, is the Program of National Solidarity (Pronasol), commonly known as Solidarity.

A neighborhood or village eager for assistance contacts Pronasol, which dispatches a representative to an assembly open to all local residents. Eventually the people elect a board of directors, set their priorities and decide whether they will match the government's contribution to, say, the construction of a clinic, with pesos, materials or their own labor — "sweat capital."

In the past, Pronasol coordinator Benito A. Collantes Martinez told me, the decision whether an Indian village in faraway Oaxaca state needed electricity, a school or a paved road was made by "desk-bound bureaucrats in Mexico City." Now, "local folks determine not only what they need most but how they will get it."

To avoid "mordidas," or rake-offs by politicos, Solidarity works directly with community leaders, often bypassing state governors. The program also teaches grass-roots whistle-blowers how to ferret out waste in local budgets.

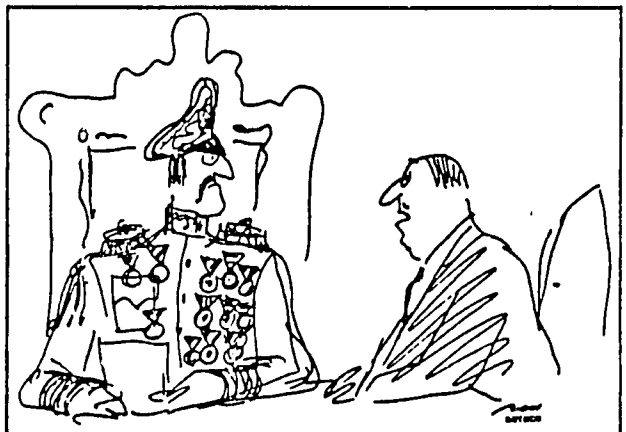
Solidarity's detractors claim that the program enables President Salinas to dispense boodle to burnish his image, reward political favorites, gain electoral support for his party and co-opt neighborhood leaders who quickly learn that Mexico's PRI-dominated regime has infinitely more resources than its foes.

Several of these charges are valid, but opinion surveys reveal that Mexico's downtrodden believe that — for the first time in decades — their president cares about them even as he engineers an economic sea-change by opening the nation to market forces.

Poor, blue-collar and many middle class Venezuelans demonstrate no such confidence in Mr. Perez. They associated him with their nation's oil boom in the 1970s when he first held the presidency. They expected him to restore prosperity when he returned to the Miraflores presidential palace in 1989.

But his indifference to the plight of the average citizen, combined with unlimited tolerance toward corruption — especially by former President Jaime Lusinchi and his entourage — explains a legislative drive to cut short his current five-year term.

If Mr. Perez remains blind to social problems, perhaps his successor will crack down on speculation and earmark more oil income to community development. That is, if the armed forces haven't taken matters into their own hands.



"Medals do not a democracy make, Felipe."

George Grayson, a professor of government at the College of William & Mary, is author most recently of "The Church in Contemporary Mexico."

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THE JOURNAL OF COMMERCE, October 14, 1992

China Tackles Labor Unrest

By MARY CHILD

ASIA VIEW

HONG KONG — When Harvard economist Jeffrey Sachs, guru to reforming socialist economies, met with Chinese policy-makers and economists in Beijing last month, he won no converts to his "shock therapy" school of reform. They have seen what happened when Poland and Russia took his advice — destabilizing, rampant inflation and large-scale unemployment — and they don't feel China can afford that. That's why, despite the Communist Party's imprimatur on a faster pace of reform at the 14th Party Congress this week, the Chinese government won't abandon its piecemeal approach to market reforms.

Beijing won't free all prices immediately, eliminate all state subsidies or privatize every industrial sector, as Mr. Sachs would prescribe. The party considers capitalism a means for creating a "socialist market economy," not an end in itself. Even if the government carries out half of the ambitious reforms set out broadly in the party platform this week, however, China still will be faced with massive labor dislocation and the ensuing social problems. If the government fails at the national level to manage unemployment effectively, the party's sweeping reform program could fizzle.

China's unemployment rate at the moment is officially reported to be 3% and the government has promised to keep it there. The real rate, however, which includes unregistered migrant labor and "on-the-job unemployment," is much higher. Most of the economic reforms set out broadly in the Central Committee's report to the party Congress spell yet more job losses.

The government, for example, will continue to step back from the business of micro-managing state-owned companies, allowing them to operate independently along market principles. It no longer will prop up money-losing enterprises to the tune of 50 billion yuan (US$9.7 billion a year) a year. It intends to foster more privatization. If these reforms are fully realized, at least 20 million to 30 million underemployed people should lose their jobs.

Ambitious plans to restructure and reduce government all the way down to the local level are expected to cost millions more jobs as the government moves away from central planning.

Unemployment has far more potential to disrupt social welfare in China than in a non-socialist country because of the large role work units play in providing benefits. Losing a job with a state enterprise or government unit in China means more than losing a source of cash income. It can mean losing the family apartment, medical insurance, pension, day care, schooling and other benefits that are not readily or widely available or affordable outside the protective nest of the work unit.

On the one hand, enterprise managers have been encouraged by the government since 1985 to make more cost-effective staffing decisions. But they also have been pressured heavily to keep redundant or unproductive employees in their work units so they will remain eligible for benefits. Fortunately, the practice of hiring new workers on a short-term contract basis is increasingly replacing the old lifetime job security system.

At the moment there is no state insurance fund in place to cover laid-off workers, although the legal basis to establish one has been in place since 1986. The new party platform includes a plan to create a national unemployment insurance system. That would give local authorities the financial backing to phase out or transform more money-losing companies. It also should help reduce the incidence of violence toward managers by disgruntled, laid-off workers.

To facilitate the movement and adjustment of labor and to mitigate the pain of unemployment, China must begin to disentangle its social welfare net from the workplace. The government should start by eliminating the free housing system and begin to develop a real estate market to delink housing from job security. The city of Beijing already has begun working toward that end and hopes to have 20% private ownership by 1995. Next, government should make medical insurance affordable and widely available outside the work unit.

Local governments, meanwhile, are on their own. Guangdong province is paying for unemployment benefits, in part, by taxing tertiary industries, collectives and private business. Other areas are still struggling with large-scale unemployment problems.

In the city of Chongqing, for example, 2,600 workers were laid off from a knitting factory this August. The local government is guaranteeing laid-off workers basic wages for up to two years and has taken over pension plans. Workers have been allowed to stay in factory housing for the moment, but the government won't bail them out with new state jobs. Less than 8% of those workers were reported to have new jobs by early September. The majority likely will be carried on the Chongqing budget for a long time.

Similar scenarios may be repeated all over China if local officials are convinced they can afford unemployment, politically as well as economically. Beijing, for its part, must take steps early on to support and retrain workers and to foster new job growth at the national level to head off social unrest.

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A Capital Idea?

During the presidential campaign, Bill Clinton pledged to boost the economy and create jobs with a massive public works program. But some critics say that such a program may not really be needed and, even if it is, that it may not provide the quick stimulus Clinton is hoping for.

BY KIRK VICTOR

Remember the missile gap? During the 1960 presidential campaign, Democrat John F. Kennedy made a lot of political hay by talking about the sorry state of U.S. military forces in comparison with the Red menace. He pledged to redress the imbalance in defense capabilities.

Twenty years later, Republican Ronald Reagan fired similar salvos at President Carter. He attacked Carter for neglecting the nation's military and allowing the Soviet Union to exploit the situation.

In both cases, however, when the newly elected Presidents assumed office, they learned that their campaign rhetoric didn't jibe with reality. There was no missile gap in 1961, and Carter had already launched a big buildup in military spending by 1980. In both cases, the challengers had exaggerated the problems in U.S. defense preparedness.

This year, some critics say, there's been a replay of that kind of misdirected attack by a presidential challenger, but on a different issue. During the presidential campaign, Democrat Bill Clinton emphasized "an investment gap" between the United States and its global competitors. He stressed that in contrast with other advanced, industrial nations, the United States had suffered a decline in productivity because of its failure to invest enough resources in the country's physical capital—highways, mass transit, railways, airports and sewers, as well as in the information networks and technologies of the future.

But Clinton's solution—massive public works spending—may not really be needed, critics say, and even if it is, it may not provide the quick stimulus he is hoping for.

"We're investing a much smaller percentage of our income in [infrastructure] than all of our major competitors," Clinton said in the second presidential debate, "and our wealth growth is going down as a result of this, making the country poorer." Putting a futuristic twist on what seemed to be a call for massive spending on public works projects that evoked images of the 1930s, Clinton promised to pour a sizable chunk of the $20 billion a year in spending that he'd called for into high-technology communi-

Richard A. Bloom

Barry P. Bosworth of the Brookings Institution "We're fighting yesterday's war."

cations networks, environmental cleanup and high-speed rail systems.

Such big bucks theoretically would give the nation's economy—which Clinton argued had been allowed to falter terribly, particularly in its failure to create new jobs—a powerful jump-start. The campaign's widely distributed booklet of promises, "Putting People First: How We Can All Change America," compared Clinton's proposed program to the one begun in the 1950s with construction of the interstate highway system.

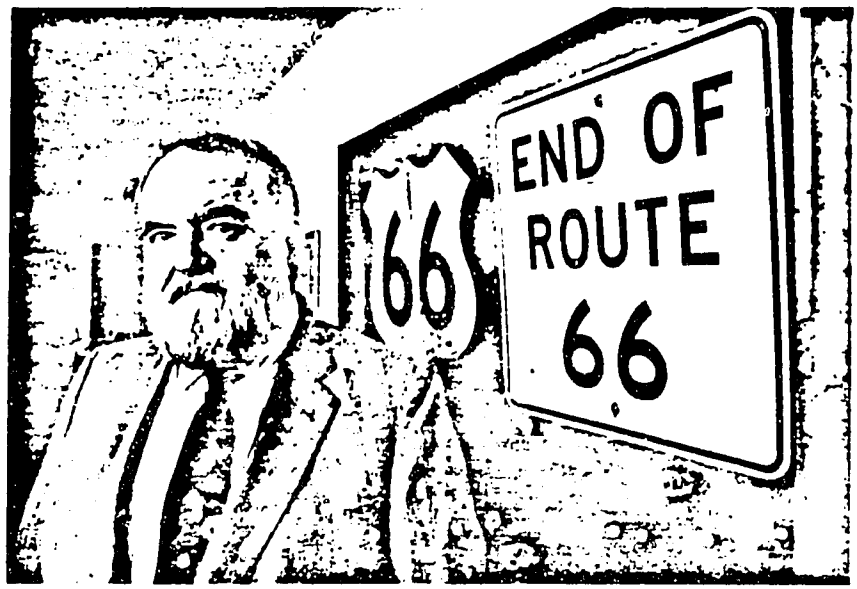
Clinton's economic blueprint predicted that such spending would create "large, predictable markets" that would "stimulate private industry to invest in our economy, create high-wage jobs and smooth our transition from a defense to a peacetime economy."

But some analysts suggest that Clinton has failed to recognize the impact of a massive new program to repair roads, fix bridges and boost transit facilities that's already in place. Last year, Congress passed an ambitious, six-year, $155 billion Intermodal Surface Transportation Efficiency Act (ISTEA) to address these needs. *(See NJ, 12/14/91, p. 3016.)*

"We're fighting yesterday's war," Barry P. Bosworth, a senior fellow at the Brookings Institution, said in an interview before the election. "There is a lot of evidence that the system itself was deteriorating in the United States in the first half of the '80s, in the sense of growing potholes and deterioration of roadbed surface. [But] there has been a major turnaround in government spending on highways, initiated by two five-cents-a-gallon increases in the gas tax at the federal level, plus other increases at the state and local levels. As a result, the physical condition of the road system has turned around, and it is now stable or improving." *(See table, p. 2717.)*

Bosworth and others even question whether the insistence on specificity from voters and the news media during the primary season prompted Clinton to float a dollar figure for his "Rebuild America" package without first having put it through a rigorous analysis. "I get the impression that the number $20 billion was chosen first," Bosworth said, "and then somebody has been trying to figure out what to do with it, when instead we should have approached it the other way around."

"From a long-run point of view, I think the problem is much exaggerated," said Rudolph G. Penner, a former director of the Congressional Budget Office (CBO) and now the director of economic studies at KPMG Peat Marwick. "I think you've not even seen the effects of the highway act of '83 yet, and we have put more money in there in the 1990 budget agreement, and then we had the surface transportation act. So we've already done a lot.



Francis B. Francois, who runs an association of state transportation officials "The issue is whether there are enough projects out there ready to go . . ."

"When I travel the interstate highway system, I run across construction, it seems, every five miles or so—we may be in danger of paving over America again. That doesn't mean that the job is finished; it just means that we've already reacted to what was, at the beginning of the '80s, undoubtedly a serious maintenance problem."

Critics say that new projects won't produce rapid results and might actually dampen private investment rather than encourage it.

If Clinton is hoping for a quick economic stimulus, critics contend, he may be disappointed. They say that because new construction projects would take so long to get under way, they wouldn't produce rapid results and might actually dampen private investment rather than encourage it. Others argue that an economic upturn already has begun, rendering a major spending program unnecessary.

"If you ramp up too fast, you create waste, you create distortions and you create uncertainty," Federal Highway Administration chief Thomas D. Larson, the Bush Administration's point man on infrastructure, said in an interview before the election. "If you put $20 billion on the line next year, then every business that's involved, every hiring hall, every union hall . . . are put into a huge state of uncertainty as to whether to ramp up full-bore and then to have to retreat, perhaps, to what is a sustainable number."

Larson, whose career includes a long stint as Pennsylvania's transportation secretary, added: "We don't need the perturbations of the kind that Mr. Clinton is talking about—a new dash of $20 billion into this landscape. It would not be a productive investment at this time."

INVESTMENT PORTFOLIO

Others, however, argue that the analogy to Kennedy and Reagan is inapposite, that the nation's physical capital—notwithstanding recent progress—still needs plenty of shoring up.

"We've got cities that are literally falling apart," said Robert M. McGlotten, the AFL-CIO's legislative director and a longtime cheerleader for infrastructure spending as a way to create jobs (and, of course, to boost union rolls). "In many communities, there is a deterioration in the downtown area. We need this kind of repair and restructuring to revitalize our cities."

Like McGlotten, others who favor a big push on infrastructure spending come from the core Democratic constituency—

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Budget expert Rudolph G. Penner of KPMG Peat Marwick
"I think the problem is much exaggerated."

big-city mayors, transit advocates, labor leaders and Keynesian economists who advocate more federal spending despite its effect on the already enormous budget deficit. During the presidential transition, the mayors, in particular, will press Clinton to increase spending.

Long before the election, the U.S. Conference of Mayors had put together two volumes that resemble huge phone books and list more than 7,000 ready-to-go projects that are languishing in 506 cities because of a lack of money. Bemoaning the "disinvestment" in urban areas over the past decade, Judith A. Burrell, the conference's assistant executive director, said that local governments have been forced to defer maintenance on these projects.

To further buttress the case for action, some economists use statistics from the Federal Highway Administration to make the case that American businesses are suffering large losses because of an overloaded transportation system, which produces daily horror stories of delays and congestion. Almost 70 per cent of daily peak-hour travel on the urban interstate system in 1989 occurred in congested or highly congested (near-stop-and-go) conditions, up from 55 per cent in 1983.

The Texas Transportation Institute has estimated the cost of highway congestion in 39 of the nation's largest cities to be about $34 billion, mostly as a result of the increased labor costs stemming from delays and billions of gallons of wasted gasoline. Structural deficiencies in 23 per cent of the nation's highway bridges exacerbate the problem, according to the Federal Highway Administration. And air traffic is no better: Airline passengers in the United States endure an estimated 20,000 hours of flight delays annually as a result of limited runway and terminal capacity and an overburdened air traffic control system.

"America must invest more in its public works if economic renewal is to be anything more than a pipe dream," Pat Choate, the managing director of the Washington-based Manufacturing Policy Project and an adviser to Ross Perot, wrote in a recently published monograph. He added in an interview that spending on infrastructure has "a massive effect" on stimulating the creation of jobs and boosting construction and related businesses, which have been mired at the bottom of the economic cycle.

But skeptics question whether general public works spending produces lasting dividends. Because the real problem is congestion, Bosworth said, the only way to get a real bang from more federal spending is through "congestion taxation"—the imposition of user fees based on peak-hour travel and pavement wear and tear (heavier vehicles, for example, would pay higher fees). "All of a sudden, we'll find out we that don't need to invest as much as we think we have to," Bosworth said, "because we'll also be using the existing [highway and runway] stock more efficiently."

Clinton eschewed such specificity in his campaign, leaving him open to the criticism that his plan merely throws money at the infrastructure.

"The Democrats can't believe a Republican President would ever spend money on these things," said Stephen Moore, the director of fiscal policy studies for the Washington-based Cato Institute. "They'll come in and spend still more money on highways. What do they want to do—build a whole new interstate highway system? I don't know how you can spend the money faster than Bush has."

"You can still find highways that are crumbling and bridges that are crumbling," Penner said, "but the point is, we're probably fixing them as fast as the system has capacity."

"You have to remember that [several] years ago, the federal aid highway program was running at $9 [billion]-$10 billion a year, then it went to $13 billion and now it's $15 [billion]-$16 billion in actual projects, which means it has grown immensely," noted Francis B. Francois, the executive director of the American

John Lincoln

Federal Highway Administration chief Thomas D. Larson
"We don't need . . . a new dash of $20 billion into this landscape."

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Association of State Highway and Transportation Officials. "The states are prepared to spend the ISTEA-authorized money at full funding levels, but this [Clinton proposal] would be way beyond that. . . . A job-creation activity is something that you want up and running as quickly as you could. The issue is whether there are enough projects out there ready to go to make use of that funding in calendar 1993."

But Jacki Bacharach, the chairman of the Southern California Rail Authority and a Los Angeles County transportation commissioner, who's been part of an informal task force advising Clinton, said that "the money has been flowing, but if you look at the [highway] trust fund, it didn't get spent."

She said that large surpluses were allowed to accumulate in the trust fund, which, along with matching state funds, are used to build and repair highways and bridges and mass transit systems. Because the federal government wouldn't "spend down" the surpluses, she said, communities were forced to "constrain their programs."

Bacharach's comments echoed complaints from transportation interest groups in recent years about the government's failure to spend the trust fund surplus, which the General Accounting Office (GAO) has estimated will top $11 billion by the end of this year. Yet the GAO recently found that in meeting ISTEA's requirements, the surplus would disappear by fiscal 1995, and that if its projections hold true, the trust fund would have a shortfall of $5.9 billion by 1999. The GAO's estimate was based on a decline in highway excise taxes as a result of the recession, which has caused a drop in driving and less revenue from fuel taxes.

Such a scenario raises the question of where Clinton will find the money to pay for his proposals, because the trust fund could not provide it, Francois said. Moreover, he said, it was unclear whether financially strapped states would be able to come up with their share if Clinton's plan requires the states to provide matching funds, as the current highway program does.

Critics also question why all taxpayers should have to pick up the tab for the mayors' wish list, which includes everything from local street improvements to traffic signal repairs.

"When localities have to pay for this stuff themselves—that is, the users—they are much more efficient and much more cost-conscious," Cato's Moore said. "You want people who use these kinds of services to pay for them. You don't want the person in Seattle to pay for a wastewater plant in Des Moines."

INVESTING IN THE INFRASTRUCTURE

The federal government nearly tripled its spending on public works from 1956-60, as construction on the interstate highway system took off, but since then the nation's annual investment in infrastructure has leveled off. Public works spending as a percentage of all federal outlays hit a peak of 5.5 per cent in 1965 and has fallen steadily since.

	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1956	$3.5	•	•	$0.1	$2.3	•	$6.0	2.0%
1960	13.2	•	$0.2	0.7	3.3	•	17.3	5.0
1965	17.1	•	0.3	0.7	4.6	•	22.7	5.5
1970	14.6	$0.4	0.7	0.6	3.6	•	20.0	3.7
1975	9.7	1.8	4.3	1.0	4.5	$1.0	22.4	4.1
1980	12.2	2.7	6.5	1.2	5.1	1.6	29.4	4.7
1981	11.2	3.3	5.5	1.0	4.6	0.6	26.2	3.9
1982	9.6	3.2	5.2	0.8	4.5	0.7	24.0	3.4
1983	10.7	3.4	4.1	1.0	4.0	0.5	23.6	3.0
1984	12.4	3.7	3.5	1.2	4.0	-0.4	24.4	3.0
1985	14.4	2.7	3.7	1.4	4.2	0.4	26.8	3.1
1986	15.4	3.0	3.8	1.8	5.0	0.1	29.2	3.3
1987	13.6	2.8	3.2	2.0	3.5	0.1	25.2	2.9
1988	14.5	2.5	2.6	2.0	3.9	•	25.5	2.8
1989	13.5	2.7	2.6	2.6	3.2	•	24.6	2.6
1990	14.0	3.1	2.6	2.7	3.7	•	26.2	2.5

* less than $50 million
SOURCE: Congressional Budget Office

HOG HEAVEN?

Clinton and other advocates of more public spending on infrastructure argue that the benefits extend far beyond a locality's immediate needs and are in the national interest. Choate, for example, emphasized the disadvantageous position in which the United States finds itself as a result of huge investments by its international competitors in state-of-the-art public facilities.

Japan will invest more than $3.1 trillion in infrastructure in the 1990s, for example, and Germany has embarked on a 10-year, $1.5 trillion program, much of which is earmarked for high-speed trains, fiber-optic networks and environmental technologies. By contrast, U.S. policies call for less than $1.2 trillion in such investments.

By the end of the 1990s, the United States will emerge with fewer usable public facilities than it had at the beginning of the decade, Choate wrote in his monograph.

But Bosworth argues that such comparisons can be misleading. "Included in [foreign countries'] statistics for public infrastructure are a lot of things that we consider private business," he said. "Our public utilities are in the private sector, for example, not the public sector. Also, in countries like Japan, the construction of roads is fantastically more expensive because they are not very good at it and the cost of land is much higher than in the United States."

Still, Choate's argument is supported by David Alan Aschauer, formerly the senior economist of the Federal Reserve Bank of Chicago and now a professor at Bates College, who argues that boosting public spending on the infrastructure is the key to reviving U.S. private-sector productivity and investment. Clinton's "Putting People First" booklet also suggests such a correlation.

"The Japanese, the Europeans—we all know they have bullet trains, they are experimenting with maglevs [magnetic-levitated trains], electric cars, automated highways—those are the places we ought to be thinking about and planning for infrastructure improvements over the next decade," Choate said. "We need to build infrastructure to compete in the 21st century."

Others contend that the futuristic approach fails to recognize the political hurdles that any public works projects—high-tech or traditional—must surmount. "The tradition of transportation-public works programs is that the money must be spread equally across all congressional districts," Bosworth said. "By definition,

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John Eisele

Jeff Faux, the president of the Economic Policy Institute Public works have always been called pork.

that's wasteful, but that's politics. The idea is that every district has to get back what it put in; you cannot use this money to reallocate toward areas of need."

Bosworth and Clifford Winston, who is also a senior fellow at Brookings, recently co-authored a chapter of *Setting Domestic Priorities: What Can Government Do?* (Brookings Institution, 1992) in which they pointed out that approximately $6.5 billion of the highway money in ISTEA went for "demonstration projects," which are frequently the product of pork barrel politics on Capitol Hill. "Demonstration projects approved in the 1991 ISTEA depended solely on successful lobbying and congressional debate and are not subject to any uniform evaluation," they wrote.

Investments in transit do not benefit the growing numbers of people who live in the city and work in the suburbs or live in one suburb and work in another, said Thomas J. Donohue, the president of the American Trucking Associations Inc. Most transit systems are designed to serve people who live in the suburbs and commute to the city, he said.

A study last year by Illinois-based consultants Jean Love and Wendell Cox found that despite more than $100 billion in federal subsidies over the past 25 years, mass transit ridership has plummeted from 23.5 billion passengers in 1945 to 7.5 billion today. In 1985, then-Sen. William Proxmire, D-Wis., gave his "Golden Fleece Award" for the wasteful use of taxpayers' money to the Urban Mass Transportation Administration, calling the agency "the Edsel of federal programs."

"It's not a simple issue the way it was in the 1950s," Donohue said. "When you build transit and rapid rail, you've got problems. It is a huge undertaking just to get from the idea to the doing, because you've got land use and environmental issues. In the short run, if this [Clinton proposal] is to be a stimulus program, the money is going to go to roads."

Contending that such an analysis is "stuck in time," Thomas M. Downs, the commissioner of New Jersey's Transportation Department, argued that a boost in transit spending could help reduce congestion. "Transit is in the process of reinventing itself as a mobility machine rather than a line service into a big city in the morning and out in the evening," he said.

Rural counties in New Jersey, for example, are interested in "suburban mobility—they don't want to build huge roads," Downs said. "They want a different kind of mobility, and it's not rail mobility and not even sometimes bus mobility. Sometimes it's as simple as trying to figure out where to put medium-sized and large intercept parking facilities where people can drive and take carpool and vanpool or the traditional transit."

Downs called New Jersey a good example of the benefits of increased public works spending. "We got hit awfully hard by the recession, and one of the few tools [to help] was capital expenditure," he said. "It worked here. It's given people a sense that we are working hard as hell to get people back to work on real public investment jobs."

Still, the skeptics aren't persuaded. "All these programs that are now called investment—transit, highway programs the environmental programs, airport programs and such—in the Reagan years we called these pork barrel, and they were at the top of the chopping block list," Moore said. "Congress has no incentive to give up control over these programs; they like to keep control and can't resist the temptation to just make these pork barrel."

"People have been saying public works projects are pork since time immemorial," Jeff Faux, the president of the Washington-based Economic Policy Institute, countered. "I think there is a lot of sort of knee-jerk conservative reaction—either you think building water systems and roads and bridges contribute to economic growth or you don't. I think they do."

Just walk down the streets of any city and think about all the public works projects, whether roads or highways or sewer systems, Faux said. "If you went back to the newspapers of the day, you would find that they were denounced as pork," he said. "Well, it really turns out that yesterday's pork barrel politician is today's farsighted statesman."

Faux, like Aschauer, argues that the United States has suffered a decline in productivity because investment in public capital has steadily fallen as a percentage of U.S. gross domestic product over the past two decades.

A CBO report that was issued last year, however, found that some studies "have exaggerated the importance of additional physical infrastructure." The report concluded, "Although further carefully selected investments in public infrastructure may well be productive, there is little evidence to suggest that substantial, across-the-board increases in current programs would be more productive on average than private investment."

"That's a straw man—they are taking an extreme statement and saying, 'Well, you can't prove that a dollar spent in the public sector is more productive than a dollar spent in the private sector,' " Faux said. "That's a dumb way to think about economic policy. The fact is that there is synergy there—they complement each other. Look down the road—you've got the road, you've got the motel, you've got the restaurant. Now, you tell me which is more important. These are things that go together."

Clinton, who has a reputation as an artful compromiser, may see some political benefits in public works spending that go beyond an economic stimulus. Knowing that Members of Congress and key Democratic interest groups are salivating at the prospect of bringing more bacon to their constituents, he may well choose to cut a deal: In exchange for lots of new projects, they would agree to support other parts of his ambitious domestic agenda.

That's the kind of old-fashioned horse trading that another southern President, Lyndon B. Johnson, could appreciate. ■

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It's Capital Formation, Stupid

By LAWRENCE A. KUDLOW

The pessimism that emanated from the Little Rock economics teach-in does America a great disservice and plays fast and loose with the facts.

True enough, serious tax and regulatory mistakes in recent years, committed by a Republican president and a Democratic Congress, ended the Seven Fat Years of the longest peacetime expansion in history. But let's not forget that the volume of wealth creation, business creation and job creation during the 1983-89 period was a great achievement. What's more, free-market principles of limited government, lower tax rates, deregulation, disinflation and falling interest rates provided a global standard of economic success that has been copied in virtually all corners of the world, including Latin America, Western and Eastern Europe, the former Soviet Union, parts of Africa, and most of Asia.

Let's also not forget that American workers are the most productive in the world. According to a recent study by the McKinsey Global Institute, assisted by Little Rock's leading pessimist, Nobelist Robert Solow, a full-time American worker produced $49,600 of goods and services in 1990. In dollars of equivalent purchasing power, a German worker produced $44,200, a Japanese worker $38,200 and a British worker only $37,100. The study also found that German and Japanese factory workers produced just 80% as much, on average, as American workers on an hourly basis. This is why U.S. real exports have doubled in just the past six years.

A Hands-Off Attitude

What's more, except for Japan's lead in machinery, electrical engineering and transport equipment, the U.S. boasts superior productivity over Japan and Germany in every category, including: basic materials, metal products, chemicals, petroleum, rubber, plastic products, wood, paper products, textiles, apparel, leather, food products, beverages, tobacco and total manufacturing.

And, according to a recent New York Times story, the McKinsey study corroborates earlier research by economists William Baumol and Edward Wolff at New York University, Dale Jorgenson at Harvard, Robert Summers and Alan Heston at Penn, as well as Michael Porter of the Harvard Business School. Moreover, the reasons for American productivity superiority include Washington's relatively hands-off attitude compared with Tokyo or Bonn, which allows American companies much greater freedom to change prices, lay off workers, or enter or exit lines of business. Furthermore, America's competitors are much more likely to prop up older industries, sacrificing higher living standards for all to preserve jobs for some.

Monday's lead story on The Wall Street Journal's front page reported that American high-tech companies have regained the lead in semiconductors, and are poised to surpass the Japanese in high definition TV, electronic books and wireless phones. The U.S. now runs a healthy surplus in advanced technology, moving from a low of $15.6 billion in 1986 to $36 billion in 1991. And this year, U.S. chip makers will reclaim the global lead from Japan.

Turning back to the domestic scene, one notes that the Little Rock pessimists ignored the following socioeconomic facts:

- During the Seven Fat Years of the 1980s, real after-tax income rose 16% for all Americans, including a 12½% gain for the median of all Americans.
- According to studies by the Treasury Department and the Urban Institute, America during the 1980s experienced remarkable upward mobility, as 86% of the lowest quintile moved up, 60% moved out of the second lowest quintile, and 47% moved above the middle quintile. The top 1% actually did the worst.
- The largest relative income gains were generated by women, with an 11% gain in median women's income as a percentage of male income.
- The income tax share paid by the upper 1% of income earners increased 54%, moving from 18.2% in 1981 to 28% in 1988.
- Meanwhile, real gross business fixed investment as a share of gross domestic product was 11½% from 1981 to 1989, compared with 10½% between 1971 and 1979 and 10⅛% between 1965 and 1969.

Workers do not create jobs; businesses create jobs. The great economic issue facing the U.S. in the last decade of the 20th century is not infrastructure or job training — it is the need for capital supplies and capital formation.

Moreover, as virtually every statistic released in recent months shows clearly, the U.S. economy is getting better, not worse.

Real GDP so far this year has risen at a 2.8% pace (3.6% excluding net exports), and other hard economic data measured against year-earlier levels show across-the-board gains: economic profits, adjusted for hurricanes Andrew and Iniki (up $74 billion); hurricane-adjusted cash flows (up $76 billion); nonfinancial productivity (up 3.5%); retail sales (up 8%), apparel store sales (up 11%); automobile sales (up 13%); income (up 4.9%); nondefense capital goods orders (up 8%); business start-ups (up 13%), construction (up 6%), housing starts (up 13%); semiconductor book-to-bill ratio (up 12%).

Initial unemployment claims are down 150,000. Producer price inflation is only 1.3%, consumer price inflation, 3%, and business output inflation, 1.5%. Interest rates are low — 3¼% Treasury bills, 6¾% 10 year Treasury notes, and mortgage rates of around 8%. Even the banking system is recovering from three years of overregulation; bank profits in the third quarter reached a record $8.5 billion (nearly twice that of a year ago), and equity capital as a share of total bank assets has reached 7.39%, the highest level since 1966.

Next year will be the best year for business since 1987-88, with GDP growth of perhaps 3½% or better, largely because this year Washington failed to legislate any new punitive tax and regulatory costs, and thus the private business sector has finally adjusted to the policy shocks and damage inflicted on business over the five prior years. In other words, it is late 1992, not 1932.

Finally, the constantly heard mantra of "worker as victim who needs to be retrained in order to create jobs" is sheer economic nonsense. Workers do not create jobs; businesses create jobs. Former presidential candidate Paul Tsongas put it best last winter when he said that the trouble with Democrats is that they like employment, they just don't like employers.

The great economic issue facing the U.S. in the last decade of the 20th century is not infrastructure or job training — it is the need for capital supplies and capital formation. Workers need capital for new business formation, capital for new technology, capital for job training and retraining, capital for education, capital to convert the defense industry, capital for expanded health care, capital for the inner cities, capital to compete with Europe, Asia and Latin America, and, most of all, for job creation and wealth creation and income creation for all Americans.

Right now this nation has an abundance of capital. More than 100 million Americans, either through direct ownership of stocks and bonds (or mutual funds), or indirect ownership through pension funds and retirement plans, have roughly $1.25 trillion of unrealized capital gains. But this is dead money, locked up by punitive tax rates on investment and the threat of still higher future rates.

Unlock Capital

If, however, the tax rate on capital were lowered by 50% or more for all assets — both old and new, broadly defined — then the unlocking, realizing and reinvesting of $1.25 trillion would unleash such a flood of business and job creation that the economy would be propelled ahead by at least 4% a year, while the budget deficit would drop by roughly $200 billion through 1996, with plenty of secondary and tertiary resource multipliers to provide the wherewithal to begin solving any number of social problems along the way.

Furthermore, lowering the cost of capital by allowing for inflation-adjusted economic depreciation of capital equipment would reduce the cost of capital and stimulate investment far more effectively than a temporary marginal investment tax credit.

With the correct diagnosis, and the right incentives, any problem can be solved by creative men and women. America today has a shortage of capital, not a shortage of taxes or regulations or government direction. By solving the capital shortage through human action and free-market resource utilization, the Little Rock pessimists would soon discover the benefits of optimism and growth, the twin political pillars of the last successful decade.

Mr. Kudlow is chief economist at Bear Stearns.

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PERSPECTIVE ON THE ECONOMY

Spend Now, Tax the Rich Later

John Kenneth Galbraith, professor emeritus of economics at Harvard University, author of the seminal 1958 study "The Affluent Society" and, this year, of "The Culture of Contentment" (Houghton Mifflin), talked recently with Nathan Gardels, editor of New Perspectives Quarterly, about the state of the U.S. economy. Following are excerpts.

Question: After the long ideological winter of the Reagan-Thatcher-Bush era, can we therefore expect to see [with the Clinton Administration] the return of the respectability of [John Maynard] Keynes across the world—that is, a return to the policy of jump-starting the economic process through increased government expenditure?

Answer: Contrary to the implication of your question, Keynes was never in eclipse. The 1980s was a period of extreme Keynesian support of the U.S. economy through a very large public deficit used to finance the arms buildup. This was an manifest example of using Keynesian deficit financing to support the economy. The notion that Keynes was abandoned in the 1980s was the peculiar misapprehension of people who mistook the rhetoric of free enterprise for the reality of massive deficit spending.

What is now being talked about is using government support not for arms, but for civilian goods. But this doesn't alter the fundamental situation in any respect. Government investment is still being looked to for the ways and means to stimulate and support a weakening economy.

Q: Judging by Clinton's campaign, what is of course different is a belief in using deficit financing to put purchasing power back in the hands of the working and middle classes through public investment in infrastructure, instead of the rich through tax breaks.

A: Certainly, this is the chief difference in economic policy. I don't quarrel with that for a moment. But trickle-down economics, the liberation of the rich from taxes, was neither pro nor con with respect to "Keynesianism." It was merely the peculiar contribution of Ronald Reagan and George Bush to the Keynesian tradition.

On the issue of investment in infrastructure, the important thing when speaking about deficit spending is to separate strong tangible effect from theory.

The theory holds that, by various kinds of tax concessions—in the case of the politically rich George Bush, a reduction of the capital-gains tax—you could have theoretical effects on the economy. In other words, those who receive such tax breaks might invest their wealth productively. That kind of theory is something we can no longer afford to rely on.

At this late stage of our troubles, it is imperative that we have economic policies that without a doubt have concrete, tangible results; that, in fact, physically put people to work through such endeavors as repairing bridges and roads, or building rail lines and optic-fiber networks.

That is the policy shift now occurring. It seeks job creation through public investment in infrastructure, which is also wealth-creating. I wholeheartedly agree with this approach.

But there is something else which I think has not been sufficiently stressed, and that is the need for greater federal government support to states and localities. . . . Federal cutbacks to states and localities over the last 10 years need to be restored at least to their previous level. I can think of few better ways to add to the depressive conditions that beset America as a nation than these cutbacks by states and localities, which diminish purchasing power. As was the case in California over the summer, they also provoke bitter public discussion over priorities between such perfectly respectable and equally necessary expenditures as school funding or welfare for poor mothers or police protection. You couldn't have designed a better way to make the California economy worse than by inviting such acrimony.

The two possibilities where the relationship between action and effect is not in doubt are public investment and federal support to states and localities.

'What Wall Street thinks is right has no relation to the health of the U.S. economy. The notion that people associated with money have intelligence is a silly notion that we can finally dispense with in the aftermath of the Reagan-Thatcher-Bush era.'

Q: How are we going to pay for these two possibilities of restarting growth?

A: I would accept, with Bill Clinton, an increase of taxes on the rich. That will not have a necessarily adverse effect either on private spending or public investment. The marginal propensity of the rich to spend what is not taxed in ways that will create jobs is not high. Unlike the poor and middle class, the rich are not going to provide the large-scale consumer spending needed to get us out of these depressive conditions.

And I would go further than the idea of only increasing taxes on those with incomes above $200,000. I would have no hesitation going down to $100,000. I am not going to weep for anyone who has an income of $100,000 a year or more.

Second, I would urge a further shift from military expenditures, which we no longer need and where the effect of multiplying employment is weak, to infrastructure investment, where the employment effect is more efficient.

Having said that, I would then accept an increase in the deficit on the understanding that we have the discipline to reduce that deficit when the economy recovers. Once the recovery kicks in and the economy resumes the rates of growth and employment levels we had in the 1980s, then it will be safe to raise taxes. . . . In other words, stimulate, then tax.

Q: The United States has a $4-trillion deficit. If you try any stimulation on top of that, won't the bond market panic at the prospect of higher rates and hyperinflation? Won't investors lose confidence and shy away from productive investment?

A: This mystical argument displays that wonderful capacity to be compassionate for those who don't need to be cared for or protected. The bond markets ought to be totally ignored, absolutely. As ought to be clear by the mess this country finds itself in today, what Wall Street thinks is right has no relation to the health of the U.S. economy. The notion that people associated with money have intelligence is a silly notion that we can finally dispense with in the aftermath of the Reagan-Thatcher-Bush era.

Moreover, if the economy is performing so much below capacity that there is such high unemployment, it is an indication that inflation is not a problem.

Once we get back to high employment, then let's worry about inflation, which can be curbed by increased taxes to slow things down, and by higher interest rates.

We have learned that interest rates do work against inflation, but they don't work against deflation. You can pull on the string, but you can't push on it. That is one of the great recent lessons of Alan Greenspan's tenure at the Federal Reserve, where he has continued to reduce interest rates to no effect whatever. The lesson is that growth isn't led by business expansion through lower rates of capital. The economy is pulled by growth of consumer spending.

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Why 'Growth Companies' Aren't Picking Up the Slack

Just about everyone now agrees that job concerns explain America's economic funk. Big companies are firing but that's to be expected. What really hurts is the reluctance of smaller, growing enterprises to hire.

Although survey data from the National Federation of Independent Business (NFIB) showed even sharper drop-offs in hiring plans during the 1975 and 1980 credit squeezes, the 1990s have seen a peculiarly *sustained* job drought in this sector.

What accounts for this? In Boston, the birthplace of venture capital, I called on Inc. magazine, which during America's

Business World

By Tim W. Ferguson

entrepreneurial decade of 1979-89 established itself as friend and counselor to the nation's "growing companies." Like many of its subjects, Inc. has paused to take a breath the past few years, with circulation lingering just below 650,000. New ways – books, a data base – are being tried to make money off the old franchise.

Editor George Gendron, who came to Inc. in 1982, hears much the same from his readers. "For the first time since I've been at the magazine, I pick up a very different attitude on the part of rapidly growing companies, ones that are doing real well, actually profiting from the downturn. I've had CEO after CEO tell me, 'We've really changed the way we think about hiring. We're very slow to hire, very reluctant to replace people who leave, much more anxious to figure out how to use contract people to replace full-time people.'

"I'm talking about companies with 15 to 20 million dollars in sales, growing 20%-25%, the type of company that was doing a lot of job generation in the '80s. I think we're going to see substantially less job generation per dollar of revenue in the '90s. I almost think of it as the Europeanization of hiring . . . In the '80s, companies prided themselves on hiring two people a day for the last year."

It's all part of a drive to minimize fixed costs and debt in a deflationary setting. Mr. Gendron says the much-discussed credit crunch was often just a comeuppance for companies that had gotten careless or arrogant about borrowing. Now prudent firms look to customers or big corporate allies for financing. Or they do it from cash flow, like Kingston Technology, a Fountain Valley, Calif., upgrader of personal computers, founded in 1987 by two immigrants from Taiwan. With revenues pushing $200 million and a staff of 140, it heads the latest Inc. 500 list.

Today's managers want a lower break-even point and more flexibility, Mr. Gendron says. "People want to get in and out of things with fewer encumbrances." They don't staff up for chancy projects thinking something else will come along if needed to sop up the added payroll.

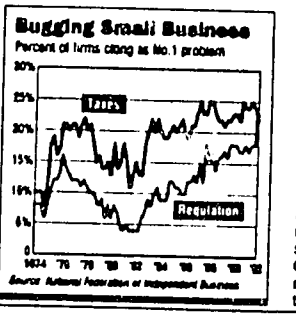
"There's an astonishing percentage of this part of the U.S. economy that is barely surviving," he says, and one reason is that casualties already strewn about have left bad debts to be carried. Partly, this is caused by lax bankruptcy laws, and creditor companies are steaming. Inc. ran an "innocuous" piece about a guy who was self-financing by stretching out his payments, the editor recalls. "We were deluged with faxes, calls and letters" complaining about the sympathetic slant.

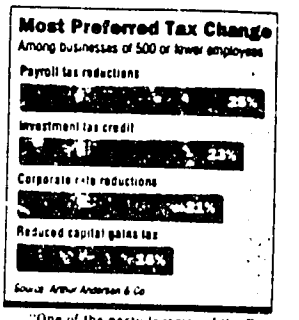
It's not just the marketplace that has small business on edge. Government, in the form of taxes, bureaucracy or the courts, keeps many enterprises from starting their engines. Dread inhibits hiring.

"Nearly every CEO you talk to has either had a sex discrimination or an age discrimination suit or knows somebody who has," says Mr. Gendron. "So there's a high degree of paranoia these days in small companies about what they view as frivolous litigation." Include in that the new cottage industry of lawyers who go looking for high-tech companies they can sue for stock price volatility.

If sexual harassment is a murky thing, so is the new disabilities act. Indeed, the gamut of regulation is the top complaint of business people for the first time in Mr. Gendron's memory. NFIB figures over an 18-year span confirm his soundings, as the chart shows. Regulation has risen to be a top concern, far surpassing other factors such as credit, consumer demand and labor productivity.

"In most cases what really debilitates CEOs of smaller companies these days isn't a specific government agency. It's the expense and frustration of dealing with conflicting government regulations, state, local or federal. The most articulate people seem to argue – and I hear a lot of this in California – that the real issue is the cost of compliance: Can't we make the process of compliance more cost-efficient? The rules aren't clear. They may be contradictory.





"One of the nasty legacies of the Reagan administration, which we all thought might have real benefits, is that Reagan pushed a lot of enforcement down to the local level," Mr. Gendron observes. A company doing business in a dozen states may have to "negotiate compliance" a dozen times.

The other big worry is taxes. A survey for National Small Business United found levies on payroll the top candidate for reduction (see the bar graph).

If you include the health-care tab and workers' compensation insurance, the threshold cost of the first dollar of wages is many times that. CEOs are wondering to Mr. Gendron "whether there's a whole exempt portion of the work force we're just not going to offer benefits to."

One burden they're game to shoulder is worker training. Says the Inc. man, "It's a thoughtful commitment the likes of which I've never seen before: clever, ingenious, not faddish, home-grown, not outside consultants doing off-the-shelf solutions." The CEO message to Bill Clinton, who wants a new tax for training? "Let market forces take care of it."

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A Letter to the G3

by Lester C. Thurow

It's Time For a Reality Check, Boys.

Dear Messrs. Bush, Kohl, and Miyazawa,

In the euphoria over the demise of communism, you guys have dropped the ball on the problems of capitalism. The numbers are irrefutable. In the 1960s, the non-communist world economy grew at 4.9 percent per year. In the 1970s, this slipped to 3.8 percent per year. The decline was attributed to the oil shocks and necessity for governments to impose restrictive monetary and fiscal policies to control the inflation flowing from the oil shocks. It was then confidently predicted that when the oil shocks went away and inflation was under control, growth would spring back to 1960s levels. It did not happen. In the 1980s, the oil shocks and inflation went away, but the economic growth of the non-communist world economy slowed even further to 2.7 percent. Thus far in the 1990s, the world economy plods along at less than 1 percent per year.

The long-term drift toward slower growth and stagnation can be seen from other perspectives. In the 1960s and 1970s, every part of the world participated in real per capita economic growth. In the 1980s, much of the world (Africa, Latin America, South Asia, parts of the Pacific Rim such as the Philippines) had no growth or were actually declining on a per capita basis. In the 1980s, Western European unemployment rose to and remained stuck at double-digit rates — and some countries such as Spain and Ireland hovered in the high teens. The small improvements made in European unemployment in the late 1980s have been mostly lost in the recessions and slow growth of the 1990s.

Great Britain is stuck in a recession that, although it is shallower, has now lasted longer than its Great Depression of the 1930s. While America enjoys a technical recovery from its recession, its growth rates are not high enough to be seen as a recovery by anybody in their everyday economic life. At mid-year 1992, Japan and Germany both have negative rates of growth. If property prices are included in the index, deflation has replaced inflation in many countries.

If one looks at almost any industry on a worldwide basis and asks how much could be produced if every factory in the world were running at capacity, essentially every industry can produce much more than will be bought.

If Lord Keynes arose from the dead, he would think that the world had entered a time warp and he was back in the 1930s. Then the speculative bubble known as the 'Roaring Twenties' led to a financial crash and the recession produced by that financial crash stretched on for a decade and became known as the Great Depression. Looking at the 1990s, Lord Keynes would think that he was looking at a horror movie being run over again. Having thought that he had taught the world how to control such situations, he would be shocked to see that nothing has been learned. It is as if collective memories of the previous mistakes have been wiped clean and everyone is going to repeat their mistakes once again.

Like the 1920s and early 1930s, a speculative bubble collapsed in much of the industrial world in the late 1980s

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and early 1990s. Canary Wharf on the Isle of Dogs will come to be seen by future historians as the ultimate tulip in the financial mania of the 1980s. This bubble, like all other bubbles, ended in a financial collapse. Starting in the savings and loan industry in the United States, spreading into world property markets and engulfing Great Britain, and then galloping into Japan with a collapsing stock market and falling property prices, a financial collapse once again as in the late 1920s, swirls around the globe.

The world enters what in the best of circumstances would be a long and difficult period of cleaning up the mess left behind. In 1992, the world is not attempting to recover from just another of capitalism's inevitable cyclical downturns. That, as history has shown us, is easy (think of the rapid 1982-83 recovery after the 1981-82 recession). Cleaning up the mess after a speculative bubble is much harder and longer in the best of circumstances.

Every $40 billion of export surplus in Japan represents 1 million unemployed workers elsewhere in the advanced industrial world.

Like the United States retreating into isolationism in the 1930s and refusing to see the problems of the rest of the world, Germany retreats into isolationism in the 1990s using the excuse that it must focus all of its economic policies on bringing eastern German incomes up to western levels. If those policies hurt the rest of the world, so be it.

Like Britain refusing to continue managing the world trading system in the 1920s and 1930s, the United States uses none of its political energy to get a successful conclusion to the Uruguay GATT round.

Like the 1930s, exclusionary trading blocks are being formed. The Common Market of Europe has the cover that it is designed to eventually lead to political integration — the only situation under which a violation of most favored nation principles is permissible under the rules of GATT — but no one in the North American Free Trade Agreement is even thinking, much less talking, of eventual political integration. NAFTA is a direct violation of both the rules and spirit of GATT. So, too, is talk about making the countries of Eastern Europe associate members of the European community and forming the Common European Economic Space with EFTA before formally adding those countries to the European Community.

Like the 1930s, beggar-my-neighbor policies are once again the rule of the day. Facing a recession, Japan pushes its export surplus up to annual rates that, depending upon what month is multiplied by twelve, are running from $120 to $160 billion per year. Every $40 billion of export surplus in Japan represents 1 million unemployed workers elsewhere in the advanced industrial world, and many more when those surpluses are with the developing world.

While not a formal trading block, the good performances of the Pacific Rim countries in the early 1990s depend upon running export surpluses and transferring aggregate demand from America and Europe to the Pacific Rim. Southeast Asia and southern China are doing what the exclusionary trading blocs of the 1930s tried to do — run a trade surplus with the rest of the world and keep your economy running at the expense of making it harder for economies in the rest of the world to function. Sooner or later, the rest of the world will react as the world did in the 1930s and simply use import controls to stop the Pacific Rim from accentuating their local recessions. When the rest of the world clamps down, as it sooner or later must, growth will also stop in southeast Asia and southern China as it has in the rest of the world.

If the economies of Central and Eastern Europe are to have any chance of making it from communism to capitalism, they must join a capitalist world where aggregate demand for goods and services is rising (not falling or stagnant) and where there are sectors with shortages where they can compete (not worldwide excess capacity for everything). In the present macroeconomic environment, few of them are going to make it.

The problems of the 1990s will not lead to the big declines in GNPs experienced in the 1930s. Governments have not suffered complete collective amnesia about their experiences in the 1930s. Before that happens, they will institute effective counter-cyclical policies. But the problems of the 1990s are apt to reduce the 1990s growth rate by more than the one percent per decade decline that has been occurring in the three previous decades. Without effective worldwide aggregate demand management, the world faces a decade of very slow growth in the 1990s.

By slashing interest rates, sharply cutting income tax rates, and doubling the defense budget, America in 1982-83 pulled the world out of its 1981-82 recession. But that

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was the last gasp of the American economic locomotive. It is no longer able to act alone. What America used to do alone, cross-country coordinated macroeconomic policies must now do. In the aftermath of the 1987 stock market crash when everyone expected a sharp recession in 1988, everyone practiced macroeconomic stimulation in the major industrial countries and the world enjoyed its best growth year of the 1980s in 1988. With everyone simultaneously pressing down upon their economic accelerators, the world economy roared ahead. But when it was clear that the dangers from the 1987 stock market crash were past, the world returned to uncoordinated macroeconomic policies and a history of ever slower growth rates resumed.

While the G7 supposedly exists to coordinate economic policies, increasingly it doesn't even pretend to be able to carry out this function. Year by year, the fraction of its time devoted to economics goes down and the fraction of its time devoted to other issues such as Yugoslavia goes up. In any case, the difficulties of coordination rise rapidly as the number of countries grows. What is needed is not G7 coordination, but G3 coordination. Seven-country coordination is simply beyond the bounds of feasibility. Even three-country coordination may lie outside the set of political feasibility.

What is needed is not G7 coordination, but G3 coordination.

The problems are not economic. If Germany, Japan and the United States adopted integrated policies, everyone else would fall in line and even if they didn't, it wouldn't matter since none of them is big enough to offset the effects of common G3 actions. Let the G7 talk about whatever it likes, but follow it with a subsequent G3 meeting where real actions are expected.

What needs to be done at this moment is clear.

(1) The United States should be stimulating its economy by pushing up public investment (infrastructure, R&D, education) and finance this investment with borrowing in the short run and by changing its tax and credit systems to encourage (force) greater savings in the long run.

(2) Germany should also be paying for its investments in eastern Germany by borrowing and its consumption expenditures by taxation. High interest rates are not the right vehicle for stopping wage push inflation in either eastern or western Germany.

(3) Japan should be running a substantial trade deficit while adopting macroeconomic policies that would provide aggregate demand enough for a recovery both in Japan and in its trading partners.

But it is clear that none of these three countries is going to do what they should do to help the world economy. No one wants to inconvenience themselves to help the world economy, since no one is now large enough relative to the world GNP, as the United States was, to see that the success of the system is more important to themselves than anything they could do in terms of looking after their own narrow self-interest. The problem is much like an accident on a superhighway versus an accident on a country road. On the country road, everyone stops to help since they know that there is unlikely to be other help along soon. On the superhighway, no one stops since there are thousands of others who could just as well stop to help.

Unfortunately, the conclusions are inconvertible. No system of macroeconomic coordination will be put in place in the years ahead. If there were a severe worldwide depression, the world would act together to stop it, but it won't act to stop stagnation, slow growth, or local recessions that spiral around the world from country to country but never appear everywhere at the same time. If the world cannot coordinate in 1992, given all of the problems that exist in 1992, it isn't going to coordinate except under the most dire of circumstances.

By focusing on its own narrow short-run self-interest, each country thinks that it will be better off than if it focuses on worldwide systems problems. If someone else takes care of the system, they are correct, but if no one takes care of the system and it falls apart, each stands to lose much more from system failure than they can possibly gain from local optimization.

In the end, the rate of growth of the world economy is the most important factor in everyone's local success. The countries of Central and Eastern Europe now have GNPs far below where they were in 1989. With little practical help from the old capitalistic world and a slowly growing world economy, they will be lucky to get back up to 1989 levels by 1999.

Worldwide real economic growth in the 1990s will be substantially lower than it was in the 1980s. Bet on it.

With warmest personal regards, Lester ◆

Rise of Nouveau Protectionism

By WILLIAM J. FINK

President-elect Bill Clinton has often acknowledged that international investment benefits the U.S. economy. Indeed it does, by creating jobs, higher wages and lower prices.

But in recent years, lawmakers have introduced, and often passed, legislation that discriminates against foreign companies. Once in office, Bill Clinton should try to put a stop to it.

The new protectionists argue their legislation will reduce the persistent trade gap with Japan, create American jobs and "open" foreign markets. The reality is different: The result of legislation closing U.S. markets to foreign exporters is the closing of foreign markets in return.

The U.S. legis[illegible] also violates many U.S. treaty obligati[illegible]ed to encourage international investm[illegible] ult is a U.S. investment policy at wa[illegible], a war that unfortunately is being wo[illegible]otectionists.

The protectionists employ four "weapons" to discourage international investment.

The first is to redefine a "U.S. company." The traditional definition of a company has been by place of incorporation. This concept has allowed subsidiaries of foreign companies located in the United States to receive the same benefits that U.S. companies enjoy.

Some bills, though, try to shift the definition to percentage of stock owned: A U.S. company would then be one in which more than 50% of the stock is owned by U.S. citizens. That would dramatically increase the number of firms against which protectionists could proceed.

A practical problem with this definition of ownership is that foreign ownership can be achieved with a single 1% trade of stock; foreign ownership could be lost again when that stock is later sold.

Moreover, it would be impossible to know on a given day whether a publicly held company is, in fact, U.S. or foreign-owned.

Beyond that practical problem, the definitional change could harm foreign-owned U.S. companies that have done business here for years, by denying them benefits accorded to other U.S. companies.

For example, the American Technology Pre-eminence Act of 1991 provides financial assistance to "industrial-led private sector efforts" to increase research and development in critical technologies.

The act's Advanced Technology Program supports high-risk, high-technology projects that have the potential to create entire new industries.

Leaving aside the question of whether the U.S. government should hand out money to companies from any country, a change in the definition of a U.S. company would require American subsidiaries of foreign firms to meet additional requirements for funding.

The second method of restricting foreign investment is insisting on reciprocity — also known as "you hurt us, so we'll hurt you."

This principle actually should read, "you hurt yourself by closing your markets, so we'll hurt ourselves by doing the same."

Proponents of reciprocity claim that closing U.S. markets will open foreign ones. Reciprocity would, for example, require foreign companies applying for U.S. funds to be based in a country that affords U.S.-owned companies comparable opportunities to those it gives its own companies.

But consider how this works in the real world. Changing the criteria for receiving funding under the advanced technology program, for example, could hurt the U.S. subsidiary of a company such as Siemens, a German firm that employs 15,000 Americans in manufacturing jobs.

Depending on Germany's laws, that U.S. subsidiary might not receive the same benefits that other U.S. companies receive. That, in turn, may make Siemens less inclined to locate operations in the United States.

A related method of discrimination against foreign firms is a practice called "reciprocal national treatment."

"It's a picture of me rejecting the mindless iconoclasm of recent decades."

National treatment is an internationally recognized concept requiring host countries to treat foreign firms the same way they treat their own. The United States and its trading partners have derived numerous benefits from this practice.

Reciprocal national treatment, on the other hand, reflects a belief that the U.S. government can foster natio[illegible]l treatment abroad by providing for its select[illegible] denial at home.

For example, [illegible] proposed amendment to the 1984 National Cooperative Research Act would extend the law's coverage to include joint manufacturing ventures in addition to joint R&D ventures.

Joint production ventures would have to be located in the United States, or in countries according reciprocal national treatment in their antitrust laws, to qualify for immunity against U.S. antitrust laws.

But denying national treatment to foreign companies undermines the very notion of national treatment. Thus, the commonly used term "reciprocal national treatment" has nothing to do with national treatment, as protectionists would have us believe, but actually is its antithesis.

Moreover, this approach is likely to contribute to a long-term erosion of national treatment by subjecting foreign-owned U.S. companies to treatment that is arbitrary, inconsistent and discriminatory.

Under the fourth protectionist technique, firms would have to manufacture in the United States in order to receive the benefits of certain U.S. programs. The intent is to encourage joint ventures and affiliates to locate in the United States.

However, to be competitive in today's world economy, firms must be able to locate wherever costs and other factors lead to the highest return. Trying to force companies to locate in the United States regardless of the returns is likely to cause them to avoid investing in joint ventures covered by such laws.

In sum, the subtle shift toward discrimination against U.S. trading partners will hurt the U.S. economy by decreasing international investment.

It also is contrary to the United States' international treaty obligations, which have created enormous economic growth. These obligations should not be abandoned to a piecemeal, protectionist agenda.

William J. Fink is a legal policy analyst with Citizens for a Sound Economy Legal Alliance in Washington.

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THE NEW YORK TIMES, October 3, 1992

The Truth About the Deficit

By Charles J. Zwick
and Peter A. Lewis

In 1967, President Lyndon B. Johnson's Commission on Budget Concepts issued a report on how the budget deficit should be defined and presented. At that time, the Government faced an $8 billion -- or $13 billion — deficit, depending on how the budget was defined.

Today, when the deficit may exceed $400 billion, when Ross Perot argues that it is the country's most pressing problem and George Bush and Bill Clinton express concern, not one person in 10,000 — including most members of Congress and professors of economics — has the foggiest idea how the deficit is, or should be, defined.

This disagreement arises because the budget is not simply a way to divide up revenues but also a way to stimulate or cool down the economy by influencing purchasing power, growth, inflation, interest and exchange rates.

Although there never will be a right or perfect budget, the nation must agree on what is in the budget and its deficit before it goes to war over its size and strategies to deal with it.

There are at least six major questions for which there are no simple answers but whose answers dramatically change the size of the deficit.

Should interest payments be part of the deficit?

No, some say. They argue that when interest rates go up, the deficit automatically rises by the increase in interest costs, yet unlike normal budget expenditures this increase does not create any new demand for goods and services. They argue further that interest costs relate to the financing of the deficit and should not be considered part of the deficit.

Opponents of this view, including us, argue that interest payments, which absorb 18 percent of Federal revenue today, could eventually absorb almost all such revenue — and then what?

Is a deficit caused by a shortfall in revenues in a recession a true deficit?

No, some say. During recessions, taxes fall. This creates a deficit, but it is not a bad deficit, for there is slack in the economy and additional purchasing power will not create inflationary pressures.

But we argue that recessionary deficits increase debt and long-term interest burdens, and therefore cannot be ignored.

Should capital expenditures be included in the same budget as ordinary expenditures?

No, some say. Capital expenditures, they argue, are long-term assets; thus, deficits created by spending on roads, schools and harbors should be excluded from the operating deficit. All growing businesses would show a deficit if capital costs were deducted immediately against earnings rather than being amortized over the life of a project.

Opponents argue that capital and other expenditures chase goods and services and have an immediate economic impact and thus should be included. We would propose a separate capital budget as part of the grand total.

Does inflation reduce the deficit?

Yes, some say. Inflation reduces the value of outstanding indebtedness, so that when such debt is repaid it will be in cheap dollars. For example, a 3 percent reduction in $3 trillion of debt would be equivalent to a revenue gain of $90 billion — a large percentage of our deficit.

What's counted — and who's counting?

Yet, most experts, including us, would say that inflation does not cut the deficit. Inflation is not an unmixed blessing and has no immediate cash impact.

Should the savings and loan fiasco be included in the budget?

No, some say. They would argue that depositors in failed banks gained no additional purchasing power because of the Government rescue. These depositors never realized their savings were in jeopardy. If the Government had not protected them, many depositors would have been wiped out and national purchasing power would have been drastically reduced. On balance, we agree with this analysis.

Opponents argue that the Government must still borrow money to replenish the insurance funds and that such borrowing creates higher long-term interest burdens.

Should the Social Security programs remain in a unified budget?

No, some say. Social Security funds are trust funds held for the benefit of participants and should not be used to distort the size of the deficit.

But we argue that the surplus (or deficit) in the trust funds has a major impact on the economy and that this overwhelming reality should be recognized.

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Depending on which items are included, the $351.9 billion deficit in President Bush's budget request for fiscal 1993 could be as high as $470 billion or become a surplus of $155 billion! The issues cannot be answered with a simple yes or no. A campaign is not the ideal time to have these issues addressed.

But the President-elect should immediately appoint a new bipartisan commission to review the rules.

When a new debate is joined over a constitutional amendment requiring a balanced budget or a revised Gramm-Rudman deficit-reduction act, the participants, the press and public should first know what is meant by the deficit. □

Charles J. Zwick was director of the Bureau of the Budget and Peter A. Lewis was assistant director in the Johnson Administration.

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A Deficit Reduction Plan to Boost the Economy

By MARTIN FELDSTEIN

As leader of the Democratic Party, President-elect Bill Clinton has an enormous advantage. He can expect the Democratic-controlled Congress to enact his budget proposals. For more than a decade, Republican initiatives for deficit reduction were blocked by partisan wrangling. If all goes well, the new president can put that behind us.

A reliable multiyear deficit reduction law passed early in 1993 would not only provide the future capital for healthy growth but, by reducing the real long-term interest rate, would stimulate a stronger recovery in the near term. A large enough ironclad multiyear deficit reduction that starts in 1993 would reduce long-term rates by enough to make a short-term fiscal stimulus both unnecessary and unwise.

In his campaign, Mr. Clinton promised to "cut the deficit in half by 1996." That means cutting the deficit from $290 billion in fiscal 1992 to $145 billion in fiscal 1996, a reduction to 2% of gross domestic product. That's not as much reduction as I would like to see, but it would be a substantial accomplishment and a major step toward budget balance before the year 2000.

CBO Estimates

Cutting the 1996 budget deficit to $145 billion should not be as hard as it may seem. The bipartisan Congressional Budget Office recently estimated that economic recovery will automatically shrink the 1996 deficit to $254 billion without any reduction in government programs or increases in tax rates. Even after raising the annual level of spending by $60 billion for infrastructure and training, which candidate Clinton promised in the campaign, the new president could hit his 1996 budget target by deficit cuts that average $40 billion a year over the next four years, slightly more than 1% of combined spending and taxes.

Mr. Clinton has already indicated some of the ways in which his promised deficit reduction could be achieved. Not surprisingly, his most publicized proposal was to lower defense spending. President Bush's most recent budget proposed cutting real defense spending by nearly 20% from 1992 to 1996. The Clinton plan would cut defense by an additional 6% in 1996, or $16.5 billion. Some military experts will argue that this goes too fast and perhaps too far. I will not try to assess that, but only note that even with these proposed defense cuts Mr. Clinton would still need $150 billion of 1996 nondefense deficit reductions to offset his proposed new spending and still meet his budget target.

In the third presidential debate, Mr. Clinton called for reducing Social Security benefits for upper income people who "get more out of it than they have paid in." Current retirees receive five or six times as much in benefits as they have paid in. Just taxing benefits like ordinary income would raise $25 billion a year by 1996 without imposing any burden on those retirees whose incomes are low enough for them to pay no income tax. An additional $25 billion a year could be saved by 1996 if the automatic cost-of-living adjustment of benefits is scaled back to the excess of inflation over 2%.

Medicare health benefits for the aged will cost $200 billion in 1996. Mr. Clinton has endorsed the idea that people should "pay more for Medicare if they can." Taxing the insurance value of Medicare subsidies would raise $25 billion in 1996. Increasing the annual deductible for physician services to just $200 a year would save about $5 billion more.

Excise taxes on alcohol and tobacco collected revenue of 1% of gross national product under President Kennedy, but only one fifth as much now. Returning to the earlier level would raise more than $50 billion in 1996. An environmental president should be willing to boost gasoline taxes by five cents a gallon each year until 1996, adding $20 billion to 1996 revenue.

If Mr. Clinton and the Democrats don't like the distributional implications of these reforms and tax increases, they could use some of their proposed tax increase on high income individuals to achieve what they regard as a fairer distribution of the costs of deficit reduction. It would be irresponsible, however, to use the proceeds from a tax increase on high income taxpayers, as the Clinton campaign proposed, to finance a middle class tax cut at a time when the budget remains in serious deficit.

This combination of spending cuts and tax increases should be enough to cut the 1996 deficit to $145 billion. But experience shows that actual deficits generally exceed predictions. A pay-as-you-go rule like the one in the 1990 budget accord would ensure that any new spending voted by Congress would be offset by other spending cuts or additional revenue. And deficit reduction should be guaranteed by a tougher version of the old Gramm-Rudman law that automatically cuts spending across-the-board and raises all taxes by an equal percentage if the actual deficit exceeds its annual target.

Deficit reduction legislation that turns a campaign promise to halve the budget deficit into an ironclad legal guarantee would reduce long-term interest rates substantially. That fall in long term rates would stimulate housing construction and business investment. The lower yield on dollar bonds would cause a decline in the dollar, boosting the volume of America's exports to the rest of the world and shrinking imports from abroad.

Board of Contributors

The right strategy is a long-term deficit reduction plan enacted now and starting in 1994. Long-term deficit reduction is the needed short-run stimulus.

It would be very dangerous to pursue the opposite budget strategy advocated by some Clinton advisers: attempting a Keynesian demand stimulus by increased 1993 government spending and a temporary investment tax credit while postponing action to reduce the deficit. Although more government spending would directly raise GDP, the financial markets would inevitably extrapolate the higher budget deficit of a Democratic president into even greater deficits in the future. The resulting rise in real long-term interest rates would hurt business investment, housing construction, and net exports. The net effect of an attempted Keynesian fiscal stimulus is therefore likely to be counterproductive.

A temporary fiscal stimulus in 1993 would not raise real long-term interest rates if it is accompanied by legislation that provides an ironclad multiyear deficit reduction package. But with the lower real long term rates that result from good budget legislation, a fiscal stimulus might be excessive, causing too fast an upturn with a resulting rise in inflation.

There is, in short, no need to choose between short-run stimulus and long-term deficit reduction. Nor is there a need to combine the two. The right strategy is a long-term deficit reduction plan enacted now and starting in 1994. Long-term deficit reduction is the needed short-run stimulus.

It is critical that the long-term deficit reduction be an ironclad legislative guarantee. Financial markets are rightly skeptical of budget agreements after both Gramm-Rudman and the 1990 budget accord did not achieve the deficit reduction that they promised.

The economic plan included in Mr. Clinton's campaign document, "Putting People First," is not reassuring. No one believes wishful-thinking cuts in government waste would save the projected $25 billion a year or that preventing "tax avoidance" by foreign companies would raise $14 billion a year. The Clinton plan to increase spending on infrastructure and training would simply add to projected deficits. The higher taxes on the top 2% of taxpayers would not even pay for the proposed middle-class tax cuts.

Failure to enact a credible multiyear deficit reduction plan could cause a sharp jump in long term interest rates and a new economic downturn in 1993. The private saving rate remains exceptionally low and the inflow of funds from the rest of world has fallen sharply along with the improvement in our trade deficit. Without deficit reduction, the funds available for business investment and residential construction over the next few years would be an astonishingly low 3% of GDP. That inevitably would mean higher interest rates and a less competitive dollar.

Immediate Reaction

If financial markets conclude that such a future rise in long term interest rates is inevitable, they will react immediately, pushing up interest rates now and driving down all types of interest-sensitive spending. Unlike in the early 1980s, when the fear of rising deficits also drove up real interest rates, there would now be none of the positive factors – falling inflation, declining taxes on business and individuals, a rising defense budget and a small initial size of the national debt – to offset the adverse effect of high interest rates on overall economic activity.

Enacting legislation to halve the budget deficit by 1996 will be the first major test of President Clinton's credibility and leadership. The Democratic-controlled Senate and House may balk at inflicting pain on middle class voters through spending cuts and higher taxes. But after defeating the Reagan and Bush proposals for deficit reduction for 10 years, they must now accept the responsibility of supporting the Clinton deficit cuts or putting the current economic expansion in jeopardy.

Mr. Feldstein, former chairman of the president's Council of Economic Advisers, is a professor of economics at Harvard.

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THE WASHINGTON POST, September 23, 1992

Robert J. Samuelson

The Truth About Deficits

Sen. Warren Rudman, Republican of New Hampshire, and former senator Paul Tsongas last week announced the formation of the Concord Coalition, which they hope will build a popular movement to curb federal budget deficits. Good luck. The budget should be balanced, and in that spirit, I will now tell you everything you always wanted to know about deficits but were afraid to ask. Here's the hardest truth: Ending the deficits won't necessarily do us much immediate good.

Compelling reasons exist to balance the budget. Permissiveness toward deficits—an attitude dating from the Kennedy-Johnson economic policies—encourages sloppy government. It relaxes pressure to kill unneeded programs or to justify new spending with tax increases. Interest on the $3 trillion federal debt now accounts for 14 percent of spending, up from 9 percent in 1980 and 6 percent in 1959. If continued, this could heavily burden future generations. It could also tempt government to inflate: to repay its debt in cheaper dollars.

Imagine the consequences. It's 2017, and interest payments are now 25 percent of spending. Government tries to meet demands for new spending through inflation. Large parts of the baby boom—just retired or near retirement—are impoverished, as the purchasing power of their life savings rapidly erodes.

But you see the problem: All my reasons for dealing with the budget involve vague dangers that lie in the hazy future. Meanwhile, all the pain of balancing the budget (spending cuts, tax increases) exists now. Every politician knows who's being hurt without knowing who—if anyone—is being helped. This has always been the crux of the matter. It explains why the deficits don't figure in the presidential campaign. It explains why there's been only one budget surplus (1969) since 1961.

Our political culture often demands a "crisis" to justify unpopular action. The budget deficits haven't provided one. Advocates of deficit reduction try to overcome this obstacle by arguing (a) that unless deficits are cut soon, some calamity will occur or (b) that cutting the deficits will quickly improve the economy—in other words, we get ice cream after eating our spinach. The trouble is, these arguments are usually wrong.

Let's review some of the preposterous claims:

- **Budget deficits worsen inflation.** Oops. Since 1980, inflation has dropped from 13.5 percent to about 3 percent. What largely determines inflation is how much new money the Federal Reserve pumps into the economy.
- **Budget deficits cause trade deficits (the "twin deficits").** Ouch. In 1985, the budget deficit was $212 billion and the trade deficit was $134 billion. In 1991, the budget deficit was $269 billion and the trade deficit $87 billion. Our trade balances reflect mainly exchange rates and economic growth here and abroad.
- **Budget deficits raise interest rates.** Yes, but their impact is dwarfed by other influences—expectations of future inflation, Federal Reserve policy and tax effects. In 1981, the "real" interest rate (the actual rate minus inflation) on a 10-year Treasury bond averaged 8.8 percent. The budget deficit was 2.7 percent of gross domestic product (the economy's output). By 1986, the real interest rate had fallen to 3.8 percent while the deficit had ballooned to 5.2 percent of GDP.

It's also hard to blame the economy's present sluggishness on deficits. Cautious consumers, cuts in defense spending and the overbuilding of commercial real estate are basic causes. Slightly stronger (but still weak) is the argument of the Rudman-Tsongas group that cutting the deficits will quickly improve economic growth and living standards by releasing more funds for private investment. This is probably true, but the effect is modest.

A study by three economists at the Brookings Institution indicates that eliminating the deficits might raise our future wages by about 10 percent over 50 years. Even if the actual increase were twice that, the gain would occur only gradually and would be quite small in any one year. The reason for this is that business investment is only one factor affecting living standards. Moreover, there's already a $9.8 trillion investment base of plant and equipment. Raising new investment ($541 billion in 1991) by 20 percent or so annually only slowly increases the total investment base. What really matters for our future living standards is how well businesses manage all their investments, new and old.

Why bother with deficits, then? The answer is that there are distant dangers, even if we don't know precisely what they are or when they might occur. Italy has run huge deficits for years. People marveled: How could this continue? Well, it hasn't. Italy is now in the midst of an immense political and economic crisis. The longer we wait to cut our deficits, the bigger risks we run and the harder the job.

It's not so tough now. Adjusted for the recession, the deficit is about 3 percent of GDP. Suppose we eliminate that by equal spending cuts and tax increases. A tax increase equal to 1.5 percent of national income isn't crushing. In the long run, we can't control budget deficits unless we curb health spending. That will be tough, but if it isn't done, runaway health costs will overwhelm governments at all levels and depress take-home pay.

The truth is that, by itself, balancing the budget is no obvious panacea for anything. It requires sensible spending cuts and tax increases. If the reduction occurred too quickly, it could temporarily hurt the economy. And frankly, the deficits might fester for decades (as they already have) without triggering any crisis. Some Democratic economists—sensing victory in November—already argue that the deficits can be temporarily disregarded. The same argument was made in the 1980s by Republican supply-siders for the same reason: They want to pursue their own agenda.

In a sense, both are correct. We won't get ice cream for reducing the deficits. There's no instant payoff. As long as we insist on one, we will remain paralyzed. A balanced budget—not at all times or in all circumstances, but as a general rule of conduct—is merely a necessary discipline for a responsible society. Who knows, if we ignore that long enough, we might even emulate Italy.

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THE WALL STREET JOURNAL, November 20, 1992

The New Convenant and the Deficit

By ISABEL V. SAWHILL

Those appointed to serve in the new administration would do well to remember the president elect's commitment to what he has called the new covenant, "a solemn agreement between the people and their government based not simply on what each of us can take but on what all of us must give to our nation." The recent election provided no mandate for old fashioned tax-and-spend liberalism, not only did Bill Clinton reject such policies but a majority of the voters endorsed the leaner and meaner platforms of Ross Perot and George Bush.

Democrats who want to tackle the tough challenges facing the country will need more than one term to do so; to stay in power, they need to reach out to Americans less than solidly in their corner. The new covenant is one important vehicle for doing so. By keeping the focus on what is distinctive about the "new Democratic Party," the president-elect and his team can help knit the country together in a governing coalition that is far more sustainable than today's dissatisfaction with an incumbent president's handling of the economy.

In their book, "Putting People First," the Clinton-Gore team spell out the implications of the new covenant most completely in the areas of welfare and education. Welfare recipients would receive additional training and other services but would, after two years, be expected to work. Students would be given college loans but would be expected to pay them back, either through a surtax on their earnings or through national service.

But what are those of us who have finished our schooling and are comfortably well off expected to do? This will need to be spelled out as the new president addresses the tough economic and budgetary issues come January.

A fiscal stimulus package may be needed early in 1993 to get the economy moving again. But adopting one without simultaneously reducing the longer-term deficit would be irresponsible and might frighten the financial markets. Quite apart from the economic arguments for linking short-term stimulus to longer-term restraint, the principles of the new covenant call for exactly such coupling of the bitter with the sweet.

Under the new covenant, government would promise to create additional job opportunities, but once the economy had recovered, and incomes and tax revenues were up, everyone would be expected to pay a little more or do without some current benefits. The stimulus package could include some quick revenue sharing for state and local infrastructure projects, a sizable but time-limited (or declining) investment tax credit, and (if politics demands) a small, temporary middle-class tax cut. These would be accompanied by permanently higher taxes on the wealthy, cutbacks in defense, and other deficit restraining measures to be phased in more gradually in a way that would reduce the size of the debt relative to the economy.

To ensure that the deficit reduction measures were actually dedicated to that purpose, a commitment would be made to finance all other domestic policy initiatives on a pay-as-you-go basis. Pay-as-you-go financing is, after all, just the new covenant in fiscal clothing. A pay-as-you-go mechanism already exists in the 1990 budget agreement, but it should be revised to permit more flexibility in making trade-offs among all types of expenditures, as well as between expenditures and taxes.

An effort should be made to link new spending and revenue measures in ways that the public can understand and support. A long-term infrastructure program could be paid for by a gasoline tax; investments in new communications might be linked to an excise tax on long-distance telephone calls; environmental cleanup, to a tax on consumer packaging.

Programs for the homeless and those living in public housing could be paid for by capping the mortgage interest deduction. The exclusion of some of the gains on investments in new businesses, or a more permanent investment tax credit, could be paid for by taxing foreign or domestic corporations more heavily. The elderly's natural interest in their grandchildren and their often rich memories of their own childhoods could be tapped in an effort to gain their support for new investments in the next generation.

This logic should not be pushed too far and, in most cases, legal earmarking of specific revenue sources for specific purposes should be avoided; however, the specific benefits and trade-offs associated with each set of politically unpopular actions would be clear. Asking those living in expensive homes to help the homeless, those who drive to contribute more to road maintenance, and those who produce trash to help clean up the environment has a certain moral reasonableness. If such arguments resonated with the public, new government commitments would increasingly come to be seen as entailing commensurate responsibilities from Americans and a new fiscal ethic might be born.

It is time to end the sterile debate between those who favor more government and those who favor less. The nation's problems can be solved only if its leaders make government more effective and more consistent with the public's values. The president-elect has enumerated the principles needed to succeed in this task. His major challenge now is to draw the country together as he attempts to put these principles into practice.

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A Call To Arms

by Lawrence H. Summers

One of America's Top Economists Says It's No Time For More Supply-Side Hooverite Myopia.

We live in an era of supply-side economics. Some see supply-side salvation through lower taxes and greater incentives. Others see it coming through better infrastructure and better trained workers. The supply-side emphasis in macroeconomic thinking is overdue. But it has had the unfortunate effect of subordinating traditional concerns with demand management. With Keynesians in retreat, a dangerous classical orthodoxy has emerged. The classical orthodoxy of Herbert Hoover made the Depression great. Continued fealty to today's orthodoxy dangerously threatens economic recovery around the world.

Today's orthodoxy has three tenets. First, reducing the rate of inflation as far as possible should be the sole objective of monetary policy. Second, policy should not be discretionary since more discretion is a prescription for more inflation and less output growth. Third, fiscal policy is at best irrelevant and at worst counterproductive in combatting cyclical fluctuations. Each of these tenets is a partial truth but can be disastrous if taken too far.

Is Less Inflation Always Better?

The industrialized world discovered painfully during the 1960s and 1970s that there is no stable Phillips curve whereby more inflation is associated with more growth or lower unemployment. To anyone aware of Latin American economic experience, the point should have been obvious. It is clear that sophisticated modern economies are hurt by double-digit rates of inflation or even rates of inflation in the high single digits.

But the protestations of many central bankers notwithstanding, there is no compelling case for 1-2 percent inflation rather than 3-4 percent inflation. The evidence of recent events from Europe to Canada to New Zealand seems to be that the costs of beating out the last bits of inflation can be very high and the benefits may not be great. Almost any notion of why inflation is costly would suggest that its costs would rise much more than proportionally with the inflation rate, so the benefits of inflation reduction diminish as lower and lower rates of inflation are achieved.

As an empirical proposition, no OECD country has averaged much under 3 percent inflation over the last 30 years, and those with the lowest inflation have suffered reduced growth relative to what would be predicted on the basis of their initial levels of income. And there are few, if any, examples of economies that experienced healthy growth along with under 2 percent inflation for a decade.

And it now is a particularly bad time for an aggressive war against inflation. Much of the reason why growth has slowed in the industrialized world is that debtors owe too much and their creditors have too little capital. Now is hardly the time for drastic reductions in inflation that will serve only to raise debt burdens and reduce the value of creditors' assets.

As a general proposition, it may well be that small

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positive rates of inflation are desirable as a kind of economic lubricant. In the modern world, it is unfortunately all too common for the wage a worker can command to fall by 2 or 3 percent in real terms in a year. Indeed, young American males without high school degrees actually lost ground at this rate throughout the 1980s. Without some positive inflation, real wages cannot fall without reductions in nominal wages. The result is likely to be higher unemployment.

A similar argument applies with respect to interest rates. Real interest rates have been negative near most business cycle troughs and real after-tax interest rates have been negative on average in many countries. With no inflation, negative real interest rates or negative real after-tax interest rates are impossible. The result would be higher capital costs, less investment and slower growth.

There is the final consideration that sufficiently low inflation rates may not be credible. Wage and price setters will always suspect that starting with little inflation, the temptation to inflate will be strong. Maintaining credibility will require continually disappointing those who expect more inflation with high costs in terms of unemployment and foregone output.

Governments that do too much to stimulate demand risk bequeathing a legacy of inflation to their successors. Governments that do too little to stimulate demand risk a recession that hits investment and reduces the capital stock they bequeath to their successors. Which is the greater risk? For many years, inflation has been the greater risk. But with inflation at its lowest level in decades in the United States and Japan and with disinflation sending much of Europe into freefall, it seems that stagnation is the greater risk today.

SHOULD THE ECONOMY BE TUNED?

The orthodox idea seriously advocated by many academics and paid lip service in the financial community is that policy should be governed by rules, not discretion. The argument parallels the argument against paying ransom to kidnappers. It holds that the temptation to inflate is irresistible in the short run, but has disastrous consequences in the long run. So it is suggested that policymakers should adhere to fixed rules that remove the possibility of inflationary bias.

Recent European experience demonstrates the cost of tying policy to an exchange rate mast. With fixed exchange rates, it is easy for a perverse dynamic to set in. The worse things look, the more likely is devaluation, which raises interest rates and makes things even worse. Fixed exchange rates have their place and they certainly can contribute to efforts at bringing down rapid rates of

Important Summers-Time Reading, in Brief

- Supply-side orthodoxy: (1) reducing the rate of inflation should be the sole objective of monetary policy; (2) policy should not be discretionary and should not seek to counteract the business cycle and (3) fiscal policy is at best irrelevant and at worst counterproductive.
- There is no compelling case for 1-2 percent inflation rather than 3-4 percent inflation. The costs of beating out the last bits of inflation can be very high and the benefits may not be great.
- Now is hardly the time for drastic reductions in inflation that will serve only to raise debt burdens and reduce the value of creditors' assets. It may well be that small positive rates of inflation are desirable as a kind of economic lubricant.
- Which is the greater risk, a legacy of inflation or a recession that strangles investment and reduces capital stock? With inflation at its lowest level in decades in the United States and Japan and with disinflation sending much of Europe into freefall, it seems that stagnation is the greater risk today.
- The reason there are today no monetarists under 60 is that the relationship between money aggregates and anything interesting turned out to be extremely unstable.
- In a world where inflation depends on cyclical conditions and growth is an important objective in and of itself, policymakers would be fools not to get and act on all the information on economic conditions that they can. This means gross if not fine tuning.
- Despite the length and depth of the current recession in the United States and Japan, some of those prominent in international financial circles preach the gospel of immediate fiscal restraint. This is Hooverite madness.
- A time when monetary policy's potency is reduced by all sorts of problems in the financial sector is no time to renounce the fiscal policy tool, much less to move it into reverse.
- It's time for the supply-side revolution to be complemented by a demand-side restoration.

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inflation. But foregoing monetary policy discretion in favor of an irrevocably fixed exchange rate, regardless of circumstance, is a prescription for overvaluation and very painful adjustment.

While no central banker admits to fine tuning, every central banker keeps a Reuters screen nearby and tracks every indicator. This is fortunate. The idea that policy can be set by rules presumes a degree of stability in economic relationships that is regrettably absent. The reason there are today no monetarists under 60 is that the relationship between money aggregates and anything interesting turned out to be extremely unstable. And recent experience has also destroyed confidence in traditional relationships between the yield curve or the various interest spreads and cyclical developments. Too much is changing for any simply specified feedback rule to be remotely viable.

Even if somebody someday finds a magic money aggregate or other variable that is stably related to cyclical conditions, it is hard to see why policymakers should respond to only one variable. Does anyone seriously doubt that expansionary policy was the right response to the 1987 crash? Is there any question that monetary policy needs to take account of strains in the financial system? In a world where inflation depends on cyclical conditions and growth is an important objective in and of itself, policymakers would be fools not to get and act on all the information on economic conditions that they can. This means gross if not fine tuning of the economy. .

What about the concern that fine tuners will always tune up the inflation rate? As the history of the 1970s makes clear, the concern is a real one. But there is a better solution than eliminating discretion. It is ensuring that discretion is used wisely by making the monetary authority independent. History demonstrates that countries with independent central banks have had much less inflation and marginally better growth performance over the last 30 years than countries with politically controlled monetary policies.

Fiscal Policy Work?

Budget deficits are a means of deferring payment for government services, not an alternative way of paying for them. They increase the bills that must be paid later and reduce economic growth by crowding out investment. As a long-run proposition, there can be no doubt that countries are better off with smaller than larger deficits and that ratios of public debt should, outside of emergency periods, be decreasing rather than increasing.

Current orthodoxy recognizes these verities but sometimes seems to forget that budget policies are means to the end of sustainable and steady growth. Despite the length and depth of the current recession in the United States and Japan, some of those prominent in international financial circles preach the gospel of immediate fiscal restraint.

This is Hooverite madness. For the long run, the orthodox view is right. Deficit reduction is imperative and the sooner it is legislatively locked in, the sooner long-term interest rates will fall and the sooner the economy will recover. But for the present, the last thing that the United States or Japan needs or that the world needs from them right now is a drastic reduction in domestic demand. And that is exactly what would be accomplished by immediate reductions in spending or increases in taxes. A time when monetary policy's potency is reduced by all sorts of problems in the financial sector is no time to renounce the fiscal policy tool, much less to move it into reverse.

The automatic stabilization associated with the reductions in revenue collections and increases in spending in recessions is probably the most important reason why downturns have been shorter and shallower in the post-World War II period that they were in the pre-World War II period. It is hard to believe that it is appropriate for cyclically adjusted budget deficits — let along actual budget deficits — in either the United States or Japan to be decreasing and offsetting automatic stabilization. Simply to preserve automatic fiscal stabilization, some modest fiscal stimulus is called for, if and only if it is part of a credible, fully specified, medium-term fiscal program.

Conclusion

The industrialized world is now caught in the longest period of slow growth and stagnation since the Second World War. Three months ago, forecasters expected the decade of the 1990s to witness the slowest growth in the industrialized countries since the Depression. And recent consensus forecasts of the pace of recovery in Europe, the United States, and Japan have all been revised sharply downwards. Right now one of every eight men between 25 and 55 in the United States and Europe are unemployed, and the figure is likely to increase over the next year.

Slow growth has enormous costs. The U.S. contraction is costing the average American family nearly $5000 a year. By the time it ends, slowdowns in other parts of the world will be at least equally severe. Slow growth in the industrialized world will cost the developing world more in lost exports than they will receive in foreign aid this year. And slow growth makes myopic policies of protection and underinvestment all but inevitable.

More of the same thinking will produce more of the same results. It's time for the supply-side revolution to be complemented by a demand-side restoration. ◆

Job One: The Economy

Michael Kinsley

Spinach vs. Candy

As many have noted, President-elect Clinton faces two contradictory economic challenges. One is goosing a sluggish economy in the short term. The other is the federal deficit, which is sapping our long-term economic strength. Any short-term stimulus—a tax cut, a spending increase or some combination—will increase the deficit, thus worsening the long-term problem. Which should he choose?

To a back-seat driver, the answer is obvious. Going for the short-term stimulus would be a mistake that could wreck Clinton's presidency. I count five reasons.

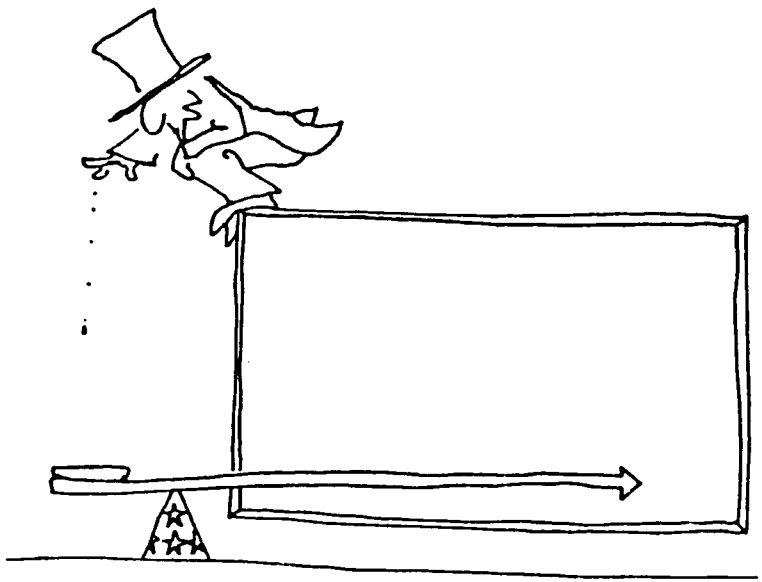
First, it may not be necessary. Before the election, Clinton was pooh-poohing George Bush's claims that the economy is on the mend. Now he can afford to admit that Bush may well be right. Government stimulus efforts usually come too late in the business cycle to do much good.

Second, in the new global economy, an artificial short-term stimulus may be self-defeating. The markets will greet any such effort by raising long-term interest rates, due to fear of rising deficits and future inflation. This will counteract any stimulus effect. In the month before the election, long-term rates went up almost half a point on the mere supposition that Clinton would [illegible] and then attempt a quick economic jolt.

(The flip side of this is that markets will reward genuine commitment to deficit restraint with lower interest rates and renewed confidence in the American economy. That will have a stimulus effect of its own.)

Third, much of the present jobs agony is unrelated to the short-term state of the economy. Huge layoffs in corporate America are part of a historic restructuring that won't be derailed by a fiscal stimulus. Nor should it be derailed. Clinton's plans for worker retraining and building new industries are the right answers for this one.

Fourth, Reagan and Bush destroyed fiscal stimulus as a useful economic medicine, at least for now, by overprescribing it. If the economy is sluggish with a $300 billion-plus deficit (and low, low short-term interest rates to boot), what will it take to stir the juices? $400 billion? $500 billion?



BY T. DIBLON

Fifth and most important, there's politics. If Clinton uses this excuse to evade the deficit problem early on, he'll never address it. Fiscal stimulus is candy. Deficit reduction is spinach. At the beginning—with goodwill from citizens and Congress, and reelection four years away—President Clinton's power will be at its zenith. If he offers candy now, spinach won't sell later.

What the Clintonites would like to do, probably, is to offer a candy/spinach package deal: an agreement in advance that a year or two of stimulus would be followed by serious deficit reduction. This is a fantasy. It would be the fourth time in less than a decade that America would have made a solemn commitment to start serious deficit reduction in a couple of years.

Count 'em. In 1985 we had the Gramm-Rudman-Hollings law, ordering across-the-board spending cuts if deficit targets weren't met. When that became too onerous in the late 1980s, the targets were extended. In 1990, when the extended deadlines would have started to bite into popular programs, we had the Budget Summit. That agreement put off tough love until after the 1992 election. And here we are.

Arguments that Clinton should ignore the deficit at least in the short term are coming not just from Keynesian liberals urging a quick infusion of federal spending on things like infrastructure. Since the election there also has been a steady drumbeat of conservative commentary demanding that Clinton prove his bona fides as a "new kind of Democrat" by quickly enacting tax favors for business such as an investment tax credit or capital gains tax cut.

Clinton got elected promising all these things in various forms, but he also promised to pay for them with compensating tax increases and/or spending cuts. Trouble is, any such "revenue-neutral" approach—giving with one hand, taking away with the other—would not provide a short-term jolt. And of course it would require selling the spinach along with the candy. That's why the Clintonites are already traveling down the wearily familiar road of claiming that various goodies will "pay for themselves," a la Ronald Reagan's famous supply-side tax cuts.

Remember the Laffer Curve? Well, please welcome the "Aschauer Curve," another economist's bid for immortality. It purports to show that public infrastructure investment—roads, bridges etc.—generates enough new economic activity to replace, in remarkably short order, the tax revenues it costs. And Clinton advisers reportedly are peddling a study by another economist making a similar claim for the proposed business investment tax credit.

It is hard to think of anything that would be more dispiriting than to see President Clinton embrace the discredited politics of the free lunch. Clinton is stuck forever, no doubt, with the label "slick." But there are different ways for a politician to display, and use, slickness. One is to give people everything they want. Another is to convince people they want what you give them. The second type of slickness is a valid part of leadership. Which kind of slick is our next president?

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THE WALL STREET JOURNAL WEDNESDAY, DECEMBER 2, 1992

If It Ain't Broke, Don't Fix It

By Bruce Bartlett

The U.S. has emerged from its ninth postwar recession – in fact, new positive numbers on the economy have already excited the press so much that it has started referring to "Clinton Prosperity." Nevertheless, pressure for the federal government to enact an anti-recession program has not abated, and President-elect Clinton has yet to abandon his stimulus plans. This follows the pattern of postwar countercyclical programs. All were enacted well after the end of the recession. They exacerbated inflation, raised interest rates and made the next recession worse. (The recession dates given are from the National Bureau of Economic Research. Figures in parentheses are in 1992 dollars.)

November 1948-October 1949. Although the recession began in November 1948, it was not until July 11, 1949, that President Truman put forward an 11-point program to combat the recession. Only one proposal was enacted by Congress – the Advance Planning for Public Works Act, signed on Oct. 13, 1949. This legislation authorized $100 million ($2.2 billion) in interest-free loans over two years for local governments to plan public works projects.

Eisenhower and Kennedy

August 1957-April 1958. President Eisenhower opposed any countercyclical policy. However, Democrats in Congress proposed several actions on their own, many of which were then signed by the president. First was an emergency highway bill, signed on April 16, 1958, that increased grants to states by $600 million ($7.5 billion) and suspended for two years the pay as you go provisions of the Highway Trust Fund. Second was a bill, signed on June 4, advancing federal funds to states agreeing to extend unemployment compensation. Third was a rivers and harbors public works act, signed July 3, that authorized $750 million ($9.3 billion) for new projects and raised limits on earlier projects by $670 million ($10.6 billion).

April 1960-February 1961. On taking office in January 1961, President Kennedy moved quickly to [illegible] another an anti-recession program. [illegible] he sent a special message to Congress asking for an extension of unemployment compensation, increased Social Security payments, and aid to distressed areas, among other things. The unemployment bill was signed on March 24, providing some $800 million ($9.3 billion) in benefits. The Area Redevelopment Act became law in May and authorized almost $400 million ($4.7 billion) in aid for depressed areas. The Social Security bill increased benefits by about $600 million ($9.3 billion) and was enacted in June.

Additional action was taken against the lingering effects of the recession in 1962, with the Public Works Acceleration Act. This bill, signed into law on Sept. 14, was a companion to the Area Redevelopment Act, authorizing $900 million ($9.4 billion) for public works in designated areas. The legislation was designed to create 55,300 man-years of employment. But a General Accounting Office study found that fewer than half that number were created. Moreover, the peak number of jobs created came in June 1964, 37 months after the recession bottomed out.

December 1969-November 1970. The only major legislation addressing this recession was passed more than a year after it ended. The Public Works Impact Program, signed Aug. 5, 1971, targeted public works spending to designated areas with high unemployment. About $45 million ($238 million) was expended in fiscal 1972, $43 million ($191 million) in 1973 and $38 million ($156 million) in 1974. It was predicted that the program would create 62,000 man-months of employment in the first two years, with 75% of jobs going to the previously unemployed. A Commerce Department study, however, found that only 39,000 man-months of employment were created and only 22% of jobs went to the unemployed. Moreover, the average job in this program lasted only 4.1 weeks and 60% of participants worked two weeks or less.

November 1973-March 1975. The first action taken was a tax rebate plan enacted in March 1975. This $22.8 billion ($86 billion) bill gave taxpayers a 10% rebate on their 1974 tax payments up to $200, payable in the second quarter of 1975. It was phased out as incomes rose. The bill also extended unemployment benefits, increased the investment tax credit from 7% to 10% and made other tax changes. The purpose was to pump up demand by putting dollars into people's pockets. But subsequent analysis indicates that most of the money was saved initially and thus had a negligible effect on spending.

In 1976, Congress believed that the aftereffects of the recession justified further anti-recessionary action. Over President Ford's veto, it enacted the Anti-Recession Fiscal Assistance Program (ARFA). Also enacted was the Public Works Employment Act of 1976, signed on July 22, which established the Local Public Works Program (LPW). ARFA increased revenue sharing to the states by $1.25 billion ($4.2 billion). The amount of aid was dependent on the local unemployment rate. LPW increased funding to state and local governments for public works projects by $2 billion ($6.8 billion).

As late as 1977, Congress was still enacting legislation to deal with the aftermath of the recession, in the form of the Local Public Works Capital Development and Investment Act of 1976, which was enacted on May 13, 1977, early in the Carter Administration. This legislation added $4 billion ($12.2 billion) to the LPW program. The ARFA program was also extended a year and its funding increased by $1.75 billion ($5.3 billion).

All postwar countercyclical programs were enacted after the recessions' end. They exacerbated inflation, raised interest rates and made the next recession worse.

Subsequent analysis shows that these programs utterly failed. A Treasury Department study of ARFA found that because the funds were not disbursed until well after the end of the recession, it failed to provide assistance when it was most needed and probably contributed to inflationary pressures during the expansion.

It was also found that rather than spend federal money immediately, state and local governments tended to, in effect, save it. Thus state and local government budget surpluses increased during this period, thereby mitigating the stimulative effect of the federal programs.

An Office of Management and Budget (OMB) study of the public works programs found they did little to help the unemployed because of the relatively low labor intensity of public works projects and the high skill level required. Moreover, because of substitution effects (replacing state and locally funded jobs with federally funded jobs) the net employment effect was extremely low. OMB found that the gross federal cost per job created was between $70,000 and $198,000. The average job lasted just 3.5 weeks and only 12% of jobs went to the unemployed.

July 1981-November 1982. Despite its general aversion to such programs, even the Reagan administration adopted two programs specifically designed to be countercyclical. First was the Surface Transportation Assistance Act of 1982, signed on Jan. 6, 1983, which raised the gasoline tax by five cents and increased expenditures for highways and mass transit by $33.5 billion ($59 billion) over five years. Second was the Emergency Jobs Appropriations Act of 1983, signed March 24, which increased spending by $9 billion ($15.8 billion) for 77 different programs.

Only 2.5% of the funds under the surface transportation bill were expended in fiscal 1983 and net additional funding to existing programs amounted to just $606 million ($1.1 billion). But the gasoline tax increased federal revenues by $1.7 billion ($3 billion) in fiscal 1983. Thus, on balance, the program was contractionary rather than stimulative in the first year. Moreover, state and local governments may have pulled back on public works spending in anticipation of new federal funds, as shown by the sharp increase in state and local budget surpluses beginning in 1983's second quarter. It is doubtful that any net jobs were created in the short run.

Scant Jobs

As to the Emergency Jobs Act, a GAO study found that funds were spent slowly and that the unemployed received only a small portion of the jobs created. Most funds were not spent before June 1984, well after the end of the recession. Peak employment created by the program was only 35,000 jobs, of which only 25% went to people who were unemployed.

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Only since the advent of Keynesian economics have governments come to believe that they can moderate, or even eliminate, the business cycle by pumping up demand through countercyclical tax and spending programs. Yet even John Maynard Keynes expressed deep skepticism about government's ability to do this. "Organized public works, at home and abroad," he said, "may be the right cure for a chronic tendency to a deficiency of effective demand. But they are not capable of sufficiently rapid organization (and above all they cannot be reversed or undone at a later date), to be the most serviceable instrument for the prevention of the trade cycle."

Many things need to be done to address our economy's problems. But we should not delude ourselves that such problems began with the recession or can be cured by an anti-recession program.

Mr. Bartlett is departing deputy assistant secretary for economic policy at the Treasury Department.

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COLUMN LEFT/
ROBERT KUTTNER

Clinton Needs a Shockproof Economic Plan

■ The mess he would inherit might require drastic—and unpopular—action.

In December, 1980, as the Reagan team geared up, David Stockman wrote a now-famous memo titled "Avoiding a GOP Economic Dunkirk." Stockman worried that the economy, reeling from high unemployment, inflation and the Federal Reserve's tight-money cure, would worsen on Ronald Reagan's watch.

The GOP did take losses in the 1982 mid-term elections. But by 1984 the Fed had lightened up, the tax cut of 1981 was stimulating a (short-lived) boom, and Reagan would be reelected handily.

Like the original Dunkirk evacuation of the British fleet in 1940, the Reagan crew salvaged enough to fight another day. The Gipper would be in happy retirement by the time reality fell in on George Bush.

And perhaps on Bill Clinton, as well? If Clinton is elected, he could also face an economic Dunkirk. The particulars are different, but the political perils the same.

The risks are several:

• *A deepening recession and stock market crash.* The Fed has kept a feeble economy on life supports, with cheap money. Much more of the same would invite collapse of the dollar. Once Wall Street concludes that the low interest-rate era is over, or that the dollar is tumbling, the stock market will likely tumble, too.

The more that reckoning is postponed, what is fairly a Reagan/Bush crash will be pinned on Clinton.

• *An international money crisis.* From late 1985 through 1988, the United States, Germany and Japan carefully managed the world's money markets. That stability was good for business. But after the Berlin Wall came down, Germany pursued its own course. Treasury Secretary James A. Baker III, the architect of global money management, moved to the State Department, leaving the Treasury to the parochial Nicholas Brady.

Today, nobody is managing the world's money. Germany and the United States are pursuing opposite courses, and Japan is reeling from its own financial morning-after. Absent real economic statecraft, global currency chaos will turn catastrophic.

• *A deepening domestic banking and fiscal crisis.* Clinton could find America's banks in even worse shape than forecast. Another bank bailout would restrict credit and spike the deficit upward. A softening economy and higher interest costs would only increase the deficit further.

The biggest risk is not in the cards that history deals Clinton, but in how he plays them. After all, Franklin Roosevelt and Ronald Reagan also inherited shaky economies. Both, in very different ways, let the conventional wisdom be damned. Both stimulated recoveries, restored confidence, and were reelected handily.

'Clinton's challenge is to avoid becoming another Democratic hostage of the money markets.'

Jimmy Carter inherited a weak economy, too. But Carter, fearing panic in the money markets, handed Paul Volcker the reins. Volcker reciprocated by sponsoring a wrenching disinflation in an election year. This had the twin virtue of restoring financial calm (at great cost to wage earners), and dispatching the Democrats.

Clinton's challenge is to avoid becoming another Democratic hostage of the money markets. A chorus of conservative commentators will soon conclude from the mounting crisis that "markets don't trust Democrats to manage the economy." Clinton will be urged to appoint people of orthodox views to key economic posts. He has already been urged to bring back Volcker as Treasury secretary!

Orthodox advisers will tender orthodox advice: Cut the deficit, rein in spending and wait for nature to take its course. Plenty of nominal Democrats—in think tanks, in powerful Washington law firms, on Wall Street—fervently believe this gospel. (Can't they just move to the GOP?)

If Clinton follows that advice, he will be stymied before he begins. Nature taking its course will doom the economy to another decade of stagnant living standards. And voters will again conclude that Democrats can't cut it.

Even if Clinton responds incrementally, with a bit of public works over here and some modest educational and medical reform over there, the results will be unimpressive. The fact is, our deferred social and economic problems are massive, and require massive remediation.

The best form of reassurance is to restore real economic health. That will require reversing the casino economy of the 1980s and its ideological underpinnings. It will entail more regulation of everything from airlines to health care to banks, more public investment and, for a time, more public debt. Deficit reduction needs to come, but after recovery.

The Reagan economic cure proved illusory. A cold-bath counter-cure would be even worse. And a medley of muddle-though would be the worst remedy of all. Clinton must live down the charge that he tries to please everybody. He needs to choose an economic course and hold to it.

Robert Kuttner is a syndicated columnist.

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THE JOURNAL OF COMMERCE, September 2, 1992

Easy Money: No Silver Bullet

By ERICH HEINEMANN

In the past year, the Federal Reserve System increased total reserves in the U.S. banking system by roughly 16%. Rapid growth of bank reserves — the high-powered funds that are raw material for the money supply — will contribute to an acceleration in economic activity in 1993.

Approximately 1.4 million more adult Americans should find jobs this year. In 1993, employment of individuals aged 20 or older will likely go up at least 2.4 million. Real gross domestic product should average about $4.9 trillion in 1992, up less than 2% from 1991.

Next year, goods and services produced by U.S. residents should rise about 4%. A powerful surge in profits will finance a boom in business investment.

Barriers to expansion remain. Congress created lots of roadblocks to new business starts, including higher taxes on capital gains and mandated outlays for health, safety and the environment. Newly formed concerns accounted for about 85% of the net new private jobs in the 1980s.

Vacancy rates in commercial real estate and multi-family housing are sky-high. Thus, construction is down. By historical standards, consumer debt service is high relative to income. Some families may restrain spending to cut debt. Defense cutbacks are widespread, and states face sharp constraints.

This list includes some of the reasons why the pace of recovery has been so painfully slow. However, do not forget the erratic pattern of Federal Reserve policy.

For more than three years, from the second quarter of 1987 through the third quarter of 1990, the central bank doggedly pursued its goal of "zero inflation" by restricting the growth of bank reserves to an annual rate of less than nine-tenths of 1%. Lingering side effects of this event continue to dampen aggregate activity today.

Because the Fed's move was abrupt, it wasn't sustainable. Thus, it will probably not have a lasting impact on inflation. Furthermore, there is no long-term choice between inflation and growth. The nation cannot trade higher prices for more jobs except for very short periods. In the end, rising inflation always leads to falling output.

During the year ended in the third quarter of 1991, the Fed relaxed. Total reserves rose 5.9%. Over the last 12 months, the monetary authorities opened the flood gates. Reserves increased at a 16% annual rate in the fourth quarter of 1[illegible], a 26% rate in the first quarter this year, 16% in the second and 6.5% this summer.

This disgraceful episode of stop-go policy has hurt the economy. Tight money drove the economy into recession, and its aftermath has slowed the recovery. Subsequently, easy money drove down the foreign exchange value of the dollar, and threatens a revival of inflation in 1993 and 1994.

The Federal Reserve's zero inflation policy has little support in Washington. A congressional resolution that would make stable prices the Fed's primary goal has been languishing for years in the House. The bill has only a handful of supporters, and long before the recession, the Bush administration pointedly refused to back the measure.

By trying to impose a fundamental change in national economic policy without a proper national political debate, the Federal Reserve placed itself at risk.

Milton Friedman, a Nobel laureate in economics, warned recently that the Fed had followed "a policy which may well precipitate political interference and destroy it as an effective institution . . . Five years down the line, we could have a very substantial inflation."

The National Bureau of Economic Research, the official arbiter of whether the economy is expanding or contracting, has not yet declared an end to the recession. Moreover, the bureau will likely wait until after the election to avoid political cross-fire.

The bureau's business cycle dating committee will almost certainly place the trough, or low point, of the recession between May 1991 and January 1992. (The recession began in July 1990.)

Based on currently available data, the best bet for the end of the recession appears to be November 1991. That is when total employment of civilian adults started to show a sustained increase.

Thus far in 1992, the pace of recovery has been slow and uneven. Consumer spending and private domestic investment went up about $74 billion during the first half of the year, but net exports and government spending dropped $22 billion.

Imports went up more than exports because U.S. shoppers are coming back to the malls at a time when many foreign economies have slowed. Meanwhile, pervasive cutbacks in defense have cut deeply into government outlays. Nevertheless, all these barriers will yield temporarily to the silver bullet of easy money in due time.

Over the longer run, however, the story is different. The economy cannot thrive without a big increase in investment to boost productivity and real incomes. Individual companies may prosper by cutting costs, but societies cannot.

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Keynes Is Still Dead

By Robert J. Barro

The presidential campaign seems to have reached a consensus that government spending can be valuable just because it stimulates the economy. President Bush has embraced military bases, aircraft contracts and agricultural subsidies primarily as jobs programs, and Gov. Bill Clinton's proposed spending on environmental management, transportation and communication seems motivated mainly by a desire to put America back to work. (Apparently, the only thing that keeps these plans for enlarged government spending in check is the fear of increasing the dreaded budget deficit.)

If we took these notions seriously, then we would conclude that Hurricane Andrew was disastrous because it led to increased employment in the construction industry. Perhaps each candidate should draw up a list of government sponsored disasters or wars that could supplement the insufficient number of natural disasters and thereby create jobs, jobs, jobs.

The idea that useless government spending can make us better off stems from the Keynesian demand multiplier. An increase in aggregate demand results from the government's higher expenditures and then supposedly leads to so much utilization of underemployed labor and capital that output expands by more than the rise in government spending – that is, by a multiple greater than one. If the economy is operating at less than "full employment," then government programs are even better than a free lunch.

No Empirical Evidence

This extremist example of demand-side economics invites comparison with the oft-caricatured version of supply-side economics in which a general cut in tax rates leads to a sufficient rise in economic activity so that tax revenues increase. The difference is that the supply-side extreme has been observed empirically, such as in Sweden in the 1970s and Peru in the 1980s, whereas we are still waiting for the first sighting of the Keynesian demand multiplier.

The Keynesian case is often thought to be clear-cut for World War II, during which the enormous governmental outlays have been unfairly credited with getting the U.S. economy out of the Great Depression. (One overlooked fact is that the economy's growth rate from 1933 to 1941 was already the highest of any peacetime period of this length for which information is available.) The data show that output expanded during World War II by less than the increase in military purchases. The other potential uses for output – private consumption, private investment, nonmilitary government purchases and net exports – each fell to release resources for the military. Thus, the public outlays had to be justified by the value of the war effort, not by a dubious appeal to government spending as an economic stimulus. No multiplier showed up during World War II, and none has been observed elsewhere, except in the mind of its advocate, John Maynard Keynes.

Since governmental programs use resources, the rationale for these programs has to come from their beneficial effects on productivity, from their direct entertainment value (as in the case of the Washington Monument, the Queen of England and perhaps the space program), or from the value that the political process assigns to the programs' redistribution of income. Since the election campaign has focused on infrastructure investment, I shall consider what is known about the effects on productivity from this type of spending.

The election campaign has focused on infrastructure investment. Yet the claims for its super-normal rates of return have not been substantiated.

An article by David Aschauer in the March 1989 Journal of Monetary Economics noted that the turndown in U.S. productivity growth after the early 1970s coincided with a turndown in the growth of public infrastructure. Subsequent research has found a similar pattern in other industrialized countries. Mr. Aschauer's inference from this relationship was that the cutback in infrastructure spending caused the change in productivity. The return from investing in infrastructure – especially in a core group that included highways, airports, mass transit, electrical and gas facilities, and water and sewer systems – then appeared to be enormous, about 60% a year, just in terms of the contribution to market output.

To accept this conclusion, we have to believe that the governments of various countries decided unwisely to curtail infrastructure investment and thereby reduce productivity at about the same time in the early 1970s. A more plausible interpretation is that productivity and infrastructure both declined in each nation in response to world-wide disturbances, such as the changing mix of technologies and movements in the prices of oil and raw materials.

Although this interpretation does not rule out a role for public infrastructure investment, it does mean that the claims for super-normal rates of return have not been substantiated. A number of research studies (which would probably receive more government funding under a Clinton administration) are trying to use these time-series data to get reliable estimates of rates of return.

Economists have also studied the relation between infrastructure capital and productivity throughout the U.S. Richer states have more public-sector capital per worker, and some investigators have incorrectly inferred from this observation that the greater amount of government capital must have caused the prosperity. More careful analyses do not find a key role for infrastructure in the determination of productivity growth across states or regions. As one example, the differences in growth performances between the Sun Belt and the Snow Belt do not relate to differences in infrastructure investment. For another, the growth rate of a state's per-capita product from 1963 to 1986 is unrelated to its per-capita public-sector infrastructure in 1963. (Starting out with more highways did not mean a state grew faster.)

Researchers have also examined the role of public investment as a determinant of economic growth across a broad group of countries. The social rates of return to broad aggregates of public and private investment appear to be similar. Thus, the total of public investment has a positive, but not super-normal, rate of return. (In contrast, a higher level of the government's consumption expenditures is negatively related to economic growth.) William Easterly and Sergio Rebelo find in their research through the World Bank that the positive relations between public investment and growth show up mainly for spending on transportation and communication, education and urban infrastructure.

The overall evidence from the aggregate data is that investment in public infrastructure as a broad category offers reasonable, but not extraordinary, rates of return. This finding is consistent with cost benefit analyses that have been applied to individual projects. The broad conclusion from these studies is that the highest returns typically derive from maintenance of existing capital (with rates of return up to 40% per year) and from highway projects in congested cities (with rates of return of 10% to 20% annually). In other words, fixing potholes is a good idea, but bullet trains and advanced communications networks are less obvious.

Perot Wins the Prize

Although the discussions of the economic effects of government spending by Mr. Bush and Mr. Clinton are disappointing, the prize for poor economic analysis by a major candidate must surely go to Ross Perot. Mr. Perot hasn't said a whole lot about infrastructure. But his theory of international trade goes something like this: Wage rates in the U.S. are $15 per hour, whereas those in Mexico are $1 per hour. If we eliminated all barriers to trade, then U.S. businesses would move to Mexico to take advantage of the cheap labor; in the end, wage rates in the two countries would equalize at about $7 to $8 an hour.

This analysis is really a remarkable insult to American workers, who might reasonably believe that their wage rates bear some relation to their skills – derived from education, on-the-job training and experience – and not merely from the government's efforts in maintaining trade barriers. One inference, therefore, is that success in business says nothing about one's ability to analyze the economy or form government policies. The reverse – that a good understanding of the economy implies nothing about skill in business – goes without saying.

Mr. Barro, a Wall Street Journal contributing editor, is a professor of economics at Harvard. He was assisted in the preparation of this article by John Fernald, a Ph.D. student in economics at Harvard who is writing a dissertation on the effects of public infrastructure.

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Robert J. Samuelson

Clinton Needs 'Trickle Down Economics'

The good news for Bill Clinton is that the economic recovery seems firmly established. The bad news is that it won't automatically cure the worst problems of poverty and low incomes. Recall that the long Reagan-Bush expansion (1983-90) didn't dent these problems. At the end of the boom in 1989, the poverty rate—the proportion of people below the government's official poverty line—was 12.8 percent, up from 11.7 percent in 1979. The recession then raised the rate to 14.2 percent in 1991.

In his campaign, Clinton belittled "trickle down economics." Reagan-Bush policies, he said, hadn't benefited millions of Americans. The conclusion was right—as the poverty rate shows—but the reasoning is wrong. To Clinton, the Reagan-Bush taxing and spending policies favored the rich at the expense of the poor. In fact, these were at most a modest cause of widening inequality. What really went wrong is that the usual relationship between an expanding economy and better incomes broke down.

It is not that living standards for all Americans are receding. But people in the top half of the income distribution are gaining only slowly while others are losing. In 1989, for example, male workers aged 25-34 with a college degree had median earnings of $33,000, up 7 percent from 1979, reports economist Frank Levy of the Massachusetts Institute of Technology. But the median earnings of workers in the same age bracket with only a high school diploma were $23,000, down 15 percent (after adjustment for inflation) from 1979.

A recovery will create jobs, but it won't inevitably improve the wages of the lowest-paid workers.

The same skewing has occurred all along the income spectrum. The rich got richer, the poor got poorer, and people in between drifted in one direction or the other. Until the 1970s, the steady rise of wages pulled more and more people out of poverty. Now, a job by itself is no longer necessarily adequate. Declining wages at the bottom frustrate upward mobility. Economist Patricia Ruggles of the Urban Institute in Washington estimates that incomes of the poorest fifth of Americans would have been 20 percent higher in 1990 if wage inequality hadn't grown.

A recovery will create more jobs, but it won't inevitably improve the wages of the lowest-paid workers. Worse, the forces depressing wages are largely beyond the government's control. For starters, the trend isn't confined to the United States. Economists Peter Gottschalk of Boston College and Mary Joyce of the Bureau of Labor Statistics have shown that earnings inequality has grown in many industrialized countries.

Nor are only the rich and poor affected. For example, the gap between the best- and worst-paid college graduates has increased. The same is true (to take one well-paid occupation) of lawyers; the gap between the top and bottom is growing. Something unplanned is happening on a massive scale.

But what? Economists have yet to find a conclusive answer. One theory blames new technologies—mainly the computer. Computers have, it is said, thrown low-skilled workers out of jobs and made them a glut on the market. Meanwhile, the demand for highly skilled workers rises, and so do their wages. Another popular villain is global trade. Unskilled workers, competing against low-paid workers abroad, have their wages driven down.

These theories, though plausible, aren't airtight. Greater trade affects only a small proportion of workers; moreover, the fiercest global competition exists among high-wage countries like Japan and the United States. Likewise, technology's impact is murky. After World War II, new technologies abounded: TV, antibiotics, jet travel, synthetic fibers, computers. Yet, wage inequality didn't explode. Nor do the theories explain growing wage gaps between skilled workers: college grads, for instance.

My explanation is simpler: The economic climate got rougher.

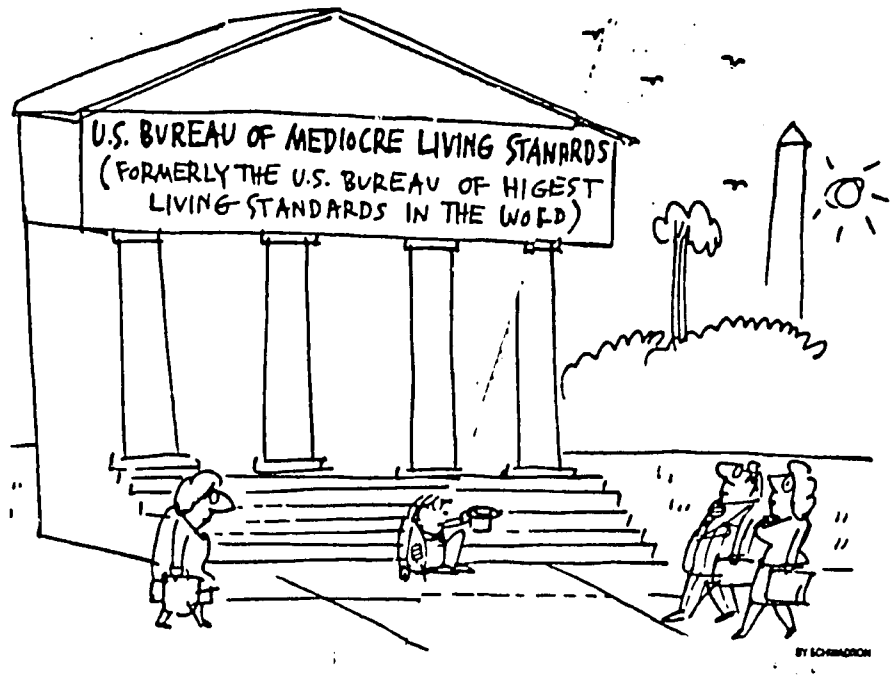
Recall the 1950s and 1960s. People thought we were approaching economic utopia. Business cycles would disappear. The economy would constantly expand—without inflation. Companies were eager to hire new workers to meet permanently rising demand. Low unemployment rates raised the wage rates for younger and less skilled workers. Companies hired them anyway. Profits would be high, because firms had covered all their fixed costs (paying for factories, for example). The economics of euphoria helped make wages more equal.

By the 1970s, these giddy assumptions crumbled. Business cycles hadn't vanished. Inflation raised costs. Profits were squeezed. Companies began to cut costs, including labor costs. The least skilled and youngest workers suffered most. Higher unemployment rates, reflecting anti-inflation policies, made it easier to hire new workers at lower wages. All these forces intensified in the 1980s. Growing trade and deregulation threatened profits and caused companies to become even more cost-conscious. The economics of fear made wages less equal.

This upheaval—the change from the economics of euphoria to the economics of fear—has increased job insecurity as well as income inequality. It also creates some do's and don'ts for Clinton. If he cuts taxes, the benefits should go to the bottom third of the income spectrum. These people benefited least from prosperity. They need the money the most. Government should also reward work by letting low-paid workers keep most of their earnings.

But Clinton shouldn't prop up wages with, say, a much higher minimum wage. That's what some European countries do. This blunts wage inequality, but only by creating more unemployment. Rather than being saddled with unprofitable workers, companies don't hire. In the 1980s, unemployment averaged 9.6 percent in the European Community and 7.2 percent in the United States. Clinton should also be wary of imposing too many regulatory costs on business. These will mostly depress wages or raise prices.

What would help is "trickle down economics." The key is faster growth of productivity (output per hour worked). It propels higher wages, and if overall wages increase rapidly, even those at the bottom should benefit. Unfortunately, productivity has been rising slowly. Clinton says his education and investment policies will improve productivity; at best, the impact would take years. But there are now faint signs that productivity may revive on its own. Clinton should hope so. He needs "trickle down economics." We all do.



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A New Look at 'Trickle Down'

By JOHN A. TATOM

Many analysts believe that President-elect Bill Clinton owes his victory to his attacks on what he called "trickle-down" economics. But he may actually owe his election, and any future economic success, to the validity of supply-side concepts.

It is ironic that the Bush administration was so bitterly vilified for its support for supply-side policies. Critics said this showed Mr. Bush was insensitive to social fairness issues.

But it was precisely those critics' mistaken notions of fairness that laid the foundation for the sorry record of U.S. investment and productivity over the past five years.

In the name of tax fairness, the Tax Reform Act of 1986 substantially raised taxes on capital gains. This tax increase, and cancellation of a wide range of other investment incentives, reduced the rate of return on private capital formation.

Some of the changes in the 1986 tax act arguably did improve the fairness and efficiency of the tax system. But overall, the tax law, along with the soak-the-rich taxes in the 1990 budget compromise, further increased the tax burden on the rich.

The result was reduced capital formation and a period of stagnation in real wage and income growth that has not been seen since the 1930s.

The tax increases in the 1986 law were significant. In the name of tax "fairness," Congress raised the tax rate on capital gains from 20% to a maximum of 33%.

In doing so, Congress accepted the conventional wisdom that capital gains are largely unanticipated windfalls, so taxing them more heavily could not possibly affect investment decisions.

The fallacy of such thinking is that most taxable "capital gains" income arises from retained corporate income, which raises the price of share of stock. These increases are not truly gains, in the sense of increases in the value of the underlying assets.

Moreover, as a practical matter there is no difference between buying a new share of stock with the proceeds of a corporate dividend check or buying it with wage income. Yet in the former case Congress increased the tax rate while in the latter case there was (and is) no tax at all.

Another large chunk of capital gains arises only from inflation. Inflationary increases are factored in when investment decisions are made. Taxing the gains, therefore, lowers the expected return, and therefore reduces the amount of investment.

Moreover, high taxes on capital gains hit small and innovative firms the hardest. Most stock appreciation from retained earnings is found in fast-growing small companies, where dividends are forgone in exchange for continuing reinvestment of capital. Rec[illegible] investment in these industries substantially lowers the nation's standard of living.

Under the 1986 tax act, the tax rate on capital income that is realized through reinvested earnings and stock appreciation was raised to 59.1% from 56.8%. The new rate includes the maximum 39% rate on corporate income and the maximum 33% rate on the gain expected from reinvesting the remaining 61 cents from each dollar of pretax earnings.

The corporate tax changes boosted corporate income tax liabilities by 47.3% — from $58.5 billion in 1985 to $86.1 billion in 1987 — while nominal gross domestic product grew by only 12.4%. The 1990 tax agreement further boosted the maximum tax rate on such corporate earnings to 60%.

As a result of these tax changes, real business investment peaked at a record high of 12.2% of real gross domestic product in 1985 and dropped fairly steadily to 10.2% at the end of 1991. This decline is the equivalent of roughly $120 billion of "lost" business investment annually.

Nor surprisingly, business productivity grew at only a 0.1% rate from mid-1986 to mid-1991, the slowest five-year pace on record, and much worse than the stagnant performance that followed the oil price shocks of the 1970s.

The recent effects of boosting the taxation of capital income provide decisive evidence — again — against those who criticize what they call trickle down.

It is doubly ironic that criticism of trickle down comes just as the economy seems to be completing its adjustment to the 1986 tax act. Equipment investment is accelerating and productivity finally has begun to rise.

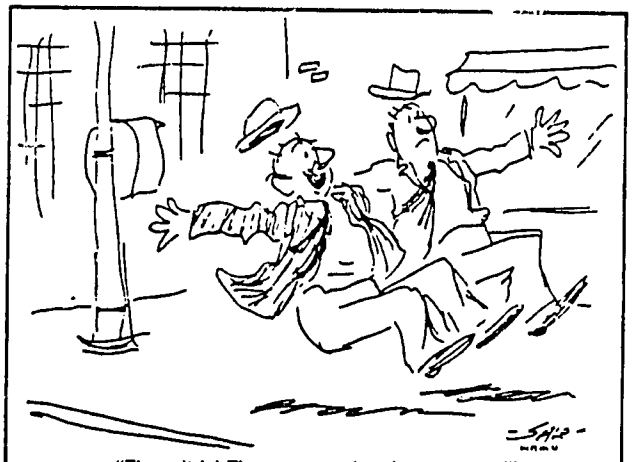
That means the nation's real income is likely to grow. But President Bush will have to watch that growth take place on Bill Clinton's watch.

While President-elect Clinton should reap the political benefits of an economic rebound, the growth is likely to be overshadowed by the losses of the past six years.

Recapturing those losses would require lowering taxes on capital income. Such a policy could deliver both a fairer tax system and 1980s-style economic growth.

Bill Clinton apparently intends to seize this opportunity for economic growth and fairness by championing some supply-side initiatives. He is likely, for example, to propose lowering the capital gains tax rate, and he already has suggested a limited investment tax credit.

If that is surprising, it is worth remembering that it took a Cold Warrior like Richard Nixon to open up relations with Communist China.



"There it is! The economy just jump-started!"

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ROBERT HAVEMAN

WHO ARE THE NATION'S "TRULY POOR"?

PROBLEMS AND PITFALLS IN (RE)DEFINING AND MEASURING POVERTY

Twenty-five years ago the federal government officially adopted its current measure of the poverty rate, a measure that has survived numerous attacks and both official and unofficial attempts to change it. This past year, in response to congressional directives and with the support of the Bush administration, the National Academy of Sciences brought together a panel of experts to revise it, with a view to either replacing it or supplementing it with other indicators of destitution.

Revising the official measure will be controversial. Movements in the poverty rate are key to evaluating the performance of political administrations and the health of the economy. Numerous pieces of legislation use the poverty measure to allocate federal funds and determine eligibility standards for receiving public benefits. Important interests—states, localities, social service organizations, and benefit recipients—stand to gain or lose from any change in the definition of poverty.

The official poverty statistic is also a symbol with far-reaching ideological and political implications. Conservatives find their interests best served by a low poverty rate, one that can muffle claims of social distress and counter calls for increased public spending. Republicans, having controlled the White House for 20 of the past 24 years, want a measure that shows poverty falling over time—or at least not rising so fast. With official U.S. poverty standing at over 14 percent, more than 2 percentage points higher than it was in 1979, those seeking a smaller public sector find much to fault in the current measure.

Liberals cite high and rising poverty as the primary manifestation of the nation's social problems and charge that it undermines efforts to reduce crime, substance abuse, teen nonmarital parenthood, and infant mortality, and to improve declining student achievement. The high rate of poverty among people of color has suggested to many a link between increasing poverty and deteriorating race relations. The past decade's growth in the poverty rate has spurred calls for increased social spending and strengthened those who support affirmative action measures.

A final source of controversy is that the official poverty measure is an arbitrary construct based on many social judgments about economic needs and well-being. What is an "acceptable social minimum level of living"? What is to be counted in comparing the well-being of people who live in widely varying family types, regions, and neighborhoods? Few of these judgments have, or can have, a reliable scientific basis. Most ultimately require political decisions, a difficult situation for the National Academy panel.

A Fragile Social Indicator

By the official measure, an American family is "poor" if its annual cash income falls below a specified income cutoff that varies with the size and structure of families. By showing the number and demographic composition of the nation's families (and individuals or chil-

Poverty Rate Grows for Hispanic Children

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COUNTING THE POOR —WITH AN ANTIQUE CALCULATOR

U.S. Poverty Rate Up; Median Income Falls

Census Finds First Increase in Poor Since '83

From GOP, A New Look At Poverty

Group Tries to Hurdle Gulf Between Parties

More Children Are Sinking Into Poverty

Who Is Poor?

THE ELDERLY ARE REALLY POORER THAN OTHERS

Children in Poverty: 1 Million More in 80's

dy Says Poverty Rising Fastest Among Whites

MONTAGE BY ROBERT WISER

dren) in poverty each year, the official measure charts the nation's "progress against poverty" and the changing race, age, and family-structure mix of its poor.

Both the income measure and the poverty cutoff line have come under heavy fire from critics, and both are likely targets for revision by the National Academy panel. The annual cash income reported in the Current Population Survey is taken by the Census Bureau at face value, though it probably fails to include most income earned "off-the-books" or illegally. It also misses all "income" in the form of barter ("You take care of my kids today, and I'll give you some vegetables from my garden.") and gifts. Cash transfers such as welfare benefits are included, but "in-kind" benefits, such as food stamps, housing and medical care benefits, and nutrition subsidies, are not. Tax payments are not subtracted. Income from dividends, rent, and interest is counted; capital gains income and fringe benefits are excluded. Holdings of financial wealth, consumer durables, and housing assets are not even considered. In short, annual cash income neglects a variety of things that contribute to a family's well-being.

The poverty cutoff line is also open to serious question. The income level taken as a socially accepted minimum is based on a 1955 estimate of the cost, for families of various sizes and types, of a minimum level of food. On the basis of crude evidence that 1950s spending on food typically absorbed about a third of a family's budget, that estimate is then multiplied by three. So defined, the poverty line is not affected by a doubling or a halving of the average income of Americans. It is an absolute concept, in spite of the view of many that the definition of a poverty cutoff should reflect the average income in the society. Moreover, critics question why today's official poverty measure should be based on preferences and consumption options of a quite different era. They also challenge the "minimum necessary" standard as being too low and the "blow-up factor" of three and the family size adjustment as arbitrary, dated, or inconsistent with research findings.

How to Measure Economic Well-being?

A yet more fundamental—and controversial—question is whether the official poverty measure reliably reflects the economic status of a family. Annual cash income is a notoriously transitory indicator of economic position. Income can fluctuate widely from year to year, especially among some families that, by any standard, are quite well-to-do. Self-employed business people are a good example. A bad year can well result in a report of zero (or even negative) income that places the family in the poverty category, regardless of its consumption spending or its lifestyle.

Researchers have tried to develop more reliable indicators of economic well-being. Susan Mayer and Christopher Jencks, for example, look to the ownership of consumer durables and other consumption items. Others use family income averaged over three or four years. Although a measure of that sort is more likely than annual cash income to reveal a family's "true" economic position, the Census Bureau does not yet routinely collect such data.

Annual cash income fails to reflect the permanent capabilities and earning power of families in other ways as well. Three examples will make the problem clear.

First, take two families, both with little education and poor skills. In the Jones family, both the husband and wife hold full-time jobs, and their teenage son works part-time on weekends. Although poor in skills and education, the Jones family escapes poverty. In the Smith family, by contrast, the husband works full-time, the wife stays at home, and the teenage son does not work at all. The Smiths' annual income falls below the poverty line. These families are identical in size and structure, but only the Jones family, by working more, escapes poverty. It is legitimate to ask: "Should the official poverty measure count as poor families who could be earning more if all members worked and not count as poor otherwise identical families, all of whose members do work? Should the strength of one's aversion to work count in measuring poverty?"

Second, the Cartwright family, a father and mother, neither of whom finished high school, and two children, lives in Louisiana. Mr. Cartwright has been out of work for a long time, and the family is eligible for Aid to Families with Dependent Children. Welfare is so low in Louisiana, however, that the Cartwrights have decided not to accept it and the restrictions that accompany it. Instead, Ms. Cartwright works as a waitress, and Mr. Cartwright works in a gas station on weekends while seeking full-time work. Together with their son's part-time earnings, the Cartwrights have enough income to escape poverty. The Epson family has the same characteristics as the Cartwrights, but lives in California. California's AFDC benefits are more generous than Louisiana's, and so the Epsons collect welfare. Neither of the Epsons works (if they did, they could lose their benefits), and their cash income, including AFDC, is less than the poverty line. Again, it is legitimate to ask whether the poverty measure should count as poor those families who face and respond to high work disincentives (caused by, say, relatively generous welfare benefits), and exclude those whose available benefits are low, but who work themselves out of poverty.

Finally, what if the Cartwrights failed to earn enough to escape poverty while the Epsons' welfare benefits plus some interest and dividends were sufficient to lift them out of poverty? Should the poverty measure count as poor those families for whom generous benefits are not available and exclude identical families who receive more generous benefits?

Anomalies in the Official Poverty Measure

The official poverty indicator is geared to measure the extent and composition of the nation's "cash deficient" population in any given year. If that is what one wants in a national poverty measure, it probably receives a marginal passing grade. But if one prefers a poverty measure that reflects the level and composition of those with deficient long-term capabilities to earn income, the official measure leads to several anomalies. For example, independent law or business school students are likely to be counted as poor despite their enormous earnings potential. As a result, the poor are recorded as being younger and more educated than they really are.

Similarly, some families (for example, those headed

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HOW EARNINGS CAPACITY POVERTY IS MEASURED

Family earnings capacity is an estimate of the capability of the head (or head and spouse) of a family to earn income if working at full capacity, adjusted to reflect the reality that illness, disability, unemployment, and child care responsibilities may keep all working-age adults from either working or working at capacity. The actual procedures are as follows. First, the earnings of all full-time, year-round workers in the Current Population Survey are related statistically to a variety of their characteristics, such as race, gender, education, age, and health status. Then, using these estimated relationships, the amount that could be earned by each adult if he or she worked full-time, year-round is calculated. That figure is adjusted downward for the time that the individual either sought work but could not find it or could not work because of health problems. After the individuals are collected into their families, their individual earnings capacities are summed. The resulting value for each family is then adjusted downward to reflect the costs of the child care that would have to be purchased if all the adults were to work to capacity. This adjustment reflects the number and ages of the children and an estimate of the per hour costs of child care. The result is taken to be family earnings capacity. When this amount fails to exceed the family's poverty line, the family is labeled "earnings capacity poor."

Table 1. Official and Earnings Capacity Poverty, 1973–88

	1973	1988	PERCENT CHANGE 1973–88
INCIDENCE OF EARNINGS CAPACITY POVERTY			
Individuals	5.8%	6.9%	+20%
Children less than 6	11.3	14.5	+29
INCIDENCE OF OFFICIAL POVERTY			
Individuals	10.2	11.9	+17
Children less than 6	15.4	20.8	+35

Source: Robert Haveman and Larry Buron, "Escaping Poverty through Work: The Problem of Low Earnings Capacity in the United States, 1973–88," *Review of Income and Wealth* (forthcoming).

by self-employed people or farm owners) have income that fluctuates dramatically year to year; some of these families also systematically "underreport" their income. Such families are likely to be counted as poor when in fact they have high levels of education, ample opportunities, and quite adequate lifestyles. Again, the poor will seem more highly educated than they really are.

Finally, as the example of the Cartwrights shows, some people with high motivation and drive, but with few skills and low earnings capabilities, tend to be underrepresented in the official poverty measure.

As a result, many officially "nonpoor" Americans may have few skills and capabilities while many of the "poor" in a given year may actually have substantial earning power. U.S. poverty statistics may be capturing a group that in many ways fails to conform with accepted notions of what it means to be down-and-out, poor, or with few means of "making it" economically.

A More Permanent Measure: Would It Matter?

It is probably unrealistic to expect the Academy panel to recommend a new poverty definition based on a more permanent indicator of economic position—say, one that more clearly reflects the capabilities of a family to earn income and to be economically independent. Yet it would be interesting to see if the picture of poverty obtained from such an alternative would differ from the official picture. Would the composition of the poor be different? Would an assessment of America's progress against poverty change?

Some 20 years ago I (together with Irwin Garfinkel) devised a measure of the capability of a working-age family to earn income if the adults in the family were to work full-time, year-round. (This measure relies on the Current Population Survey, the data source used by the Census Bureau in making its official poverty estimate.) If a family's earnings capacity exceeds the poverty line for that type of family, it is able to work its way out of poverty, if it fully uses these capabilities. If family earnings capacity is less than the poverty line, the family is said to be "earnings capacity poor."

Among the advantages of such a measure is that it is not as transitory as annual cash income. Moreover, it sidesteps the problematic issues raised by the comparison of the Smith and Jones families and the Cartwright and Epson families—issues involving families' differing preferences regarding work, responses to work disincentives, and the receipt of public cash benefits. Finally, it rests more solidly on economic principles and is close to the ideal "full-income" concept of measuring the economic status of a family over its lifetime.

Table 1 compares the incidence of official poverty and earnings capacity poverty in working-age families in 1973 and 1988. In 1973, 5.8 percent of all Americans living in such families were earnings-capacity poor—that is, they could not earn enough to escape poverty, even if the adults in the family worked full-time. By 1988, that figure had increased 20 percent, to 6.9 percent. For small children the incidence rate was much higher—11.3 percent in 1973, 14.5 percent in 1988—as was the trend increase: 29 percent.

The official poverty rate for all individuals was al-

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most double the earnings capacity poverty rate, but it rose a bit more slowly—17 percent. The official poverty rate for small children grew about twice as fast as that for all individuals; in addition, it grew even faster than the earnings capacity rate for children in working-age families.

Two somewhat different pictures of the nation's efforts to reduce poverty over this period emerge from the two measures. In both cases, poverty rates rose. But the proportion of young children who live in families unable to work their way out of poverty grew more slowly than the proportion living in families with annual income below the poverty line.

Table 2 summarizes the incidence of official and earnings capacity poverty for a few important groups of the working-age population in 1973 and 1988. Some surprising patterns turn up.

The more vulnerable groups—minorities and female-headed families—have 1988 official poverty rates that range from 24.5 percent to 57 percent and earnings capacity poverty rates that range from 11.9 percent to 36.4 percent. Rates for the less vulnerable groups are far lower as measured either way.

But while official poverty rates for the more vulnerable groups show little if any improvement from 1973 to 1988, the earnings capacity poverty measure shows significant progress for each of these groups. Their earnings capacity poverty measure *fell* by from 13 percent to nearly 40 percent, showing that their ability to earn enough to escape poverty rose substantially.

Another surprise is that the less vulnerable groups experienced small increases in official poverty but large increases in earnings capacity poverty rates. For these groups, generally thought to be immune from economic hardship, the incidence of earnings capacity poverty increased by from 20 percent to 92 percent.

Table 2. How Different Groups Are Faring

	INCIDENCE OF OFFICIAL POVERTY		INCIDENCE OF EARNINGS CAPACITY POVERTY	
	1988	PERCENT CHANGE 1973–88	1988	PERCENT CHANGE 1973–88
MORE VULNERABLE GROUPS				
Blacks	29.1%	-5%	18.5%	-13%
Hispanics	24.5	+13	11.9	-27
Female heads	33.5	-9	22.2	-26
Black female heads with children	57.0	-2	36.4	-39
LESS VULNERABLE GROUPS				
Whites	7.3	+12	4.4	+47
Intact families	8.1	+6	2.5	+20
Families headed by persons with post-secondary education	5.7	+16	2.4	+92

Source same as Table 1.

In sum, since the early 1970s, the bad news is that groups that are most economically secure—whites, intact families, and families headed by people with postsecondary schooling—have seen their earnings capacity poverty rate increase rapidly. The good news is the large fall in the earnings capacity poverty rates of the nation's most vulnerable groups.

These patterns are consistent with developments and trends reported elsewhere. To begin with, the period from 1973 to 1988 witnessed a decline in average real earnings, reflected in the increase in official poverty. The earnings decline was the greatest for the most vulnerable groups—those with little education and few skills—who experienced both increasing joblessness and underemployment. But public benefits afforded them some "safety net" relief. On balance, their official poverty rates changed little, even though their earnings capacities rose, and their earnings capacity poverty rates fell substantially.

At the other end of the distribution, the less vulnerable families sought to counter the wage rate decline by working more hours and adding second workers. They were only partially successful, as their official poverty rates did creep up. However, because of their added work, their official poverty rates rose over the period far less than their rates of earnings capacity poverty.

The large decline in earnings capacity poverty rates for low-education, minority, and single-parent families would have been better news, of course, if the marked increase in the capability of these groups to earn their way out of poverty had been reflected in an equivalent fall in their official poverty rates. Why has the nation not been able to realize this increase in productive capabilities? One possible explanation is that the economy failed to generate opportunities for these groups to make full use of their earnings capabilities. Another is that they chose not to use their earnings capacities more fully. On the assumption that the first explanation is the real one, economic growth, especially growth not driven by demand for highly skilled labor, could yield substantial economic gains for these more vulnerable groups.

Taking Poverty's Measure

Clearly, one's assessment of who is poor, of which groups have the highest poverty rates, and of the nation's progress against poverty depends heavily on the measure of economic position that one uses.

The task of developing a reliable indicator, or, alternatively, a series of indicators, of family economic well-being is a daunting one. Decisions on fundamental measurement issues will play a crucial role in determining the nation's collective view of how bad things are, on whom policies should be targeted, and whether or not things are moving in the right direction.

Whatever decisions the National Academy of Sciences panel makes, it will be criticized by many, applauded by few. But the panel also has the mandate, and hence a great opportunity, to change an important element of how we as a nation view ourselves. The definition of poverty, or perhaps the family of definitions, that is officially adopted will be a crucial statistical indicator of national performance. Like the unemployment rate, the poverty measure embodies a national goal. The Academy panel has the chance to influence heavily where the country puts its mouth on this matter, and, implicitly, where it should put its money. ■

THE WALL STREET JOURNAL MONDAY, DECEMBER 14, 1992

The 'Poverty' Lobby's Inflated Numbers

By HOLMAN JENKINS JR.

No matter what he decides at his economic summit, Bill Clinton faces the prospect of a vast increase in poverty on his watch. That's because a move is afoot to expand the government's definition of poverty and thus the number of "poor" people.

A Democratic initiative thrown in George Bush's face may thus blow up in Bill Clinton's lap. Poverty's definition does more than determine who's eligible for food stamps and Medicaid. It influences the country's image of itself and shapes its welfare strategy. Thanks to the expansive ways in which we've defined the problem over the years, poverty relief has gotten mixed up with a crusade for income equality.

Mr. Clinton, with his talk of "a hand up instead of a handout," presumably takes a different view. His new economic czar-designate, Goldman Sachs's Robert Rubin, recently chaired a poverty task force for New York's Cuomo Commission. In a personal postscript, he wrote that poverty-fighting should "rely not on income transfers but rather the development of constructive behavioral norms and useful skills." This is not the prevailing wisdom among the party's traditional poverty mavens.

Imagining the 'Poor'

Under their tutelage, the debate has long been dominated by something called the federal poverty line. At $13,924 for a family of four, it's not a lot money. On the other hand, when most Americans hear on the evening news that 36 million of their fellow citizens are "living below the poverty line," they imagine homeless people, urban slums, Appalachian shanties. In fact, most of the "poor" fall outside these dire categories.

The Heritage Foundation's Robert Rector has shown that 40% of "poor" families own their homes and 62% own at least one car. From the Census Bureau, publisher of the annual poverty line, comes word that the poorest 20% of households somehow manage to consume twice as much as they earn. And as the liberal Economic Policy Institute notes, "most poverty spells are relatively short." The turnover in the noncitizenry poor is nearly 45% a year.

In other words, a lot of what passes for poverty is just the normal ebb and flow of lifetime income. An MBA student living off a check from home is "poor." Somebody who takes a year off for navel contemplation is "poor," even when he's living comfortably off his savings or a girlfriend's paycheck. Lots of old folks qualify as "poor" even though they own houses and other assets.

Part of the problem is that a one-year snapshot of cash income doesn't tell very much about how people really live. Savings, assets and noncash government aid aren't even counted when lumping people in poverty. Also, the poverty formula includes a discredited inflation adjustment that exaggerates housing costs.

Thanks to the expansive ways in which we've defined the problem over the years, poverty relief has gotten mixed up with a crusade for income equality.

You might think the poverty technicians would be eager to hone this blunt catchall. Nope. At the prodding of Democrats in Congress, the National Academy of Sciences is looking for a new poverty calculus, and it will almost certainly drag a lot more working people into the corral.

Patricia Ruggles, a former congressional staffer now at the Urban Institute, orchestrated funding for the NAS study. She favors raising the poverty income threshold by 50%. And she's not the only one with such category-widening impulses. In their book, "The Forgotten Americans," the University of Arizona's John Schwarz and Thomas Volgy nominate 12 million more working people for poverty. Others are pushing to have the line fixed as a percentage of the median income. That way, as long as some people have higher incomes than others, a portion would always be poor, no matter how comfortably they lived.

But even given the best efforts of the poverty lobby to implicate more voters as potential beneficiaries, are taxpayers really likely to shell out more for the less poor? Americans are keen on poverty relief, not income equalization. Yet even this limited objective seems to be a failure. All the money they've dumped on the most visible and troubling poverty hasn't made a dent. The urban underclass continues to grow, along with crime and racial tension.

Maybe it's time for a new way of looking at poverty, one that's more concerned with somebody's life chances than with one year's income.

America took in six million immigrants during the 1980s, many of them poor, ill-educated but aspiring Third Worlders. We are a more diverse and dynamic society, but also one of greater extremes. Half or more of the people living in many U.S. cities are minorities, compared with less than 5% for most European cities. Our West European friends are often painted as showcases of social enlightenment. But as they've lately demonstrated, the leveling aesthetic can, under more stressful circumstances, produce a clamor to exclude.

The poverty lobby isn't insensate to these concerns. Some have started talking about the "behavioral poor" or the "persistently poor," as if poverty is about more than just having a low income. In the words of the Urban Institute's Isabel Sawhill, if somebody is prepared to live responsibly, he or she is "unlikely to be chronically poor."

How many Americans fail this test? The estimates are fuzzy. Some would count everybody who has been "poor" for eight or more years. That's about 10 million people, or less than a third of those below the so-called poverty line. Even so, it pulls in many elderly and disabled people, whose problems are quite different.

Using census data, Ms. Sawhill picks out neighborhoods where teenage mothers, high school dropouts, welfare dependents and jobless men are thickest on the ground. Between 1970 and 1980, the number of such neighborhoods tripled to 880 and their combined population rose from 750,000 to 2.5 million.

All sorts of culprits have been blamed for the swelling of the underclass — welfare, the loss of low-skilled manufacturing jobs, the free-love ethic of the 1960s. Whatever else is going on, these neighborhoods are themselves a problem.

They breed the behavior that breeds chronic poverty. Holding all other variables constant, young black men are three times more likely to land in jail when they come from such "bad" neighborhoods. In Chicago, after a housing desegregation lawsuit, hundreds of single mothers were transplanted from the projects to the suburbs. Nothing else changed, yet half those who had never worked before now have jobs, and 52% of the kids end up going to college.

The Importance of Mobility

Mobility should play a bigger role in our thinking about poverty. The current standard, preoccupied with income snapshots, only echoes the current welfare formula, with its emphasis on supporting people in poverty rather than helping them to get out.

There are better ways: workfare, school and housing vouchers, a bigger earned-income tax credit, trashing the minimum wage. But these good things take money and political capital, and those are endangered by people flogging an expansive definition of poverty and eager to spread limited money among a wider group of "poor" people.

Mollie Orshansky, the government economist who 30 years ago devised the poverty line, once quipped that "poverty is in the eye of the beholder." Bill Clinton talks as if he's genuinely sympathetic to the idea of putting the emphasis back on mobility. Unfortunately, he's not likely to get much help from his own party's poverty establishment.

Mr. Jenkins is a Journal editorial writer.

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THE WALL STREET JOURNAL THURSDAY, SEPTEMBER 24, 1992

The Economy's Power Shift

By PETER F. DRUCKER

Power in the economies of developed countries is rapidly shifting from manufacturers to distributors and retailers.

The phenomenal success of Wal-Mart, which made the late Sam Walton one of the world's richest men in less than 20 years, was based squarely on the chain's controlling the operations of its main suppliers. Wal-Mart, rather than the manufacturer – a Procter & Gamble, for instance – controls what should be produced, in what product mix, in what quantities, when it should be delivered, and to which stores. Similarly in Japan, Ito-Yokado Co. controls the product mix, the manufacturing schedule and the delivery of major supplies, such as Coca-Cola or beer, for its 4,300 7-Eleven stores.

In hardware a few very large distributors – many of them owned by the independent retail stores they serve – actually design the products (or at least write the specifications for them), find a manufacturer, and lay down manufacturing schedules and delivery times. One example is Servistar, a Butler, Pa.-based company, which buys for 4,500 stores across the U.S. and is owned by them.

The chains of hypermarkets that have come to dominate food retailing in France and Spain similarly control the product mix, manufacturing schedules and delivery schedules of their main suppliers. And so do the discount chains that take a growing share of the U.S. market in office products. In the U.S., the free-standing community hospital is no longer the principal customer for health-care products. Buying is now done by chains – for-profit ones, such as Humana; voluntary ones; denominational ones, whether Catholic or Lutheran. They set the product specifications, find the manufacturer, negotiate price, and determine manufacturing schedules and delivery.

What Customers Want

Distributing is increasingly becoming concentrated; manufacturing, by contrast, is increasingly splintering. Thirty years ago, three big auto makers shared the U.S. market. Today the market is split among 10 – Detroit's Big Three, five Japanese, two Germans. But 30 years ago 85% of all retail car sales were done in single-site dealerships; even three-dealership chains were quite uncommon. Today a fairly small number of large chain-dealers – no more than 50 or 60 – sell two-fifths of all cars in the U.S. Yesterday's dealer handled only one make. Today's chains may sell GM cars in one dealership, Toyotas in the dealership across the street, and BMWs in a dealership in the next town. They have little commitment to any one maker but go by what their customers want.

In the mid-1960s Servistar (then called American Hardware) bought less than $20 million a year and had 600 member stores. Today it serves 4,500 stores and has an annual volume of $1.5 billion. Twenty years ago, each of the current 7-Eleven outlets in Japan was an independent "mom and pop" store. Mom and Pop still serve the customers, but they have become franchisees. 7-Eleven runs the store, decides what merchandise it carries and in what quantity, buys it, stocks it, does the display, finances the store, does its accounting, and trains its people.

These large distributors are becoming less and less dependent on manufacturers' brands. Thirty years ago, only two very big American retailers successfully sold their own "private labels": Sears Roebuck and R.H. Macy. The largest American food retailer of that time, the Great Atlantic & Pacific Tea Co., tried to emulate these two. A&P's private labels were superior value. But the public refused to buy them, which all but destroyed A&P. Now private labels are flourishing.

The independent stationery store in my neighborhood carries only national brands. But the only national brands carried by the recently opened local outlet of a stationery discount chain are goods that require service, such as computers and fax machines, and they account for less than half of the store's volume. Increasingly the retail chains use cable TV to promote their own brands; they no longer depend on the manufacturers' advertising on over-the-air networks.

What underlies this shift is information. Wal-Mart is built around information from the sales floor. Whenever a customer buys anything, the information goes directly – in "real time" – to the manufacturer's plant. It is automatically converted into a manufacturing schedule and into delivery instructions: when to ship, how to ship and where to ship. Traditionally, 20% or 30% of the retail price went toward getting merchandise from the manufacturer's loading dock to the retailer's store – most of it for keeping inventory in *three* warehouses: the manufacturer's, the wholesaler's and the retailer's. These costs are largely eliminated in the Wal-Mart system, which enables the company to undersell local competitors despite its generally higher labor costs.

> *Drucker on Management*
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> *In the U.S. hardware industry, for example, the new distributors such as Servistar are doing what three levels of wholesalers used to do; 7-Eleven in Japan has eliminated five or six wholesale levels.*

The moment a 7-Eleven customer in Japan buys a soft drink or a can of beer, the information goes directly to bottler or brewery. It immediately becomes both production schedule and delivery schedule, actually specifying the hour when the new supply has to be delivered and to which of the 4,300 stores.

We would not have needed the computer to do what Wal-Mart and 7-Eleven are doing. More than 50 years ago, Marks & Spenser, the British retail chain, integrated market information and the manufacturing schedules of its suppliers and created the first just-in-time system. In the mid-1960s, O.M. Scott of Marysville, Ohio, a producer of grass, seeds, fertilizer and pesticides, built real-time market information into its manufacturing system. Both almost immediately attained industry leadership. But once the computer is there and provides instant market information, the integration of this information with manufacturing production and delivery becomes inevitable.

Since I first said it in my 1954 book "The Practice of Management," it has become commonplace to assert that results are only in the marketplace; where things are being made or moved, there are only costs. Everybody these days talks of the "market-driven" or the "customer-driven" company. But as long as we did not have market information, decisions (especially day-to-day operating decisions) had to be made as *manufacturing* decisions. They had to be controlled by what goes on in the plant, and they had to be based on the only information we had (or believed we had) – on manufacturing costs.

Now that we have real-time information on what goes on in the marketplace, decisions will increasingly be based on what goes on where the ultimate customers, whether housewives or hospitals, take *buying* action. These decisions will be controlled by the people who have the information – retailers and distributors. Increasingly decision-making power will shift to them.

Some implications: Producers will have to restructure their plants for "flexible manufacturing" – the buzzwords for production organized around the flow of market information rather than around the flow of materials as in traditional manufacturing. The more we automate, the more important this will be. General Motors largely wasted $30 billion on automating the traditional process, which only made its plants more expensive, more rigid and less responsive. Toyota (and to some extent, Ford) spent a fraction of what GM spent. But it spent the money restructuring production around market information – on "flexible manufacturing."

Another important implication. When, during the past 10 or 15 years, companies began to organize themselves internally around the flow of information – we now call it "re-engineering" – they immediately found that they did not need a good many management levels. Some companies have since cut two-thirds of their management layers. Now that we are beginning to organize around *external* information, we are learning that the economy needs far fewer intermediaries: We are eliminating wholesalers.

Warehouses Change

In the U.S. hardware industry, for example, the new distributors such as Servistar are doing what three levels of wholesalers used to do; 7-Eleven in Japan has eliminated five or six wholesale levels. And this trend has only started.

Physical distribution is changing too. In many industries the warehouse is becoming redundant. In others it is changing function. One medium sized supermarket chain now handles half its merchandise without any storage; it goes directly from manufacturer to store. The other half still goes through a warehouse. But it is not held there; it goes out within 12 hours, soon to be cut to three – in transportation parlance, the warehouse has become a "switching yard" instead of a "holding yard."

This also means that the economy needs less and less of the financing that for two centuries provided banks with their safest and most lucrative business: short-term lending on inventory. The sharp drop in the demand for such money explains in large measure why banks in developed countries are seeing their commercial-loan business shrink, even in boom times, and why they have been trying to compensate by rushing into dubious real-estate deals and loans to Third World dictators.

But the biggest implication is that the *economy* is changing structure. From being organized around the flow of things and the flow of money, it is becoming organized around the flow of information.

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Deja Vu in Currency Markets

By Milton Friedman

Bretton Woods
1944 to Aug. 15, 1971

(Out of concern for the readers' patience and the Journal's newsprint, I omit the numerous prior episodes from Diocletian's Rome to World War II.)

The first post-World-War-II noble experiment in pegged exchange rates collapsed when President Nixon closed the gold window, suspending the commitment that the U.S. had entered into at Bretton Woods to convert dollars into gold for foreign central banks at $35 an ounce. Stated differently, the U.S. was unable or unwilling to undertake the deflationary measures that would have been required to enable the U.S. to live up to its commitment.

During the 25 years after the International Monetary Fund was created at Bretton Woods to monitor a system of fixed exchange rates among member countries, there were numerous changes in exchange rates. The changes included an appreciation of the German mark in 1961 and again in 1969, major devaluations of the British pound in 1949 and in 1967, and of the French franc in 1949, 1958 and 1969. The 1969 changes came after a major foreign exchange crisis that began with the French students' strike in 1968 and extended into 1969.

For eight years during this period there was also a European Payments Union designed to foster pegged exchange rates among European countries. It was terminated in 1958.

All in all, the much vaunted Bretton Woods System of pegged exchange rates operated as intended for only eight years – from 1959 to 1967 – and even those years were not free from exchange rate changes.

The Smithsonian Turnpike
December 1971 to February 1973

An attempt was made to reconstruct a pegged rate system at a meeting held at the Smithsonian Institution in December 1971. That system lasted less than two years. Even during that brief period, there were crises and numerous changes in pegged exchange rates.

End of the Sterling Area
June 23, 1972

A sterling area consisting mostly of members of the Commonwealth survived the prewar British Empire. The participants pegged their currencies to sterling and followed sterling when it was devalued in 1949 and 1967. After many difficulties, it finally collapsed on June 23, 1972, when Britain floated the exchange rate.

The Snake
April 1972 to 1979

After the collapse of Bretton Woods, the European Economic Community embarked on a process of trying to create a narrower pegged rate system limited to members of the EEC. The initial attempt was the snake, so called because it specified wide limits for each country's exchange rate above and below central values, which themselves changed from time to time.

As Anna J. Schwartz relates in "Money in Historical Perspective" (University of Chicago, 1987): "Six countries (France, Germany, Italy, Belgium, Luxembourg, the Netherlands) originally joined the snake, three others joined in May 1972 but left in June (U.K., Denmark, Eire). Denmark rejoined in October 1972, Italy left in December 1972. France left in January 1974, rejoined in July 1975, and left again in March 1976. Sweden and Norway, non-EEC countries, joined in May 1972. Sweden left in August 1977. [And] many changes in exchange rates within the snake were made."

European Monetary System
1979 to 1992

The unsatisfactory snake was succeeded by a more formal arrangement, the European Monetary System, with narrower limits on exchange rates for the major currencies, broader ones for others. Britain was not an initial member and did not join until 1990. Changes in exchange rates were frequent throughout most of the existence of the EMS. All told, there were 11 devaluations or revaluations from 1979 to 1987, sometimes affecting more than one currency. A period of stability followed, much like that under Bretton Woods from 1959 to 1967, though even shorter. Both periods of stability had the same basic source: a major country – first the U.S., then Germany – that was willing to finance the balance of payments deficits of other members of the exchange agreement.

The situation changed drastically after the fall of the Berlin Wall and the unification of Germany. To finance reunification, Germany had to shift from being a large capital exporter, mostly to fellow EMS members, to becoming neutral or even a capital importer. That meant that it had to sell less and buy more from other countries, which required that its goods become relatively more expensive to foreigners; and their goods, relatively cheaper to Germany. That could be accomplished in only one or some combination of four ways: inflation in Germany, depreciation of the mark, depreciation of other currencies relative to the mark, or deflation in fellow EMS members.

How many more fiascoes will it take before responsible people are finally convinced that a system of pegged exchange rates is not a satisfactory financial arrangement?

Germany was unwilling to accept inflation and the EMS ruled out exchange rate changes. That left only deflation in other EMS countries. Britain and France in particular, but also Italy, Spain and other countries, subjected themselves to a severe and prolonged recession and high unemployment in order to maintain their pegged exchange rates with the mark. Finally, the price became too high for Britain and Italy. They were unwilling to take the further severe deflationary measures that would have been required, and the house of cards collapsed. If Britain and Italy had stuck it out, France would probably have soon pulled the peg. The system was doomed once Germany's position changed after unification.

Plaza and Louvre Agreements
1985 and 1987

In addition to the formal continuing arrangements for pegging currencies, hardly a meeting of the Group of Seven or 10 passes without discussions of exchange rates. The two most notable outcomes of past meetings were the Plaza and Louvre agreements under the leadership of then Secretary of the Treasury James Baker.

The Plaza conference of September 1985 was held because the dollar was deemed to have appreciated too much, having nearly doubled in value relative to the currencies of the G-10 from 1980 to early 1985. By the time the meeting was held, the dollar had already started to depreciate, and had lost nearly a quarter of its prior gain. Nonetheless, the representatives of the major nations agreed that it should be driven down further – something that did not seem to require any special action on their part.

By February 1987, when the more important Louvre Summit was held, the dollar had lost more than three-quarters of its earlier appreciation. The powers that be decided that was enough. The rate was just right. They succeeded in holding that rate for about eight months, thanks to large purchases of dollars by Germany and especially Japan. The German purchases brought unwanted inflation and later contraction. The Japanese purchases were even larger and continued longer, laying the basis for the subsequent stock and land price explosion in Japan, followed by its more recent difficulties.

Beginning in October 1987, the Louvre level gave way and the dollar started to depreciate further, ending up by December 1987 roughly where it had started in 1980, a level about which it has fluctuated since. Had the Plaza and Louvre agreements never been reached, I believe that the dollar would have continued the decline temporarily halted by the Louvre agreement, but would have ended up higher than it actually did. That sequence of events would have been far healthier for the U.S., Japanese and German economies.

Conclusion

How many more fiascoes will it take before responsible people (like the editors of the Journal) are finally convinced that a system of pegged exchange rates is not a satisfactory financial arrangement for a group of large countries with independent political systems and independent national policies?

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THE WORLD BANK and the ENVIRONMENT

Fiscal 1992

The World Bank
Washington, D.C.

Summary

The past year has seen important progress in the World Bank's continuing efforts to incorporate environmental concerns into its work.[1] But the year was more than simply part of an ongoing process. The United Nations Conference on Environment and Development (UNCED) and the publication of *World Development Report 1992* hold important implications for the Bank's future work.

Bank activities during fiscal 1992 drew heavily on the accumulated experience and research of the past several years. During this period a set of principles and policies evolved that will guide future actions. The important events of 1992 can be thought of as marking the transition from the first phase, one of efforts to integrate the goals of environment and development, to a new phase in which particular attention will be given to the implementation of these policies, so that actions will more consistently correspond to agreed principles.

The World Bank's environmental activities, which involve policy dialogue, lending, technical assistance, research, and aid coordination, have four objectives:

- To assist member countries in setting priorities, building institutions, and implementing programs for sound environmental stewardship
- To ensure that potential adverse environmental impacts from Bank-financed projects are addressed
- To assist member countries in building on the complementarities between poverty reduction and environmental protection
- To address global environmental challenges through participation in the Global Environment Facility (GEF).

Assisting Countries with Environmental Management

Assisting member countries in their efforts to improve environmental management while accelerating development is the principal objective

of the Bank's environmental work. Governments seek the Bank's technical and financial support in developing national and sectoral strategies, in strengthening institutions, policy analysis and research, and in designing and implementing investment projects.

Environmental action plans (EAPs) are emerging as important vehicles for assisting borrowers to set environmental priorities and to map out ways of achieving them. They also facilitate better project selection and design, since they allow the Bank and other lending institutions and donors to focus support for investments in agreed-on priority areas.

To date, seven International Development Association (IDA) borrowers—Burkina Faso, the Arab Republic of Egypt, Ghana, Lesotho, Madagascar, Rwanda, and Sri Lanka—have completed EAPs. The Bank's role in the preparation and implementation of an EAP is primarily to provide advice and help arrange technical assistance, at the request of the government. Each action plan is unique, but common goals include: (a) furthering environmental policy and legislation; (b) strengthening the institutional framework for dealing with environmental issues; (c) building national capacity and developing human resources for carrying out environmental management; (d) establishing environmental monitoring and information systems; and (e) addressing the management of key natural resources such as soils, water, forests, fisheries, and energy.

The number of World Bank loans for environmental management, in direct support of country environmental priorities, continues to rise. Fiscal 1992 saw the approval of nineteen projects that were primarily environmental, with Bank financing of $1.2 billion.[2] Another forty-three projects contained significant environmental components. The Bank's Africa region had six major environmental projects, amounting to about $184 million, and eleven projects with significant components addressing environmental issues. The Asia and Pacific region had eight environmental projects, totaling $495 million, and sixteen projects with environmental components. The Europe and Central Asia region and the Middle East and North Africa region together had six projects with environmental components, and the Latin America and Caribbean region had five major environmental projects, amounting to almost $500 million, and ten projects with significant environmental components.

Lending increased notably for country-level institution building and for management of critical natural resources such as forests, watersheds, fresh water, wildlife, and soils. Of the major environmental projects approved in 1992, ten were primarily concerned with better management of natural resources and six with building institutional capacity to plan and implement environmental strategies and action plans. A number of projects focused on both priorities. For example,

- In Africa the $20 million Mali Natural Resource Management Project is designed to improve management of natural resources by strengthening the capacity of local communities to manage their own resources, improving the management capacity of the Ministry for Agriculture, Livestock, and the Environment, and supporting the development of a national environmental information system.
- In Asia the $124 million Maharashtra (India) Forestry Project supports integrated investments in the entire forestry sector, including soil and water conservation activities, wildlife preservation, agroforestry, and institution strengthening.
- In Latin America the Mato Grosso (Brazil) Natural Resources Management Project allocates $205 million for sustainable management of key resources such as watersheds, forests, fresh water, and minerals.

Environmental Assessment of Projects Supported by World Bank Loans

The Bank continues to strengthen its capacity to assess potential environmental impacts from projects it supports. Environmental assessment identifies ways of making projects more environmentally sustainable by preventing, minimizing, mitigating, or compensating for adverse impacts.

A new Operational Directive on Environmental Assessment, issued this fiscal year, requires Bank staff to classify investment projects into three broad environmental assessment categories on the basis of the potential environmental impact, which in turn determines the nature and extent of environmental analysis needed. For projects assigned to category A, a full environmental assessment is required. Examples include dams and reservoirs, industrial estates, large-scale irrigation and flood control, and land clearance. Projects placed in category B undergo environmental analysis but do not require a full environmental assessment. The impacts of category B projects are not likely to be as sensitive, numerous, or diverse as those of category A projects. Examples include small-scale agroindustry, aquaculture, rural electrification, watershed management, and rural water supply and sanitation. No environmental assessment or analysis is required for category C projects—family planning, education, health and nutrition, and the like—since they are unlikely to have adverse environmental effects.

After two years of experience with environmental assessments, the Bank has completed its first review of the environmental assessment process. As of the end of fiscal 1992, about thirty environmental assess-

ment summaries had been presented to the Bank's Board of Executive Directors; of these, twenty summaries and eight full environmental assessments had been reviewed and evaluated by Bank staff. Although the Bank's environmental assessment procedures were found to be realistic, workable, and instrumental in improving development planning and environmental management, more effort is needed to strengthen borrowers' capacities to conduct effective environmental assessment. The report recommends that key borrowing countries be given high priority for EA training and that Bank resources devoted to environmental assessment be bolstered until borrowers' capacities have improved.

A notable event of fiscal 1992 was the report of the Independent Review for the Sardar Sarovar (Narmada) projects in India, commissioned in fiscal 1991 by Barber B. Conable, then president of the World Bank. The report reviewed the resettlement and environmental impacts of the projects and identified weaknesses in planning and implementation, including the lack of a resettlement strategy and the absence of a coordinated assessment of environmental impacts. It underscores the importance of good baseline data and of effective consultation of and participation by local people and the need for comprehensive environmental impact assessments and effective national and local environmental institutions.

Poverty Reduction and the Environment

Integral to sustainable development and the reduction of poverty is protection of the natural resource base on which development depends. The World Bank recognizes that promoting development and protecting the environment are complementary aspects of the same agenda. The Bank's effectiveness in combating poverty, while protecting the environment, is the benchmark by which its performance as a development institution should be judged.

The recently issued Operational Directive on Poverty Reduction and the "Poverty Reduction Handbook" are intended to guide staff in this task. They contain guidelines for and examples of best practice for implementing the Bank's poverty reduction strategy. The country poverty assessments required by the new operational directive provide the basis for a collaborative approach to poverty reduction by country officials and the Bank; analyze country policies, public expenditures, and institutions; and recommend actions to strengthen the impact of policies and programs on poverty reduction. In turn, the Bank's country assistance strategies build on the prescriptions for poverty reduction contained in the assessments. The assessments summarize key social

indicators such as child mortality, nutrition, immunization, maternal mortality, and fertility. They also indicate special environmental constraints and risks facing the poor. So far, twenty assessments have been completed.

The Bank's support for family planning and other programs to help countries reduce population growth rates is an important component of its approach to poverty reduction. As stressed in the "Poverty Reduction Handbook" and in *World Development Report 1992*, high fertility rates are also an important environmental issue. The Bank's approach is twofold: it focuses both on female education and other important determinants of the demand for family planning services and on more available and accessible family planning services. In the past few years lending for population, health, and nutrition activities has increased dramatically—from $305 million in fiscal 1988 to nearly $1 billion in fiscal 1992.

Addressing Global Challenges

The Global Environment Facility (GEF), established in 1990, is jointly implemented by the United Nations Development Programme (UNDP), the United Nations Environment Programme (UNEP), and the World Bank. An agreement on restructuring the GEF so that it may serve as the interim financing mechanism for the Biodiversity and Climate Change conventions was reached by GEF participants in April 1992 and was endorsed by UNCED. As a result, the GEF is likely to play an increasingly important role in combating global environmental problems—climate change, ozone depletion, loss of biodiversity, and pollution of international waters, as well as land degradation and deforestation, insofar as they relate to these four focal areas.

During fiscal 1992 six GEF investment projects totaling $80 million were approved. These support conservation of the environment in Bhutan; preservation of biodiversity in Mexico and in Poland; replacement of fossil fuels with biomass for energy production in Mauritius; handling and disposal of ships' wastes in six Chinese ports; and afforestation in Ecuador. By June 1992 the Facility was considering more than seventy projects amounting to $580 million.

A breakdown of the portfolio shows that 40 percent of the resources allocated so far are for projects in Asia, 23 percent in Latin America and the Caribbean, 19 percent in the Middle East and North Africa and Eastern Europe regions, 14 percent in Africa, and 4 percent for global and interregional projects. As additional projects are prepared for the rest of the pilot phase, the Bank and its partners—the UNDP and the UNEP—are making a considerable effort to bring more global-warming and African projects into the portfolio.

Future Directions

The Bank has made progress in integrating environmental concerns into its activities through a variety of initiatives ranging from environmental assessment to assisting borrowing countries in the preparation of environmental action plans. But major tasks lie ahead. One such task is the development of practical analytical approaches to help borrowing countries plan and implement strategies and programs for sustainable development. To this end the Bank's expanding research in environmental economics has begun to develop the necessary methodologies for sound environmental management through a comprehensive analysis of the environmental costs and benefits of country economic policies. New initiatives are also under way to improve environmental indicators, which are essential for combining environmental and economic information in policy development, by building on work begun for *World Development Report 1992*. In addition, the Bank is closely involved in efforts to develop a coordinated interagency strategy to implement the provisions of Agenda 21.

The Bank must also move vigorously to implement its environment-related operational directives and incorporate into its work the findings, conclusions, and lessons from its evaluations, assessments, and independent reviews. This will entail increased support for environmental projects, particularly clean water, sanitation, and energy efficiency; improvement of in-house capabilities and technical skills; and more explicit integration of environmental costs and benefits into the economic evaluation of Bank-supported projects and policies.

Individual lending operations and studies will, of course, continue to be important vehicles for the Bank's efforts to help countries address environmental problems. But the environment must assume an important place in the Bank's country dialogue on policies, public expenditures, and institutions. Preparation of environmental action plans is an important step in assessing priorities, formulating policies, and building commitment, but adequate follow-through is also essential to ensure that the priorities identified and the approaches and policies developed are successfully financed and implemented.

The association of the Bank with the operational phase of the Global Environment Facility necessitates closer linkages between global environmental considerations and Bank lending, particularly in the areas of energy planning and development and forest management and agriculture. This calls for more emphasis on country strategies and action plans and for the careful assessment of the global benefits and associated incremental costs of local actions stemming from national development strategies and priorities.

Organization of the Report

The report begins with a discussion, in chapter 1, of the emerging global consensus on the relationship between environment and development and its implications for the Bank's work. Chapter 2 reviews key operational initiatives by the Bank in fiscal 1992, and chapter 3 describes the work of the Global Environment Facility.

Chapter 4 discusses in detail current environmental work in each of the Bank's six geographic regions—Africa, East Asia and the Pacific, South Asia, Europe and Central Asia, the Middle East and North Africa, and Latin America and the Caribbean. A new feature in this year's review of regional environmental operations is a discussion of strategic priorities and new initiatives.

Chapter 5 deals with new and continuing environmental research and policy work, grouped by the main sectors. Coordination between the World Bank and the international community on environmental concerns is outlined in chapter 6. This year's annexes contain not only a list of projects with environmental objectives or components, as in past years, but also a separate list of efforts funded by the GEF.

Notes

1. The World Bank, as defined in this report, includes the International Bank for Reconstruction and Development (IBRD) and its affiliate, the International Development Association (IDA). Other affiliates of IBRD are the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). The World Bank, the IFC, and MIGA are sometimes referred to as the World Bank Group.

2. Throughout the report, dollar amounts refer to current U.S. dollars unless otherwise specified. A billion is a thousand million.

EDITORIAL/OPINION

Straight Talk on the Environment

By MARY A. GADE

At the risk of being burned at the stake for the modern version of heresy — political incorrectness — it is my proposition that George Bush *has* been the environmental president.

What he has not been is the "enviro-rhetoric" president. And in this election year, rhetoric seems more important than tangible results.

Mr. Bush mastered the skill of getting things done, balancing jobs and the environment, but he's never learned to talk about it in ways that convey his commitment. In advertising parlance, he has a great product and terrible marketing.

At the other extreme, his political opponents, Gov. Bill Clinton and Sen. Al Gore, have mastered the rhetorical skills necessary to simultaneously soothe and scare the public about a whole host of real and imagined environmental ills. Unfortunately, while long on rhetoric, their records are, at best, ones of inaction.

Mr. Bush kept his promise to break the 10-year deadlock on the Clean Air Act by implementing the single most creative idea in pollution prevention since the Romans built underground sewer systems. That idea is the use of market forces to cost effectively achieve society's environmental goals.

We have the solution to the acid rain problem today because George Bush refused to accept old fashioned command and control approaches requiring all power plants to achieve the same sulfur dioxide emissions reductions regardless of cost.

Instead, all power plants as a group must achieve an overall, environmentally protective level. Plants able to achieve reductions at less cost may sell extra reductions to others whose costs may be high. The end result? A cleaner environment at a lower price.

Thirty million Americans breathe certifiably cleaner air today than just a few years ago in cities such as Tampa, Indianapolis and San Diego because George Bush pushed enforcement. During the last four years, the Bush administration has collected more penalties, and sent more violators to jail for longer sentences, than in the rest of the U.S. Environmental Protection Agency's 18-year history.

Mr. Bush's use of market mechanisms to clean up the air are being extended to smog control. In March, the president called for the widespread buying of older, more polluting cars by industries that must reduce their emissions of smog-producing gases.

Illinois and Los Angeles are actively pushing his "cash-for-clunkers" suggestion and expecting the idea to pay off in cleaner air at less cost.

At the same time, Gov. Clinton backs a higher corporate average fuel economy standard (CAFE) of 40 miles per gallon by the year 2000 in an effort to clean up the air. These CAFE standards, which can only be achieved by building smaller, lighter cars, are estimated to result in an additional 1,700 deaths, 17,000 injuries and 300,000 American job losses.

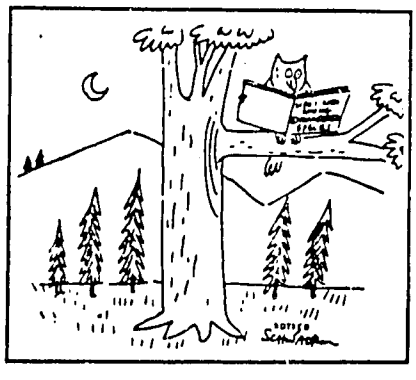
In addition, National Academy of Science studies show that increasing fuel economy only makes people drive more, negating any environmental benefits. Putting rhetoric aside, Mr. Clinton's CAFE proposal looks like the bigger clunker.

The difference between tangible results and environmental rhetoric was best summed up at the Earth Summit in Brazil. While the rest of the world and Sen. Gore were ready to place most of the responsibility for addressing global warming on the United States, Mr. Bush sought a balanced approach that would achieve U.S. environmental goals and protect American jobs.

First, Mr. Bush challenged the rest of the world to control all greenhouse gases, not just carbon dioxide, assuring that Europe does its fair share in reducing methane, the most persistent greenhouse gas.

Second, Mr. Bush called for concrete national action plans, not arbitrary deadlines and standards without scientific basis and with no real commitment to progress in controlling greenhouse gases.

Third, the president wanted an approach on global climate change that is based on logical modifications to our economy. Others, above all Sen. Gore, have called for heavy taxes on all carbon-based fuels (oil, coal, natural gas, wood) and taxes on virgin materials to address their fears of impending ecological disaster. So much for middle-class tax relief.



In the end, it should be noted that every nation signed — most with relief — the version of the treaty advanced by Mr. Bush on behalf of the United States.

His opponents, basking in environmental correctness, would have signed the first version regardless of its consequences here in the United States and its failure to address the real problems.

While the list could go on, one final illustration shows Mr. Bush's ability to deliver tangible environmental results while reconciling U.S. economic and environmental goals: the North American free-trade agreement.

This landmark accord will create hundreds of thousands of new, high-paying jobs in this country. The agreement has been characterized by William Reilly, the Environmental Protection Agency's outspoken administrator, as the "greenest" free-trade agreement ever negotiated.

Mr. Bush built into the treaty the right of any state to set higher standards than the federal government on such things as pesticide residues on farm produce. The only condition is that the standards apply equally to all produce regardless of which of the three countries is the place of origin.

While the president fought for this job-creating agreement, Bill Clinton says he isn't sure about the agreement, partly over environmental concerns. This from the governor of Arkansas, whose environmental record and laws are much worse than those of Mexico.

Whereas the hallmark of the Bush approach has been balance, Messrs. Clinton and Gore opt for a classic baby boomer "have it both ways" program. Mr. Clinton turns a blind eye to filthy rivers in Arkansas but decries the fate of the Amazon. Mr. Gore wraps his arms around an owl in Oregon but votes to bump off the endangered snail darter in his state of Tennessee to build a dam.

I'll opt for a guy who does something and can't talk about it rather than two guys who are out to sweet talk me — and then leave.

Mary Gade is director of the Illinois Environmental Protection Agency.

Bush's Nonsense on Jobs and the Environment

By Curtis Moore

WASHINGTON

Claiming that Americans must choose between their jobs and the environment is getting to be a habit for President Bush and Vice President Dan Quayle.

Last week, it was the hapless spotted owl that was demonized. Three weeks ago, it was those "environmental extremists" who dared suggest an end to the internal combustion engine. What's strange is that America's two primary economic rivals, Japan and Germany, take precisely the opposite view.

"What we're doing here is economic policy, not environmental policy," Edde Muller, a senior official of the German Government, told me last year in explaining why her country's environmental standards are stricter than those of the U.S. A few months later, Katsuo Seiki, then an official in Japan's powerful Ministry of International Trade and Industry, was more circumspect. Global warming affords Japanese companies a "very big challenge," he said, and "a rather big business opportunity."

America's competitors know what our politicians have yet to grasp fully: protection of the environment is a global economic necessity. The nation that does it best will be positioned to capture economic supremacy in the 21st century. But here, where environmentalism was born, we continue to labor under the illusion that, as George Bush says, "America's record on environmental protection is second to none."

The President is wrong.

That may have been true 10 or 20 years ago, but not today. Environmental leadership has passed to Germany and Japan, where officials see environmental protection as an opportunity for economic development, not as a barrier to growth.

Air pollution limits in Japan and Germany are nearly four times as stringent as those in the U.S. It should come as no surprise then that Japan, followed by Germany, has the world's cleanest, most efficient power plants and steel mills. The U.S. is third and falling fast.

The same can be said of gasoline mileage. Of the largest car makers in each of the three nations, Toyota is the leader in fuel efficiency, followed by Volkswagen. General Motors, the largest American car company, is a distant third. The world's most stringent controls on toxics? In Europe. The toughest recycling programs? Ditto.

In only one area of environmental protection can it be fairly said that the U.S. remains the world leader — tailpipe controls on cars and trucks. California's requirements are the world's strictest, followed by the rest of the U.S., Japan, then Europe. But European standards are nearly as tough and getting tougher. Consider also that the Swedes have adopted pollution taxes to curb driving, while the Dutch, Germans and others are banning automobile traffic in city centers. "You either walk or take public transit," said Joris Al, a senior official with the Dutch Ministry of Environment. The cleanest car is one that isn't driven, and compared with that standard of zero pollution, U.S. limits are high indeed.

To seize competitive opportunities, the Japanese have launched or strengthened business-government partnerships aimed at accelerating development of technology and promoting its sale abroad.

The Germans have adopted regulations mandating a wide range of pollution-cutting measures from industries and citizens. One program requires car makers to pick up and recycle vehicles that in the U.S. would be junked. BMW's, Mercedeses and Volkswagens now roll off the assembly line with bar-coded parts to speed disassembly, sorting and recycling. Soon, this policy will be extended to computers and cameras, then to everything from cardboard boxes to yogurt containers.

But that's not all. In six years, every power plant in the country is required to reduce air pollution by 90 percent, with most using scrubbers that remove acid rain-causing pollutants. Scrubber byproducts (considered waste to be thrown away in the U.S.) are dried and made into gypsum board and construction mortar in Germany.

The Germans, in other words, literally build homes out of pollution. The system is so successful that Knauf Gypsum, a German company, opened a plant in Britain with 1991 sales of $48 million.

The results are economies that are clean and lean, specializing in just the sorts of programs and technologies that the rest of the world is seeking to buy.

The U.S. economy, meanwhile, continues to be fueled by the twin policies of cheap oil and deregulation, which were initiated by Ronald Reagan and have been continued by President Bush. The tragic result has been an enormous transfer of U.S. technology to other nations. Consider this:

- In 1980, the U.S. was the world's largest manufacturer of solar photovoltaic cells, which produce electricity from sunlight. Today, the U.S. has fallen behind Japan and will soon be overtaken by Germany.
- Japan and Germany are the leading producers of a multimillion-dollar system for power plant pollution control called selective catalytic reduction. The technology was developed in the U.S. by Corning. Unable to find a U.S. market, Corning sold the catalyst patents to Mitsubishi, which then licensed German manufacturers. Now, makers in both countries are vying for the growing U.S. market.
- Fuel cells are clean, quiet and extraordinarily efficient devices that create electricity through a chemical reaction. The cells, developed by the U.S. space program, are now rolling off two assembly lines: one in Japan, owned wholly by Fuji Electric; the other, in Connecticut, is owned substantially by Toshiba.

These and dozens of other technologies can't get started in the U.S. because the Government is intent on ignoring environmental problems and even their solutions. Products created through American innovation and financed by tax dollars are being systematically auctioned off to foreign bidders.

Horacio Fidal Cano

Germany and Japan prosper from stricter rules.

Environmental protection is a global reality. America, once the world's environmental leader, is now a follower. To claim otherwise is not only untrue but a disservice to our children. Sadly, it is they who will pay — with their health, their quality of life and their jobs. □

Curtis Moore was counsel to the Senate Committee on Environment and Public Works from 1978 to 1989.

EDITORIALS of THE TIMES

Bush vs. Clinton: What Is an Environmental President?

To cope with the nation's mounting ecological challenges, the two candidates offer substantially different policy perspectives

From time to time before Nov. 3, The Times will examine the stands of the two main presidential candidates on some of the outstanding issues of the campaign. Today: the environment.

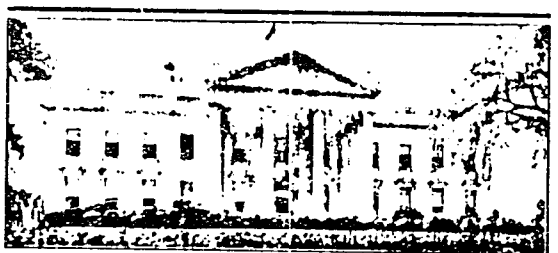
Perhaps no two presidential candidates ever have devoted more attention to the issue of environmental protection than George Bush and Bill Clinton have in recent months. But despite the continual jostling between the two, and between their running mates, over which team has the better environmental record, voters are still confused about the health of our environment, the effect of existing regulations designed to protect air, water and natural resources, and the best direction for future environmental policy.

The Cost of Doing Nothing and of Trying to Do Everything

George Bush campaigned in 1988 on a promise to be an "environmental President." Indeed, he got high marks for his environmental record in his first two years as President. He championed the Clean Air Act of 1990, which strengthened controls on virtually every source of air pollution, halted oil exploration off both coasts and ordered a government-owned electric utility to reduce pollution that clouded the Grand Canyon. Moreover, his Administration rapidly added plants and animals to the endangered species list. His appointment of conservationist William K. Reilly as chief of the Environmental Protection Agency was widely applauded.

But in recent months, as the recession lengthened its shadow over the nation's economy, the President has favored a different approach to environmental policy, one that measures environmental rules against potential job losses. The shift was first evident when Bush approved a proposal last summer that would open half the nation's wetlands to development. He removed restrictions on logging in the national forests, approved efforts by the Justice Department to relax enforcement of strip-mining laws and managed to remove from an international global warming treaty the restrictions on U.S. production of carbon dioxide. This month, speaking to loggers in the Northwest, Bush said that he wanted Congress to rewrite the Endangered Species Act to require balancing the benefits of species preservation against potential job losses.

The continuing recession has pushed the Clinton-Gore team toward a very different policy model on the environment. Gov. Bill Clinton and particularly Sen. Al Gore, who has a strong record as a moderate but committed environmentalist, reject the notion implicit in the President's recent policy statements that environmental preservation and restoration always cost money and jobs. They argue instead that the Administration has posed a "false choice" between environmental protection and economic growth and contend that a "market-based environmental protection strategy" will reward conservation and "green" business practices while penalizing polluters.



COMPARING THE TWO CANDIDATES
Issues of the presidential race

Preserving Our Resources Without Grounding the Economy

The argument over how best to protect and manage the nation's wilderness and the remarkable variety of life within it has become a lightning rod for debate over other environmental issues. Faith in the endless abundance of our natural resources—including forests, wetlands, rangelands and deserts—is a part of American mythology. But now Americans are painfully confronting the reality that our natural resources are finite, and that, long-term, our best economic interests lie in their conservation and management rather than depletion or privatization. Careful husbanding of these resources is vital not just because of their scenic value or as animal habitat. Wetlands, for example, act as ground-water filters and provide natural flood protection.

Bush has continued the Reagan-era policy of recommending timber harvesting at unsustainable levels in U.S. forests. And although he promised in 1988 that there would be "no net loss of wetlands" during his Administration, last summer he proposed a wetlands redefinition that would have eliminated protection for up to half the wetlands. In making judgments about the preservation of threatened land and animal resources, Clinton would rely more on scientific than economic assessments. For example, he supports preservation and restoration of wetlands targeted for redefinition as developable property and of ancient forests on federal lands.

Global Warming: An Issue Where the U.S. Is Vulnerable

The Earth Summit in Rio de Janeiro last summer highlighted the growing international concern about the accumulation of "greenhouse gases"—including carbon dioxide, chlorofluorocarbons, methane and ozone—that are slowly but steadily warming our planet. If it continues unchecked, global warming could produce drought in some places, flooding in others and widespread ecosystem damage. Although there is still considerable uncertainty about the pace of this climactic change, there is little doubt that the United States, with only 5% of the world's population, produces more greenhouse gases than any other country.

Even so, Bush has consistently refused to commit the United States to targeted reductions—or stabilization—of carbon dioxide emissions, even though most other industrialized nations have done so. Moreover, his this year, offers some financial support for renewable energy but gives much bigger subsidies to the oil industry and does little to curb demand for domestic oil. Moreover, Bush opposed extension of the solar tax credit and expansion of that credit to wind, geothermal and biomass energy development.

By contrast, Clinton proposes to limit CO_2 emissions to 1990 levels and improve America's overall energy efficiency by 20%, all by the year 2000. He would establish revenue-neutral incentives to encourage energy conservation and the use of renewables, and would raise the fuel efficiency standards for auto makers to 40 miles per gallon by the year 2000 and to 45 miles per gallon in the next century. These steps make sense.

Can Economic Forces Be Harnessed to Energize Recycling?

Each day, American industries produce the equivalent of nearly 30 pounds of toxic waste for every person in the United States. Americans produce about 180 million tons of solid waste every year, about four pounds per person per day.

For his part, Bush would rely largely on new voluntary reductions of industrial toxic waste and on solid waste recycling. Clinton's approach emphasizes economic incentives for recycling, the use of recycled materials and source reduction, a national bottle bill and stricter enforcement of existing regulations regarding toxic waste disposal. Both Clinton and Bush have called for reform of the slow and cumbersome Superfund cleanup program, but neither candidate has detailed how he would change the program.

A Good Start on the Clean Air Act—and Then Regression

More than 100 million Americans now live in places where U.S. clean air standards are violated at some time cause about 120,000 deaths annually and cost up to $100 billion a year in health care and lost productivity.

Bush can take much credit for passage of the tough Clean Air Act of 1990, which, when fully implemented, will cut air pollutant emissions by 53 billion pounds annually. But his own Council on Competitiveness has in effect stalled its implementation and weakened its substance, claiming that the act is burdensome to business. In contrast, Clinton has promised to enforce the Clean Air Act.

The Clean Water Act of 1972, which was intended to have eliminated U.S. water pollution by 1985, has significantly improved the quality of our drinking water. But data from the Environmental Protection Agency indicates that rivers and lakes in as many as 35 states are still polluted. In recent years, the Council on Competitiveness has intervened to weaken laws protecting ground water and drinking water from contamination. By contrast, Clinton supports new standards for "non-point" water pollution sources, such as hillside erosion, and creation of incentives for businesses, farmers and families to reduce and prevent polluted runoff at its source. To date, however, the Clinton camp has provided no cost estimates for such "non-point" programs.

In places, both Bush and Clinton's environmental proposals lack specificity. And both are predicated on some unproven assumptions: Bush too often blames environmental policies for economic decline without sufficient justification, Clinton sometimes underestimates the short-term negative economic consequences that environmental restrictions may, in some instances, impose. Nonetheless, many of Clinton's proposals, particularly the new, more substantial tax and fiscal incentives he supports for energy conservation and waste reduction, could imaginatively and meaningfully reward environmentally sound practices by business, government and individuals. That is in America's best economic, and environmental, inter-

North American 'Green Trade'

By JAMES M. SHEEHAN

The North American free-trade agreement is expected to face an uphill fight for ratification in Congress. Several congressional critics have pledged to oppose the treaty unless it is modified significantly, charging that it is not attentive enough to environmental protection. In reality, the trade pact has merged environment and trade policies more than any other such agreement. If approved, the treaty will lead to excessively stringent bureaucratic and regulatory controls over the environment, which are profoundly inimical to free trade.

Some in the environmental establishment are indeed confident the trade agreement will further their goal of uniting environmental regulatory authority across national borders. William Reilly, administrator of the Environmental Protection Agency, contends the agreement has more sophisticated environmental provisions and trilateral cooperative arrangements than exist between any nations anywhere. The trade agreement's preamble, he notes, commits the countries to environmentally "sustainable development," an important phrase not found in any comparable document.

Sustainable development is a concept that President Bush, along with other heads of state, embraced at the U.N. Earth Summit. It holds that free markets fail to protect the environment, so governments must intervene to determine what kind of industrial activity is sustainable.

As a result of this watershed commitment in the North American free-trade pact, Mr. Reilly has ecstatically pronounced it "the greenest international trade treaty the world has yet seen."

For the first time, a trade agreement has linked environmental protection to international trade policies, according to Thomas Wathen, author of a recent report "A Guide to Trade and the Environment" and program officer of the Pew Charitable Trust. Mr. Wathen notes at "the environmental impact will be felt as the free-trade agreement affects all kinds of regulation on product standards and violations."

In fact, the trade accord could dictate U.S. environmental regulation over such policies as forest harvesting, agriculture, pesticides, food safety, product labeling, biotechnology and even energy use. Congress, Mr. Wathen claims, is likely to "change a lot of environmental laws to bring them into compliance with the agreement."

The treaty contains numerous provisions the environmental lobby will celebrate. The pact obligates each nation to enforce trade sanctions in three existing international environmental treaties: the Montreal Protocols on substances thought to deplete the ozone layer; the Convention on International Trade in Endangered Species, and the Basel Convention on trans-boundary shipments of hazardous waste. The agreement also allows governments, even on the state level, to prohibit the entry of consumer goods not meeting health, safety and environmental standards.

To firmly establish bureaucratic control over regional commerce, the treaty establishes a North American trade commission to "monitor and oversee" continental trade. One purpose of the commission is to prevent the relaxation of environmental regulations that would attract foreign investment or otherwise enhance a nation's competitive advantage.

The commission will be authorized to appoint conflict arbitration panels to resolve disputes over trade barriers created by environmental restrictions. U.S. Trade Representative Carla Hills has explained that these panels will heavily favor the restrictions, as long as they have an identifiable scientific basis. And, reassures Mrs. Hills, "we won't quarrel with the science so long as a scientific methodology has been used to develop the standards."

Historically, U.S. "scientific" standards have not inspired confidence. A government panel of experts issued a startling report earlier this year entitled, "Safeguarding the Future: Credible Science, Credible Decisions," which evaluated the use of sound science at EPA.

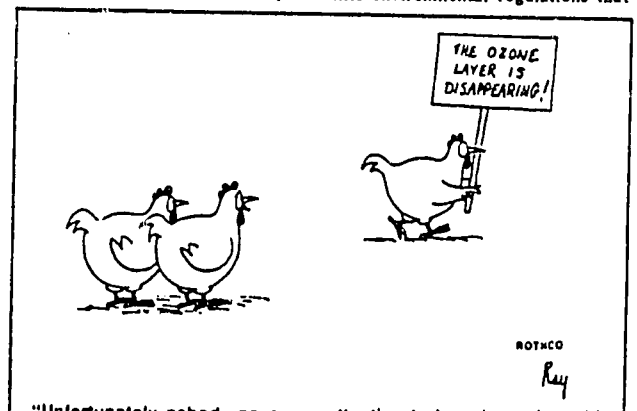
The study found that "EPA science is of uneven quality, and the agency's policies and regulations are frequently perceived as lacking in strong scientific foundation." Rather than safeguarding scientifically based standards, the trade commission is likely to perpetuate unscientific environmental regulations that mask their true protectionist purposes. By creating arcane rules that companies must decipher, the trade commission will confer competitive advantages on larger firms already more proficient at such tasks than entrepreneurs.

To ultimately achieve uniformity in environmental regulations, the pact requires the appointment of two committees, one dealing with health and safety issues and the other with sanitation standards. These committees will pressure the government perceived as having the lowest standard to raise it in accordance with the other two nations.

The trade pact will also result in unprecedented international coordination between the environmental agencies, which are rapidly growing in personnel, enforcement budgets and prosecutorial authority. They will convene periodically to conduct inquests into the environmental practices of each of the three countries. Such measures to centralize environmental protection will curtail the advantages of flexibility, experimentation and innovation that our 50 states enjoy.

The trade agreement's continental common market — heavily laden with bureaucracies, panels and commissions — bears little resemblance to free trade, which aims to eliminate obstructions. Instead, it is beginning to resemble the supra-national structure of the European Community, in which the unification process weakens the ability of its nations to attract foreign investment improve competitiveness.

Free trade is better for the environment than managed trade. Environmental risks are more dramatically reduced through economic growth, technological innovation and wealth creation than by bureaucracy. Even EPA's Mr. Reilly admits that "the future of environmental improvement will not be ensued by foreign assistance — it will be ensured by trade."



"Unfortunately nobody pays any attention to her since she told everybody the sky was falling."

James M. Sheehan is a research associate with the Competitive Enterprise Institute in Washington.

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THE WALL STREET JOURNAL THURSDAY OCTOBER 8, 1992

Bush Biodiversity Policy Risks Dangerous Side Effects

Counterpoint

By Walter V. Reid

President Bush has spent much of the current campaign drawing a distinction between being pro-business and pro-environment. On behalf of U.S. business, the administration stood alone in opposition to the Biodiversity Convention at the Earth Summit. But business may lose more than it gains from that decision. Other countries are likely to retaliate by sharply restricting U.S. access to key raw materials: the genetic and biochemical resources used in agriculture, medicine and industry.

The genes and chemicals found in nature are important resources for the American economy. All of the major crops grown in the U.S. originated in other countries, and all depend on infusions of new genes from those countries. Some 25% of all U.S. drugs are still derived from natural products, and recent advances in biotechnology have enhanced pharmaceutical companies' interest in screening plants and animals for new drugs. Taxol, derived from the Pacific yew tree, is the most promising cancer drug discovered in the past 15 years. Overall, more than 200 companies and research institutions worldwide are scouring the wealth of plant and animal species for new drugs.

The genetic resources at stake will disappear rapidly if countries have no economic incentive to conserve them. The Biodiversity Convention proposes a simple solution: Countries and companies should pay for the use of the resource. A chemical company wouldn't expect to obtain oil free of charge – shouldn't the biotechnology industry pay for its raw materials as well?

The U.S. said "no." And now there is good reason to think that barriers to the free flow of genetic resources will be erected. The Biodiversity Convention didn't anticipate the prospect of a trade moratorium, but other international agreements have. The 1987 Montreal Protocol on Substances That Deplete the Ozone Layer includes an article banning all trade of ozone-depleting chemicals with nonsignatory nations. Vicente Sanchez, chair of the International Negotiating Committee for the Biodiversity Convention, has noted that after the convention enters into force, it can be amended to include provisions such as those in the Montreal Protocol.

Individual countries could be even tougher. One by one, they could bar biodiversity prospecting by companies or individual citizens of nations not party to the convention. They could refuse to export to nonsigners genetic material or chemical extracts used in the search for pharmaceuticals. Or, they could simply require that corporations and public agencies meet the terms of the convention in order to gain access to the biodiversity in the country.

Soon after the U.S. decision was announced, Venezuela suspended collaboration with the U.S. biodiversity collectors, and seven Central American presidents signed a resolution encouraging the enactment of laws regulating access to genetic resources. Similar legislation is now being considered by Costa Rica's National Assembly. Other countries, such as Chile and Ethiopia, have already strictly regulated the export of genetic resources. When these countries are faced with requests for collecting permits, preference will be given to signatory countries.

Multinational companies will no doubt consider an end-run around such tactics, collecting material through European subsidiaries and then developing and patenting the final product in the U.S. But the negotiators were alert to this possibility. The convention stipulates that access to genetic resources will be on "mutually agreed terms." Developing countries are sure to stipulate that genetic resources collected in the country cannot be sold or transferred to nonsignatory nations.

The most obvious casualty will be the drug-screening programs of the U.S. National Institutes of Health. The U.S. will see no more painkillers like Epibatidine, a chemical found in Ecuadorean frogs and a product of NIH work. And the $8 million National Cancer Institute drug screening program – which recently located anti-HIV activity in an extract from a vine in Cameroon – will be dealt a major blow.

The U.S. Agriculture Department's international plant-collecting activities will also be brought up short. Breeders of our major crops will be forced to search ever-shrinking pools of diversity for new disease-resistant and yield-improving genes. And how will the U.S. pharmaceutical and biotechnology industries compete with European and Japanese firms that will have far greater access to the resource base of biodiversity?

The U.S. will see no more painkillers like Epibatidine, a chemical found in Ecuadorean frogs.

The supreme irony of the U.S. position is that the public and private institutions that the administration thought it was defending were already meeting the convention's requirements. The National Cancer Institute's draft policy on collecting activities, for example, states that "NCI wishes to promote the conservation of biological diversity, and recognizes the need to compensate source country organizations and peoples in the event of commercialization of a drug developed from an organism collected within their country." Similarly, in late 1991 Merck agreed to provide Costa Rica with $1 million and royalties on any commercialized products in return for access to its biodiversity.

The U.S. biotechnology and pharmaceutical industries have faithfully supported the decision not to sign, though the decision apparently took them by surprise. The Pharmaceutical Manufacturers Association, for example, did not even discuss the convention until one week after the U.S. administration said no.

The administration has argued that the convention would force companies to give up patented technologies and trade secrets. Yet Article 16 states: "In the case of technology subject to patents and other intellectual property rights, such access and transfer shall be provided on terms which recognize and are consistent with the adequate and effective protection of intellectual property rights." Indeed, this statement was viewed by the negotiators as a major concession to U.S. concerns.

Industry in Europe – home of six of the top 10 pharmaceutical firms – has no problem at all with the biodiversity convention. Glaxo Pharmaceuticals' new policy is to share profits with countries in which rare plant products are discovered. And Britain's Bioindustry Association officially lauded the treaty for recognizing the importance of maintaining genetic diversity as a source for products in the future.

In short, there is every reason to believe that the U.S. biotechnology industry and American jobs – as well as the planet's rich natural endowment – will be best served by signing, not shunning, the Biodiversity Convention. Our president should take another look.

Mr. Reid, a vice president of World Resources Institute, a policy research center in Washington, D.C., is co-author of "Global Biodiversity Strategy" (WRI, 1992).

WASHINGTON POST, September 13, 1992

Carolyn Revelle Hufbauer

Global Warming: What My Father Really Said

Taking Exception

Contrary to George Will's "Al Gore's Green Guilt" [op-ed, Sept. 3] Roger Revelle—our father and the "father" of the greenhouse effect—remained deeply concerned about global warming until his death in July 1991. That same year he wrote: "The scientific base for a greenhouse warming is too uncertain to justify drastic action at this time." Will and other critics of Sen. Al Gore have seized these words to suggest that Revelle, who was also Gore's professor and mentor, renounced his belief in global warming.

Nothing could be farther from the truth.

When Revelle inveighed against "drastic" action, he was using that adjective in its literal sense—measures that would cost trillions of dollars. Up until his death, he thought that extreme measures were premature. But he continued to recommend immediate prudent steps to mitigate and delay climatic warming. Some of those steps go well beyond anything Gore or other national politicians have yet to advocate.

Revelle never failed to point out that there are both established facts and remaining uncertainties about greenhouse warming.

"We're clearly going to have a rise in temperature in the next 100 years because of . . . greenhouse gasses . . . [but] we don't know how big it is going to be," Revelle said in a videotaped interview with University of California at San Diego biologist Paul Saltman in December 1990. "We can't say whether the temperature rise will be 2 or 10 degrees."

While avoiding the word "catastrophe," Revelle argued that the long-term effect of the predicted warming would be "quite serious because of the effect on water resources. . . . We're likely to get a large continental area, particularly in the interior of the North American continent, where it gets drier and drier and drier." He also thought that a small probability of an extremely adverse event, a 10-degree temperature rise, warranted serious action now.

So in recent speeches and writings, he recommended several kinds of action, including:

- **Change the mix of fossil fuels to use more methane and less coal and oil.** "Combustion of methane produces about twice as much energy per gram of carbon dioxide as does the combustion of coal, and about 50 percent more than combustion of oil. It is also a clean, relatively non-polluting fuel. We need to expand greatly and to conserve the world reserves of methane, particularly those of the United States." (American Association for the Advancement of Science, February 1990.)
- **Conserve energy.** Revelle advocated conserving energy by using the price mechanism (the polluter pays principle)—for example, by increasing the tax on gasoline (Cosmos, 1991). In private, he often spoke of a $1.00 a gallon tax as eminently reasonable, not "drastic." Who was the last national politician to advocate a $1.00 gasoline tax?
- **Use non-fossil energy sources.** In the Saltman interview, Revelle reiterated: "I want to see us cut down on use of fossil fuels—coal, oil and natural gas—especially coal . . . a nasty, dangerous substance." He advocated instead nuclear energy, which he argued has been safely generated in France because of good engineers and a single design. Again, the switch from coal to nuclear energy was, to Revelle, not a "drastic" step. But who was the last national politician to speak a good word for nuclear energy? Or a bad word for coal? Revelle also recommended that we develop biomass energy from trees, plants and agricultural wastes.
- **Sequester carbon in trees.** Revelle noted favorably President Bush's proposal to plant a billion trees a year for the next 10 years, which could accumulate substantial amounts of carbon dioxide from the atmosphere. Revelle would have been happy to see public spending of several billion dollars annually to promote tree growth worldwide.

All of us remember our father's frustration at the White House award ceremony in November 1990, when he received the National Medal of Science. Told he would sit next to John Sununu, a well known advocate of the "wait and see" approach, he was delighted at the prospect of bending Sununu's ear. When Sununu failed to appear, Revelle was disappointed, saying, "I had hoped to tell him what a dim view I take of the administration's environmental policies."

Roger Revelle proposed a range of approaches to address global warming. Inaction was not one of them. He agreed with the adage "look before you leap," but he never said "sit on your hands."

The writer was assisted in the preparation of this article by other members of her family: her mother, Ellen, her sisters, Anne Shumway and Mary Puci, and her brother, William Roger Revelle.

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INTERNATIONAL FOOD POLICY RESEARCH INSTITUTE

IFPRI REPORT

VOLUME 14, NUMBER 3 OCTOBER 1992

COMMENTARY: WHERE DO WE GO FROM RIO? AN AGENDA FOR REDUCING WORLD HUNGER WHILE PROTECTING THE ENVIRONMENT

As the United Nations begins to grapple with monitoring the implementation of Agenda 21 of the United Nations Conference on the Environment and Development (UNCED), developing and developed countries alike need to focus their attention on the links between environmental sustainability and food security—access by all people at all times to the food needed for a healthy life. The first is not possible without the second. Poverty and, one of its symptoms, food insecurity, are root causes of environmental damage in low-income countries.

During the past two decades considerable progress has been made in reducing hunger in the world. However, most of this progress has been in Asia. In Africa, the number of households that do not consume enough food continues to increase. Globally, the absolute number of malnourished children in 1990 was higher than in 1970. Meeting world food demands over the next 15 years will require that agricultural production increase by about 40 percent. Unless a major change in trade and aid patterns occurs, 75 percent of the increase will have to be produced by developing countries. Not only will such an increase in agricultural output be difficult to achieve, but if it is not achieved through appropriate means, it could take a massive toll on the natural resource base of these countries.

World hunger can be further reduced while protecting the environment by focusing on six areas:

1. There must be global responsibility to develop sustainable agricultural production technologies. Population growth and the associated need for food during the 1990s, and beyond, call for accelerated growth in food supplies. The technologies necessary to increase production while preserving the natural resource base are complex and expensive and cannot be developed by individual countries alone. Such research investments can be best addressed by a division of labor between international and national agricultural research institutions. Although a commitment to reducing population growth rates will also be in order, reducing these growth rates will not negate the need for increased food production in the near term.

2. The developing countries must increase food production in order to provide jobs and raise incomes while meeting the growing demand for food. Currently, the developing countries cannot be expected to meet their projected needs by the year 2000 of about 800 million tons of additional food. Technically, the shortfall could be met by surpluses from industrialized countries, but many low-income developing countries are unable to take advantage of such surpluses because of an increasing decline in purchasing power. In addition, they need to raise employment and stimulate economic growth, which, because of their agrarian-based economies, cannot happen without food production growth. Without this there could be a need for expansion of food aid to these countries.

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COMMENTARY *(continued from page 1)*

3. Economic and agricultural policy reforms must occur in industrialized and developing countries in order to facilitate efficient food production growth. Since the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) began in 1986, 45 countries have substantially liberalized their trade policies. Thirty of these countries are developing countries that have reformed their agricultural trade policies. These bold reforms by developing countries must now be matched by industrialized countries.

4. Developing countries must diversify and commercialize agriculture in order to capture the economic benefits of trade and to cope with rapid urbanization. Subsistence production, which is practiced in most developing countries, will not be a solution to the food problems of developing countries. Developing countries need to move subsistence agriculture toward expanded agricultural production for domestic trade and export. Commercial crops need not damage the environment. But policies that are single-mindedly oriented toward self-sufficiency can be damaging to the environment when they encourage the spread of low-technology food crops into environmentally fragile areas.

5. Food security must be part of any environmental policy. Only people who are "food secure" can care about the future and the generations to follow. The "food insecure" are forced to focus on survival today at any cost, including environmental destruction. An environmental policy that does not put food security first will be unsustainable. Ensuring food security for the poorest populations in developing countries can be accomplished in the short run by a combination of employment programs, targeted food subsidy schemes, and health interventions. Programs that provide jobs to the poor to build roads, construct terraces on hillsides, plant trees, and the like, can be a key instrument of public action to increase food security of the poor and improve the natural resource base.

6. A precondition to environment-related loans or grants to developing countries should be that the countries have in place a comprehensive national policy for household food security. UNCED has mobilized limited new resources for environmental loans and grants. These monies will be inefficiently used if the problems of food security and the environment are not addressed simultaneously. In the poorest developing countries, providing for food security and ensuring environmental sustainability will require external assistance. But without the precondition of food security, the poor themselves will have no chance to be partners in environmentally sustainable development efforts.

Joachim von Braun

Joachim von Braun is director of the Food Consumption and Nutrition Division at IFPRI.

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THE RIGHT CLIMATE FOR CARBON TAXES: Creating Economic Incentives to Protect the Atmosphere

Roger C. Dower (WRI)
and
Mary Beth Zimmerman
(Alliance to Save Energy)

I. INTRODUCTION

International concern over the potential for carbon dioxide and other "greenhouse gas"[1] emissions to change the world's climate has generated national and international debate over the most appropriate policy responses for reducing these emissions. In particular, countries are searching for emission-reduction tools that are cost-effective, consistent with continued economic growth, and equitable with respect to both costs and benefits.

Any number of studies have shown that a pollution tax on carbon dioxide, a "carbon tax," is the most cost-effective means of reducing carbon dioxide emissions, the major greenhouse gas.[1] But the United States and many other countries have resisted pollution taxes in general, and carbon taxes in particular, as environmental policy tools. Much of this reticence stems from the alleged impacts of a tax-based pollution control strategy—in the case of a carbon tax, slower national economic growth, reduced international competitiveness, and a disproportionate burden on certain income groups and regions.

In fact, virtually all of the basic approaches to controlling CO_2 emissions entail economic costs and make some people or regions better off than others. Certainly, any effective CO_2-reduction program will raise the price of goods and services produced from carbon-based fuels. Like carbon taxes, regulatory strategies (often called "command and control" policies), and pollution permits for carbon emissions can reduce economic output and generate regional and income disparities.[2] These effects may be harder to trace in a regulation or permit system than in the case of carbon taxes, but they are no less real.

Compared to alternative approaches, however, carbon taxes have several clear economic benefits. In particular:

- Carbon taxes offer a practical and administratively manageable means of encouraging a "least cost" approach to achieving any given level of reduction in carbon dioxide emissions. Compared to regulatory alternatives, they could save significant economic resources.
- A portion of the revenues generated by a carbon tax can be returned to the economy by lowering other taxes, providing net gains for the U.S. economy; and
- Some of the revenues from a carbon tax can also be used to compensate groups adversely affected by the tax.

Of course, dollars diverted to compensation programs may not be available to finance tax reform initiatives, and desires for economic efficiency must be balanced against those for fairness or equity. In the end, how tax revenues are allocated between the competing goals is a political call. Nevertheless, researchers can and should narrow the range of choices. Current economic modelling work helps policy-makers grasp the economic implications of recycling a large part of the revenues from a carbon tax and leaving the rest for other programs. In the future, a better understanding of how various allocations would affect various states could help build a firmer policy foundation and make it easier to determine the size and allocation formula for a block-grant scheme.

All the economic merits of a pollution or carbon tax notwithstanding, political barriers impede their implementation. The public is leery of new taxes. But pollsters' findings that the American public is willing to pay more for environmental protection imply that a pollution tax might be more politically acceptable than other types of taxes. A pollution tax that offsets other taxes would presumably be even more tolerable.

The biggest hurdle to more sensible tax policy is an underlying distrust of the system. The public does not believe that the government will raise one set of taxes only to lower another. Instead, it expects that any increase will result in more net spending. Any pollution tax strategy must be accompanied by policy initiatives for addressing this suspicion.

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NEWS RELEASE

WORLD RESOURCES INSTITUTE
1709 New York Avenue, N.W., Washington, D.C. 20006

For release August 31, 1992
Contact: Shirley Geer 202/662-2542

WRI REPORT LINKS SEVERE ENVIRONMENTAL DETERIORATION TO ECONOMIC POLICIES PROMOTED BY INTERNATIONAL LENDING AGENCIES

The economic policies supported throughout the developing world by the World Bank and the International Monetary Fund can undermine long-term economic progress if environmental consequences are not taken into account, according to a first-of-its-kind analysis by the World Resources Institute.

At a time when many developing and formerly communist countries are undergoing sweeping economic transformation, the report's findings are particularly relevant. It is being released on the eve of the joint annual meeting of the World Bank and the IMF.

This pioneering analysis, **The Environmental Effects of Stabilization and Structural Adjustment Programs: The Philippines Case,** is significant because it demonstrates that macroeconomic policies included in stabilization and structural adjustment programs can have pervasive ecological effects. Analyses of such policies carried out by international funders and national governments have largely ignored environmental factors.

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"Macroeconomic policies have momentous but little understood environmental consequences," conclude authors Robert Repetto, vice president and senior economist at WRI, and Wilfrido Cruz, a leading Philippine environmental economist who worked on the study while on leave from the University of the Philippines. "In regions now undergoing dramatic transformations, environmental degradation has been as obvious a symptom of the failure of previous policies as economic collapse."

Repetto and Cruz examined the environmental implications of macroeconomic policies in the Philippines before the onset of a debt crisis in the early 1980s, and the consequences of the ensuing stabilization and structural adjustment programs financed by the IMF and the World Bank. (Stabilization policies are short-term measures aimed at reducing total expenditures, shifting resources to produce trade goods, and refinancing debt. Long-term structural adjustment policies target changes in the exchange rate and trade policies, government expenditures, and government control over the economy.)

From 1970 to 1987, the analysis reveals, the Philippines' balance sheet deteriorated more from depreciation of natural resources than from foreign borrowing. Depreciation in just three sectors--forests, soils, and coastal fisheries--averaged more than 4 percent of gross domestic product (GDP) per year, 0.8 percent higher than the annual rise of external debt as a percentage of GDP.

The study shows how development strategies, often supported by international donors, worked to create this long-term pattern of environmental degradation. In the two decades leading up to the debt crisis, economic policies in the Philippines encouraged immediate consumption of natural resources while the nation piled on more and more external debt, thereby dimming future economic prospects.

Misguided development strategies and government mismanagement failed to effectively convert resource assets into productive capital, resulting in the decline of investment productivity throughout the economy. Over a 25-year period up to the early 1980s, the raw materials and energy required to produce a unit of output actually increased by about 40 percent, raising both production costs and environmental pollution.

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Philippine industrial and trade policies discouraged investment in forests and agriculture, and promoted capital-intensive industries. Distorted price signals provided Philippine industry with incentives to become more materials-intensive while fiscal policies heavily subsidized such pollution-prone and energy-intensive sectors as pulp and paper, mining, chemicals, and petroleum products. Because government policies favored industries closely tied to consumer markets, there was a pronounced concentration of relatively inefficient, pollution-prone processing industries in the metropolitan Manila area, causing severe environmental degradation and congestion.

Amid rapid population growth, Philippine policies retarded job creation and penalized agriculture, thus perpetuating severe income inequalities and poverty. Tens of millions of low-income and landless households were pushed into small-scale coastal fishing or into shifting cultivation in upland forests, overtaxing those fragile natural resources. The cost of living increased more than 50 percent in 1985, undercutting wages and leaving 58 percent of the population below the poverty line. When the Philippine government sharply contracted the economy to meet IMF stabilization targets, migration into the upland forests accelerated markedly, as more than 2.5 million new migrants fled from unemployment into subsistence farming.

Repetto and Cruz argue the need, especially among the major donor agencies, for analytical models that relate natural resource use and environmental impacts to macroeconomic policy changes. "As countries in Eastern Europe, Asia, Latin America, and Africa work to undo decades of state intervention and market distortion, the international community is being called on to provide advice and support for structural reforms. New economic policy packages must address and reverse ecological as well as economic deterioration," Repetto said. "It is crucial that these policies focus not just on the immediate crisis, but also on the requirements of longer-term sustainable development."

Building environmental factors into macroeconomic analysis might provide an early warning of ecological as well as economic losses -- a critical issue particularly for

countries heavily dependent on their natural resources for employment, revenue, and foreign-exchange earnings.

Based on their analysis, the authors conclude that external adjustments must be accompanied by domestic policy changes to ensure sustainable use of natural resources. Measures to reduce the adverse impacts of stabilization policies on the poor are needed to prevent increased over-reliance on fragile environments for subsistence. Resource royalties and energy taxes should be used to correct fiscal imbalances while eliminating incentives favoring unsustainable resource use. Reforms to create more equitable and secure tenurial arrangements must be put in place to ensure that shifts in demand for resource-based commodities don't lead to boom-and-bust exploitation. The authors find that such adjustment measures could have produced growth, employment, and poverty alleviation while reducing environmental pressures.

The Environmental Effects of Stabilization and Structural Adjustment Programs: The Philippines Case builds on the authors' earlier work in **Wasting Assets: Natural Resources in the National Income Accounts** (WRI, 1989) and **Accounts Overdue: Natural Resource Depreciation in Costa Rica** (WRI, 1991), which challenge the validity of traditional indicators of economic success because they fail to account for the depletion of natural resources.

The World Resources Institute is an independent policy research center based in Washington, D.C.

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Copies of The Environmental Effects of Stabilization and Structural Adjustment Programs: The Philippines Case can be obtained for $12.95 plus $3.00 shipping and handling from WRI Publications, P.O. Box 4852, Hampden Station, Baltimore, Md. Complimentary copies are available for journalists.

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A Global Forestry Initiative

Roger A. Sedjo

As evidenced by the recent Earth Summit, interest in protecting the world's forests is growing. Turning this interest into action is difficult due to concerns that an effective international forest protection effort would entail a binding agreement that might infringe on national sovereignty. Recognizing that the global environmental and ecological outputs of forests can be protected only through international cooperation, researchers at Resources for the Future have proposed a global system of tradable forest management obligations that would internalize the benefits of forest conservation to forest owners, thereby providing incentives for sustainable forest management. Modeled on the U.S. system of tradable emissions permits, the proposed system could emerge from a recent forestry initiative, which envisions voluntary forest partnerships between the developed and the developing countries.

Just before the United Nations Conference on Environment and Development, the so-called Earth Summit held in Rio de Janeiro in June 1992, President Bush announced an initiative that would commit the United States to substantially increasing its current expenditures to protect the world's forests, particularly tropical forests. Far from being a feeble last-minute effort to gain credibility with the environmental community, the "Forests for the Future" initiative was actually the outgrowth of the Houston Communique drafted in July 1990 by the Group of Seven (G7) member countries—the United States, Canada, the United Kingdom, France, Germany, Italy, and Japan. The communique called for negotiations to be completed by 1992 on an international convention or agreement to curb deforestation, protect biodiversity, stimulate positive forestry actions, and address threats to the world's forests.

The forestry protection efforts urged by the Houston Communique appear

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to be more concrete and substantive than the highly general set of "forest principles" that emerged from the Earth Summit. These principles express concerns, goals, and intentions regarding forests, forest management, and forest protection. The nonbinding "Statement of Forest Principles" adopted at the summit stresses that "forest lands should be sustainably managed to meet [the] social, economic, ecological, cultural, and spiritual human needs of present and future generations." In addition to affirming the responsibility of countries to ensure that forestry activities within their jurisdiction or under their control do not cause damage to the environment, the statement explicitly acknowledges the sovereign right of individual countries to exploit their own forest resources. Indeed, it was the reluctance of countries to relinquish sovereignty in domestic activities that precluded a binding agreement that would prescribe, for example, specific forest management efforts and the quantity of forest each country must protect and preserve.

Although it appears modest, the "Forests for the Future" initiative announced by Bush may prove to be a greater catalyst for increasing protection of forests than the "Statement of Forest Principles." On the surface, the initiative consists simply of a unilateral pledge to increase the current sum of $120 million for forest conservation efforts in the developing world, Eastern Europe, and the former Soviet Union to $270 million in 1993, and to further increase monetary assistance in the future if other countries also contribute to these efforts. When viewed in the context of the Houston Communique, however, it is clear that the real import of the initiative is not the pledge of financial assistance but the intention of precipitating major commitments to forest conservation by the other industrialized nations.

To avoid the problem of encroachment on sovereignty that has plagued most attempts to develop forestry programs that could be accepted in the context of a global agreement, the "Forests for the Future" initiative envisions voluntary forest partnerships between developed countries and developing countries. Through these partnerships, the developed countries would finance forest protection, conservation, and restoration projects proposed by the developing countries. Since it is unlikely that all of these projects could be funded, donor countries would allocate money to the countries they felt had developed the best proposals. To bring potential donors and recipients together, the initiative calls for the convening of a forest partnership forum as early as the end of 1992.

The importance of the Bush initiative lies in the intention to precipitate commitments to forest protection by other industrialized nations.

The concept of partnerships between the developed and developing countries was echoed in a communique issued at the G7 summit in Munich in July 1992. This communique calls for "rapid and concrete action" to create "worldwide partnerships" to follow through on the initiatives emerging from the Earth Summit, and it specifically mentions the "Statement of Forest Principles" in connection with these partnerships.

Global environmental and ecological outputs of forests

Why should the world's forests need the special protection urged by the "Forests for the Future" initiative, the Houston Communique, and the "Statement of Forest Principles"? The answer is that not all of the outputs of forests can be captured and allocated by markets or nonmarket actions on the part of individual governments. Those that cannot be captured and allocated are undervalued and, as a result, are likely to be degraded over time.

Two types of forest outputs are likely to be valued and thus protected within national economies. These are commodity and direct service outputs, such as timber and recreation, and local environmental outputs, such as local watershed protection. Markets provide incentives for the efficient capture and allocation of commodity and direct service outputs, with socially desirable results. Local environmental outputs, on the other hand, often require nonmarket interventions such as government regulation if they are to be captured in any orderly way. These interventions can be made on a local level and would not benefit from the involvement of other countries.

In contrast, the capture of two other kinds of forest output—global environmental outputs, such as carbon sequestration, and global ecological outputs, such as biodiversity—requires international cooperation. It is the realization that neither existing markets nor actions by individual governments are likely to protect these outputs that have led the G7 to seek a global forest agreement.

Alternative approaches to global protection of forests

Several approaches to preserving the global environmental and ecological outputs of forests have been suggested. The basic dilemma of these approaches is to achieve real protection of forests without undermining national sovereignty.

One approach would be a binding agreement that sets forth (for example) country-by-country forest-cover quotas and prescriptions for sustainable forest management. Such an agreement could substantially increase forest protection because it could impose tough compli-

Under the proposed system of tradable forest management obligations, industrialized countries might fulfill their "surplus" obligations by investing in efforts to curb destruction of the Amazonian and other rain forests.

ance and monitoring standards. However, many countries view the imposition of such standards as unacceptable due to considerations of national sovereignty.

Another approach would be a series of nonbinding principles or expressions of intent. While avoiding the politically unacceptable constraints imposed by a binding agreement, such principles and expressions are often shallow and typically lead to little, if any, action. Thus the forest principles agreed to at the recent Earth Summit are likely to generate little forest protection.

The problems with the two above approaches suggest that if any international system of forest protection is to be effective without infringing on national sovereignty, it must meet four criteria. First, such a system must create incentives for producing global environmental and ecological goods that will balance the already existing market incentives to produce commodity and direct service goods and the political incentives to produce local environmental goods. Second, it must allocate responsibilities for forest protection to all nations. Third, it must allow flexibility in how these responsibilities are met. And fourth, it must promote cost-efficient ways of meeting them.

Applying the concept of tradable emissions permits

The system of tradable emissions permits that is increasingly used in the United States to control air pollution could provide a model for a global system of forest protection that satisfies the criteria noted above. The permit system is implemented by fixing an acceptable amount of pollution, issuing emissions permits equal to that amount, and establishing some system for fairly distributing the permits to the entities creating the pollution. These entities are allowed to emit more pollution than the amount specified by the permits they hold, but they are free to sell their permits or buy those of other entities. Because the permits can be traded, they become an asset. Even though permits are initially received free of charge, their use precludes their sale and thus involves opportunity costs.

The number of permits created and thus the amount of pollution allowed is a nonmarket decision, as is the distribution of permits. Once the permits have

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been distributed, however, the market reallocates them so as to penalize increases and reward reductions in pollution. In this way the polluter is forced to bear a cost that had been borne collectively by society. This cost creates an incentive to reduce pollution.

Under a global system of tradable forest protection obligations, poor countries would, in effect, be compensated for the environmental and ecological benefits provided by their forests.

The concept of tradable pollution permits could be applied to forestry activities with the objective of internalizing the benefits of forest conservation to forest owners, thereby providing incentives for the sustainable management of forests. To do this, researchers at Resources for the Future have proposed a global system of tradable forest protection obligations whereby countries would voluntarily accept the responsibility to maintain or improve the quality of forests within their own jurisdictions, within other countries, or both. This system would be implemented by creating a set number of obligations and distributing them among countries. Like emissions permits, the obligations would be tradable. Countries could fulfill them directly or induce another country to assume them, presumably in return for payment.

One of the attractive aspects of the proposed system is that, through the distribution of obligations, poor countries would be compensated for the environmental and ecological benefits provided by their forests. Poor countries, particularly those with large amounts of forested land, would assume obligations to protect less forested land than actually exists within their boundaries. Wealthy countries, on the other hand, would assume obligations to protect more forested land than actually exists within their boundaries. Thus they would fulfill their "surplus" obligations by protecting forests in poorer countries.

To fulfill these obligations, wealthy countries could provide payments to poor countries to facilitate efforts to protect critical forests. These efforts could include the establishment of forest preserves, the restoration of forest habitats, or the introduction of sustainable management practices. In some cases, payment might be made only after countries were successful in maintaining the integrity of protected areas for some specified period of time. Thus the payments could be tied to actual performance and not simply to promises.

Under the proposed system, protection of any one acre of forest would not necessarily be equivalent to protection of any other one acre of forest. In fact, the system would be fairly complex in operation. It would recognize that forests differ in type and in condition and management, and therefore differ in

The proposed system would recognize that forests differ in their capacity to generate global environmental and ecological outputs, and thus would make distinctions in the value of protecting different types of forests.

their capacity to generate global environmental and ecological outputs. Thus the system would make distinctions in the value of protecting, for example, ten acres of virgin wet tropical forests, which are rich in biodiversity, and the value of protecting ten acres of northern boreal forests, which are less rich in biodiversity and far more abundant than virgin wet tropical forests. This means that if a country fulfilled its obligations by protecting tropical forests, it would have to protect fewer acres than if it fulfilled its obligations by protecting northern boreal forests.

Transition to a system of tradable obligations

A global system of tradeable forest obligations would have to be implemented gradually because it would constitute a sharp departure from the usual manner in which foreign assistance is allocated and because initially only the wealthy countries would be in a financial position to assume obligations. However, Bush's "Forests for the Future" initiative could be the first step in the transition to such a system.

The major achievement of the initiative is that it encourages the participation of the G7 countries and other industrialized countries in forest protection efforts that are in the spirit of the "Statement of Forest Principles" that emerged from the Earth Summit. Like the proposed system of tradable obligations, the initiative calls for these countries to make investments in forest management in developing countries. While the initative only proposes fixed monetary expenditures (as opposed to fixed obligations) for this management, it is similar to the proposed system in that it considers forest conservation to include not only the creation of protected areas, but the promotion of broad multiple uses of the world's forests. Moreover, the forest partnership forum proposed in the "Forests for the Future" initiative could serve as a clearinghouse for facilitating creative investments in these uses under a global system of tradable obligations.

Roger A. Sedjo is a senior fellow in the Energy and Natural Resources Division at Resources for the Future.

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NEWS RELEASE

HOLD FOR RELEASE
6 P.M. EST
Saturday, December 12, 1992

INDIGENOUS PEOPLES' SURVIVAL CRITICAL TO SAVING ENVIRONMENT

Human cultures, like plant and animal species, are becoming extinct at unprecedented rates. In addition, the fates of cultural and biological diversity are closely linked, reports a new study from the Worldwatch Institute.

Of the world's 6,000 languages--representing approximately the same number of cultures--half will likely disappear within a century as their speakers are driven off their territories and assimilated into dominant societies, according to Guardians of the Land: Indigenous Peoples and the Health of the Earth.

"Far from a vestige of the colonial past, the extinction of cultures has accelerated in this century as the modern economy has scoured the globe for resources and markets," said author Alan Thein Durning.

As indigenous cultures vanish, so do vast numbers of animal and plant species unknown to Western science--as well as intimate knowledge of their use. Native peoples' homelands encompass many of the planet's last tracts of wilderness--ecosystems that shelter millions of endangered species, buffer the global climate, and regulate hydrological cycles.

"Even without considering questions of human rights and the intrinsic value of cultures," said Mr. Durning, "indigenous survival is a matter of crucial importance. We in the world's dominant cultures simply cannot sustain the earth's ecological health without the help of the world's endangered cultures."

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WORLDWATCH INSTITUTE

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The report contains hopeful news as well: Native peoples are poised as never before to defend their resources and cultures. Hundreds of indigenous communities have joined forces to struggle for their rights.

Indigenous peoples encompass 4,000-5,000 cultures, and total between 200 and 600 million people, depending on how "indigenous" is defined.

Descended from the original inhabitants of an area taken over by more powerful outsiders, indigenous peoples remain distinct from their country's dominant group in language, culture, or religion. Their social relations are often tribal, and they commonly maintain strong ties to a subsistence economy. They are, or are descendants of, hunter-gatherers, fishers, nomadic herders, slash and burn farmers, or subsistence cultivators. Most consider themselves custodians and caretakers--not owners--of their land.

Whereas indigenous peoples exercised control over most of the earth's ecosystems as recently as two centuries ago, the territory they now occupy has shrunk to an estimated 12 to 19 percent of the earth's land surface. Whole peoples have disappeared: Brazil lost 87 tribes in the first half of this century alone.

"But around the world, where there are still indigenous peoples, you' usually find healthy ecosystems. And where there are healthy ecosystems, you'll usually see indigenous communities," said Mr. Durning. "That's true from the coastal swamps of South America to the sands of the Sahara, from the ice floes of the Arctic to the coral reefs of the South Pacific."

In fact, native cultures remain the day-to-day stewards of an area of the earth larger than all the world's national parks and nature reserves put together.

Indigenous homelands also shelter a disproportionate share of the earth's biological diversity. Of the nine countries that together account for 60 percent

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of human languages, six are also what biologists call "megadiversity" countries--those with exceptional numbers of unique plant and animal species.

Native peoples maintain a body of knowledge about nature that continues to astonish Western-trained experts. Their understanding of medicinal plants alone has aided billions of people elsewhere. One-fourth of prescription drugs dispensed by United States pharmacies are derived from plants; of those, three-fourths have similar uses in traditional herbal medicine.

Native peoples cultivate unique varieties of the world's major food crops. These varieties form the gene pool that Western crop breeders use to protect modern strains against pests and changing soil and climate conditions.

Women of the forest-dwelling Kpelle of Liberia are representative: They sow more than 100 varieties of rice, making their fields jigsaw puzzles of genetic diversity. According to the International Society for Ethnobiology, "native peoples have been stewards of 99 percent of the world's genetic resources."

Indigenous peoples are not hands-off preservationists. But the way they use forests, grasslands, farms, fisheries, and wildlife usually sustains those resources over the long term. Witness the stewardship techniques practiced by the Tukano people of Brazil's Rio Negro: Tribal law sets aside broad areas of the watercourse as fish sanctuaries, where fishing is strictly forbidden, the prohibition is backed up by the belief that the ancestors of the fish will kill one Tukano child for each fish caught in a reserved stretch of the river.

However, the study finds that when pressed by the cash economy, modern technologies, and encroaching groups--or, occasionally, by their own numbers--native stewards are likely to find their traditional approaches collapsing.

Indigenous systems of ecological management persist in places where native peoples win legal control of their land and other resources, organize themselves

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to withstand outside pressures, and find allies in the dominant society.

"Progress has been slowest in securing land," said Mr. Durning. "Soaring consumer demand among the world's rich, and burgeoning populations among the poor, form a juggernaut that is driving into native peoples' territories. Loggers, miners, commercial fishers, small farmers, plantation growers, dam builders, oil drillers--all come to seek their fortunes."

Indigenous peoples cannot stem this tide without legal backing. Yet native peoples now have rights to use at most 6 percent of the globe's territory, and in many cases those guarantees are partial, qualified, or unenforced.

Guardians of the Land points to several promising ways to aid indigenous peoples in the early nineties. These include:

- demanding respect for basic human rights;
- mapping and demarcating indigenous lands;
- establishing legal aid groups to exploit unenforced pro-indigenous laws;
- pushing for passage of a strong U.N. Universal Declaration on the Rights of Indigenous Peoples to establish a high standard for state actions;
- pressing for implementation of indigenous peoples' policies already on the books at the World Bank and other development agencies.

Indigenous peoples may be the first to suffer, but no culture is safe from degradation of the global environment. The report concludes with the words of a Guarani elder from Argentina, "When the Indians vanish, the rest will follow."

- END -

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Newsmaker Interview

Donella Meadows

Modeling a Better World

Donella Meadows, who holds a Ph.D. in biophysics from Harvard University, is an adjunct professor at Dartmouth College in the Environmental Studies Program. For the past 20 years she has been generating computer modeling studies of social, environmental, energy and agricultural systems. She is the award-winning author of "The Global Citizen," a nationwide syndicated column, and she is the principal author of the best-selling book, The Limits to Growth, *published in 1972. Along with Dennis L. Meadows and Jorgen Randers, she recently published* Beyond the Limits, *a highly acclaimed sequel to* The Limits to Growth. *Dr. Meadows recently spoke with ZPG's Jennifer Merrill. We are pleased to share Dr. Meadows' thoughts with our readers.*

ZPG: With the publication of *Beyond the Limits*, you argue that human society is now using resources and producing waste at rates beyond the regenerative abilities of many of the planet's ecosystems. What has changed in the 20 years since the publication of *Limits to Growth* that would prompt you to publish a sequel?

Meadows: The human economy has doubled, in physical terms. Also in monetary terms, but the physical terms are the ones that are important. In general, human beings are taking twice as much energy and materials from the ecosystem as we were 20 years ago, and we're putting out twice as much pollution and waste. And that has taken us above a whole lot of limits.

ZPG: What do you mean, specifically, by the term "economy"?

Meadows: I mean all human activities. From my point of view, it is the physical throughput. The effect on the environment. The taking of materials and energy from the environment, diverting them through human activities—agriculture, cities, cars, television sets, whatever—and then the return flow out of the human economy in the form of solid wastes, gaseous wastes and water wastes.

ZPG: How significant a factor is human population in the current and future environmental and economic health of the planet?

Meadows: That flow of materials and energy depends on two things: how many people there are and how much of a flow of material and energy each person generates. Together those factors make up the impact and define our limits. Whether we're overpopulated depends on how much material and energy flow each person insists upon having.

In the last 20 years human population increased by about 50 percent, but the increase in throughput per person was even more significant. I don't mean to minimize the importance of that 50 percent increase in population, from 3.6 billion in 1970 to 5.3 billion in 1990; that's a big change. But let's look at throughput in terms of automobiles, for example. In 1970, there were 250 million automobiles; in 1990, 560 million. That's more than a doubling in the number of automobiles, and more cars per person, in 20 years. Lots of people would say, "Great! That represents increased affluence." And that's true. But it's also increased oil use and emissions, steel use, rubber use, glass use, and road mileage and so on.

ZPG: In *Beyond the Limits* you outline several future economic and environmental scenarios that differ depending upon when and what kinds of actions people take to mitigate environmental stress. Please briefly describe the best- and worst-case scenarios.

Meadows: Very briefly, the worst is collapse, and the best is a sustainable, sufficient lifestyle for everybody. Taking into account the computer model we used, and considering what world population is now, we think 8 billion people living at a roughly western European level of affluence, though with much more efficient use of energy and materials than western Europeans now use, is possible. But if you try to take that

population up to 12.5 billion, which is what the World Bank and the U.N. project is likely in terms of current growth trends, we can't make it. We either have to really cut down on lifestyle, or we get into the other scenario, which is collapse.

ZPG: And that means, basically, that ecosystems simply stop functioning?

Meadows: No, actually, ecosystems don't stop functioning; what stops functioning is the human economy. This is not to say there couldn't be ecosystem collapses; there are many going on right now. But according to our model, what causes the collapse is multiple human problems coming so fast—because of the exponential growth of both the population and the economy—that there just isn't enough capital, attention, technology, political will, organization, and skilled human power to take care of the pollution problem and the food problem and the reinvestment problem and the resource-depletion problem and so on all at once. What you really run out of when there's exponential growth is time. As the problems come on faster and faster, there's less and less time to solve them and there's less and less problem-solving capacity to allocate to each problem.

> ***"...We think 8 billion people living at a roughly western European level of affluence, though with much more efficient use of energy and materials than western Europeans now use, is possible."***

Three things are absolutely essential to reach our best-case scenario. First, much greater efficiency of use of energy and materials. That will get us below the limits, to give us time to do the other things. We are now above the limits, we are unsustainable. We've got to stop draining the resources and producing pollution at the rates we're doing it now, and technology alone can't do that.

If we keep on growing we'll undo the technological time we gained. So the other two necessary things are population stabilization as quickly as possible and, let's call it, "affluence stabilization": a decision that there's a certain amount of material sufficiency that we will define as enough. We mig change the way our affluence looks, get more varie diverse...but we won't be in this search for ever more maten stuff in our lives.

ZPG: You describe the transformation to a sustainab society as revolutionary in nature. What sorts of behavi and attitudinal changes do you envision individua making?

Meadows: I see a completely different mindset or philosopl or whatever you want to call it than the one we've been taug to have by our materialistic, advertising-driven society. Ar that's why I call it a revolution; it's on that scale. I mean "click" in our minds to a whole new way of seeing things

For example, our whole industrial system has been mac up of sucking materials in one side and spewing them out th other into a planet that operates instead by recyclin. Fortunately, most people in this country now understand th. we can recycle resources and why we should. The only way w can fit on the planet is for our own economy to operate b recycling. What's important is asking the right question. It taking each of our little daily activities and asking: "Fro where this originated to where it ends up when I throw it ou what effect am I having?"

But there's another click that has to take place, and th gets us to population growth. First, we need to realize th population growth is a major factor in environmental impac Rather than worry about whether to use a disposable or washable diaper, we should worry about whether to have th child in the first place; that's the big decision. Secondly, we the rich world need to realize that population growth happening mostly in the poorer world, or among the poor the rich world, where women are the most uneducated, whe there are the fewest job opportunities, where women dor have the technology of birth control or, in many cases, th empowerment in their culture to make that decision fo themselves, and where children are viewed as a net econom asset.

The only thing that anybody has figured out to do to brir birth rates down, and what has always worked to bring birt rates down, is to give people the technology, the power and th economic rationality to have fewer children. And the tw things that make the most difference, apparently, are fami planning programs and the education of women.

If the rich people of the world could click that poverty ar population growth are *their* problem, as well as the proble of the poor, and that the whole Earth's future depends c solving these problems, then maybe we'd get a little more cor passionate and feel a little more partnership with the poo people on Earth. You wouldn't allow girl children in yo family to be uneducated and unempowered, not to mentic starve to death. And we shouldn't let that happen to ar human being.

ZPG: Are you optimistic that this kind of a "click" ca occur?

Meadows: Yes, of course it can. It happened to me. I wasr born knowing these things. Not only me, but thousands ar millions of people have already seen this click and are wor ing on creating a sustainable life for themselves and a su tainable society. Nobody really knows, after the click, how make a sustainable society; that's a matter of experimentatic and trying. But you don't even try if you haven't got th message.

ZPG: What is your New Year's wish?

Meadows: I can't think in terms of years; I think in terms centuries. I need a year 2000 wish, and that's very clea Wouldn't it be wonderful if by the year 2000 the commitmen to sustainability and sufficiency and equity had happened all of the educated people of the world, and they were well o their way to the experiment and the adventure of designing sustainable world economy!

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October - December, 1992

People versus the environment

Most visitors to Rio de Janeiro would be surprised to learn that Brazil is a recipient of WFP food aid. The famous beaches are full, shops are well stocked, restaurants serve overwhelming portions for all but the heartiest eater and, at least during the recent United Nations Conference on Environment and Development, the poor are out of sight.

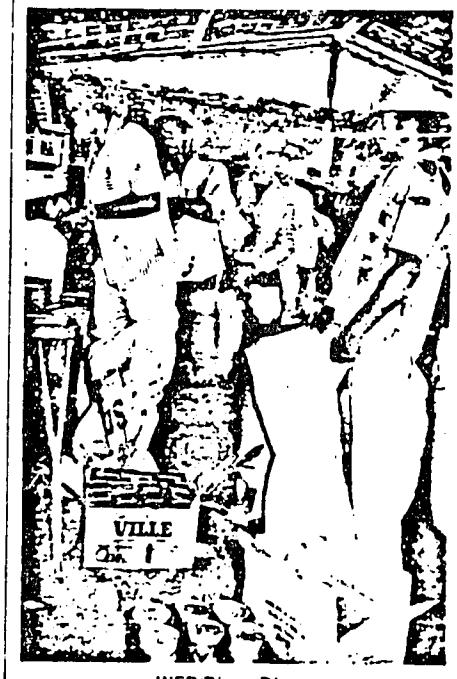
However, in the northeast of the country, a short drive inland reveals a different story. Large families live in very small houses, many made of wood and clay, without water or sanitation; roads turn to tracks and then disappear. In these areas the literacy rate is often as low as 15 per cent and the most that a labourer can hope to earn is cz$8,000 a day, US$1.6, a third of the cost of a meal in a coastal restaurant.

Yet Brazil is one of the world's largest producers of coffee, sugar cane, soya beans and orange concentrate and a major exporter of iron ore. The country also has rich reserves of bauxite, manganese, tin, natural gas, oil and timber. However, Brazil s economy is crippled by one of the world's largest external debts — US$115 billion — and the income from exports mostly goes towards paying the interest.

The government of the northeastern State of Sergipe is trying hard, despite a lack of funds, to improve the lives of the poor. Sergipe is the smallest state in Brazil — small, that is, by Brazilian standards; with an area of 22,000 square kilometres it is bigger than El Salvador, Israel and Swaziland. Most of its land is low lying and, as a result, suffers from salinization and both a lack of, and too much water — heavy rains at times follow droughts, destroying roads and flooding agricultural land.

In the new village of Sao Francisco, in the municipality of Cristinapolis, a group of villagers is determined to escape the grip of poverty. Mostly landless farmers, they joined together a few years ago to persuade the State to give them some land. Eventually they succeeded and 52 families were given communal land for crops and grazing, and a hectare of land each on which to build a house and a well, three kilometres away from their native village.

"It has been hard, very hard," recounts Periquito de Oliveira, the community leader. "Until the houses were built we slept out in the open on our new land, covered only by sheets of plastic. Nearly everyone went hungry. Yet despite the hardship, only one of the original 52 families gave up and left."



WFP/Diana Dixon

The food is delivered to the village in bulk. It is then up to the settlers to arrange the distribution, measure out the rations and ensure that everyone receives their fair share.

Periquito is proud of his position and very proud of what his village has accomplished so far. Each family has a house — some built of wood and clay and others of brick; each family has a well; and in August a school will start in the new community centre.

The villagers work well together. On the communal land they have planted fruit trees and there is a well-established grove of coconut trees. This year's harvest was good and with the proceeds from the sale of coconuts and fruit, together with funds from the State, they bought roof tiles for their houses and 52 cattle. The milk from the cows makes a valuable addition to their meagre diet.

All decisions concerning the village are made together. "So far," Periquito says, "there has been no fighting and we all help each other."

They have achieved much, but life is still far from easy. The seven-metre deep wells are already starting to dry up and the water is not safe for drinking; the first crops planted gave a poor yield because the seed was poor; there is no medical care and although there is a doctor in a nearby village, the settlers do not go because they cannot afford to buy medicine.

All the families in the village are large and most families have at least six children. According to the men, "the women are jealous of their husbands, which is why they like to be pregnant". The women are more reticent and shy of strangers, but judging from their tired faces they probably have a different tale to tell. Their lives are hard and their days consist of working in the fields,

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WFP/Vincenzo Battaglino

Maria Lucia dos Santos's most modern convenience is this sink in which to wash clothes.

looking after the house and the children, and collecting drinking water.

One of the settlers, Evangelista Alexandre dos Santos, and his wife Maria Lucia, built their brick house in January 1991. It is small — just 17 square metres — for a family with six children and another one on the way. However, it is theirs.

On the land around the house they grow papaya, cassava, maize and beans but they need more land to become self sufficient. Whenever possible, Evangelista finds work as an agricultural labourer but he says that without the food rations supplied by the World Food Programme they would go hungry.

Despite the difficulties, Evangelista is convinced they made the right decision in moving. "This is our house and our land. Now we need outside help because we cannot grow enough to feed our families, but in two years time we will be independent."

The biggest problem the village faces is caused by Brazil's new measures to protect the environment. When the new settlement was first approved, the villagers were promised 467 hectares of land. However, some of it is classed as Atlantic Forest and a preservation order was placed on it two years ago.

In a fight between environmentalists and large multinational companies, there is little doubt about who is in the right. In Sao Francisco it is more complicated; without more land the village has no future and their hard work will be in vain.

Periquito is hoping for a compromise. "We don't want to destroy the forest but we need land." The problem still has to be resolved. It is certain that at least 90 hectares of the forest will be preserved, but the State hopes to find more land nearby for the villagers.

WFP/Vincenzo Battaglino

Evangelista dos Santos, happy to have his own land at last.

WFP helps Pronese, the State organization responsible for resettlement projects in Sergipe, by providing food rations for the settlers. Until the village is established and the new settlers become self sufficient, family rations of cassava flour, rice, sugar, oil and tinned fish are given in return for time spent constructing houses, wells and community buildings; planting trees; and working on the communal land.

The local market price of a family ration for ten days is cz$25,000 — more than three days wages — so the food is very much appreciated by the new settlers.

However, they are not the only ones to benefit from WFP aid. WFP buys the cassava, sugar and oil locally, mostly from small-farmer cooperatives, and has spent US$97,300 so far this year — a valuable boost to the State economy.

Roberto Alves, the head of Pronese, is well aware of the problems faced by Sao Francisco and the other 15,562 villagers being helped. Realizing that food aid alone cannot solve all the problems, he has asked other State agencies to provide the villages with technical assistance for agriculture and irrigation, health care, training and education. However, due to the lack of funds, not all the villages can be helped.

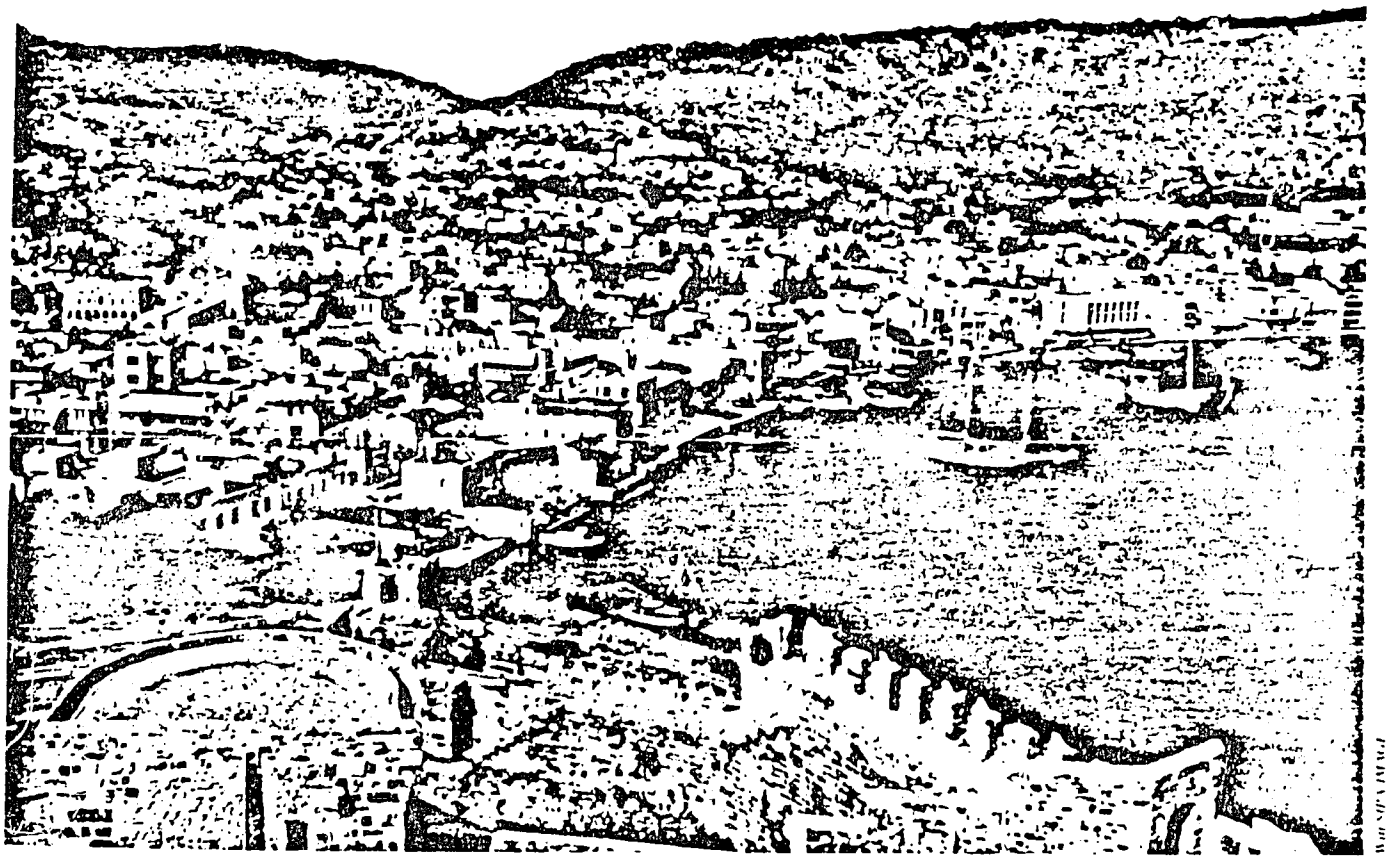
In the new village of Sao Francisco, Periquito's eyes light up as he tells of his plans for the future. "When we have more land we will produce more and sell more; maybe we will be able to buy a truck to reach more markets."

If hard work and determination are enough, then the villagers of Sao Francisco will succeed. They deserve all the help they can get.

by Diana Dixon

Environmental Policies in Turkey

Ferenc Juhasz



Economic and demographic developments in Turkey during the 1980s have revealed, despite some progress, shortcomings in Turkey's environmental policy. Its improvement is crucial for the welfare of the Turkish people, for the future economic development of the country, and for the Mediterranean area as a whole.[1]

Turkey is a large country: with 800,000 km² it is bigger than France and the United Kingdom combined. It is the major land link between Europe and the Middle East. It is the major eastern-Mediterranean country, with international responsibilities for the waters of the Mediterranean, the Aegean Sea, the Straits of Bosphorus and the Black Sea. The Euphrates and Tigris both flow through Turkish territory. It also lies on one of the major routes for migrating birds.

Economic growth during the second half of the 1980s averaged over 6% per annum, the highest for any OECD country. Turkey's population of 57 million is expected to reach 65 million by the year 2000, and 92 million by 2025. Its rapid population growth – an annual average of 2.2% over the last ten years – combined with heavy migration from the countryside, means that all urban areas are undergoing major expansion, often through large-scale unauthorised construction.

This urban growth, combined with industrialisation, has led to air and water pollution, as well as to the generation of waste and noise. In many cities the quality

1. Environment Policies in Turkey, OECD Publications, Paris, forthcoming 1992.

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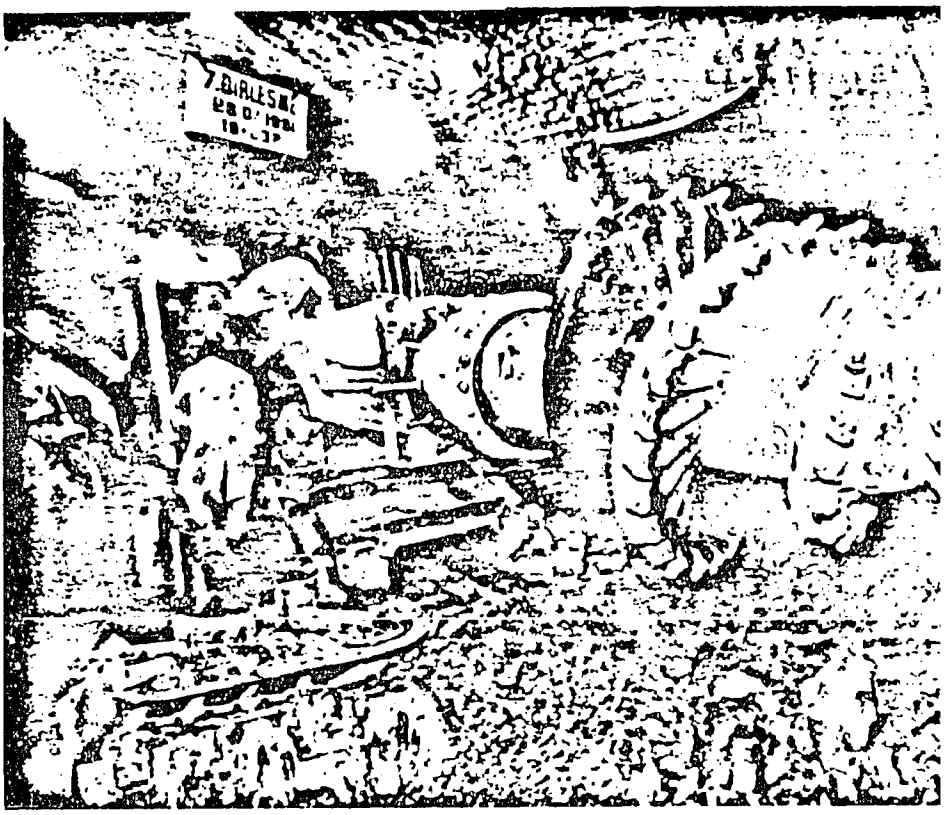
of the ambient environment is so poor that the required standards (Turkey aims at EC standards) will not be met before the year 2000 (the EC SO_2 guidelines for winter months were exceeded in 24 cities). Although 56% of the urban population is served by sewerage systems, moreover, only 6% has adequate treatment of waste-water. By contrast, the air quality in parts of Ankara has been improved considerably through the introduction of natural gas for domestic heating.

Coastal areas, Turkey's main natural resource (coastal provinces provide 60–70% of GDP), are developing fast through urbanisation, industrialisation, tourism and shipping. Population density in the coastal areas, between 130–40 people per km^2, is twice the national average and is growing twice as fast. Net tonnage of goods landed in Turkish harbours has doubled over the last ten years. Coastal waters near major settlements, particularly in semi-enclosed bays and estuaries, are badly polluted by domestic waste, industrial discharge, agricultural run-off and ballast water from shipping. Pollution from industrial activity has reached critical limits in some areas such as Izmit, Izmir on the Aegean coast and Iskerendum on the Mediterranean. Fish catches in recent years have declined dramatically, largely because of the pollution of the Black Sea. In addition, the number of foreign tourists arriving in Turkey has increased fivefold – to 5 million – since 1982, adding considerably to the pressure on coastal areas.[2]

Turkey is well endowed with water resources – unevenly distributed, perhaps, but enough for hydro-electricity to provide more than 40% of total electricity supply. Water use per capita is relatively low by OECD standards: it is, for example, less than half of that of Spain or Italy. The largest use of water is for agricultural irrigation. Over the next ten years total water withdrawals are estimated to rise by about 140% (average annual growth in consumption in the OECD area is about 1.1%), in large part because of the projected South-eastern Anatolia Project (GAP), which is intended to develop the basins of the Euphrates and Tigris rivers. When the project is completed (it involves a total of 14 dams and 11 hydro-electric plants and covers an area equal to Belgium and the Netherlands combined), the total irrigated land area of Turkey will increase by 40%, and hydro-electric capacity will double.

2. See Sergio Arzeni, 'Tourism in Mediterranean Cities', **The OECD Observer**, No. 164, June/July 1990.



Arali/SIPA PRESS

The South-east Anatolia Project takes shape.

What Progress?

The Turkish economy has a tradition of substantial governmental involvement in all sectors: governmental planning in economic development, and a sizable degree of state ownership in industry, mining, transport, energy, and all economic infrastructure. During the 1980s, therefore, a major effort was made to liberate market forces and to decentralise governmental power. The high degree of centralisation allowed a legislative framework of environment policies to be developed rapidly. Yet the state ownership of industry simultaneously retarded the implementation of environmental regulations, partly to maintain the operation of outdated, polluting plants, particularly in areas of high unemployment.

The Environmental Law of 1983 provided the basis for a range of regulations to control air and water pollution, and to limit noise and solid waste. Since then other laws have been passed, to govern water products, tourism, conservation of cultural and natural assets and the coast, that are intended to be complementary – yet in some cases they are contradictory or incompatible with the initial set of environmental policies. Other important regulations, on the assessment of environmental impact and on the handling of hazardous waste and chemical substances, are under preparation.

The Prime Ministerial Undersecretariat for Environment, first created in 1978 with a simple co-ordinating role, was up-graded in 1991 to become the Ministry of the Environment. It is expected that its duties will be diversified and expanded to supervise and implement policies aimed at controll-

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ing and preventing pollution and conserving natural resources.

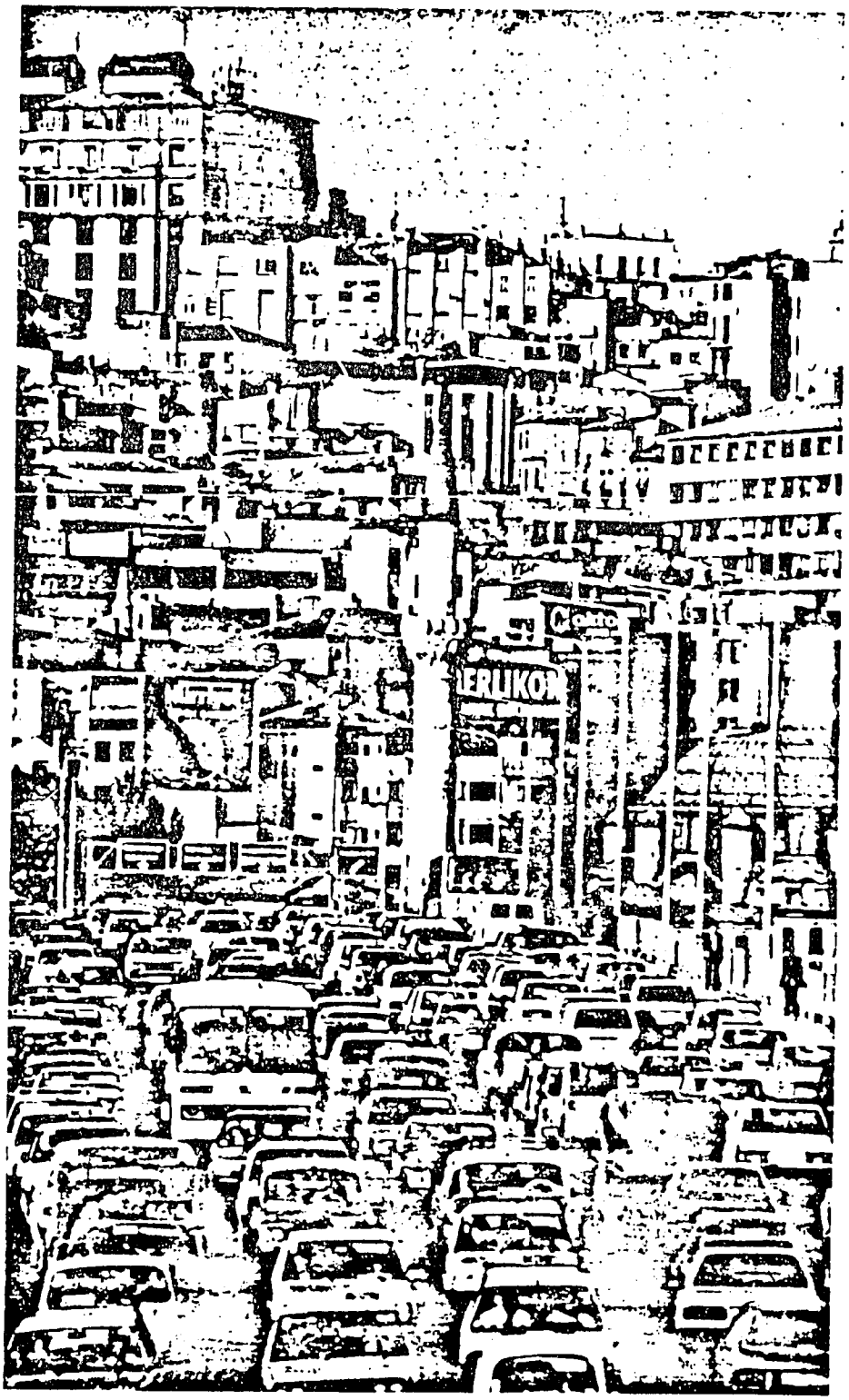
The passing of environmental legislation and the creation of the Environment Ministry are examples of the adoption by the Turkish government of sustainable development as the guiding principle of their environmental policies. Progress towards sustainable development has also been achieved with the design and launching of major development projects in water resources; with initial investments in sanitation and waste-water treatment facilities; with reinforcing public transport as a major mode of urban transport; with substituting natural gas for dirty fuels; and with rehabilitating inner cities.

What Change?

A report prepared by the OECD offers a set of recommendations for consideration by the government of Turkey, and suggests that recent environmental measures be followed up – by integrating environmental and more specifically economic policies in all sectors of the economy – and by vigorously implementing existing laws and regulations through institutional and financial improvements. These recommendations, when put into practice, would lead to a significant improvement in policy formulation and implementation.

Policy integration could reduce economic and environmental loss now and provide preventitive policies for the future. And in Turkey, with the prospect of high population and economic growth, preventitive policies are even more important than in other OECD countries. The relentless pursuit of tourism in coastal areas, for example, is already in conflict with industrial development and has produced environmental degradation that threatens tourism itself.

The integration process would have to be carried out at various levels of the state. First, the central government would have to demonstrate its commitment to sustainable development by adopting formally a number of explicit principles of environmental policy and concrete objectives in the reduction of air and water pollution, possibly in the framework of a 'White Paper on Environmental Strategy'. Such a document, covering a ten-year



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perspective as a minimum, would set out strategic planning (for land use, for example); project planning (for the GAP, for instance); recommendations on the state-enterprise sector; and proposals for international action (not least for the Mediterranean Sea).

Second, the respective impacts of economic and environmental policy would have to be reconciled in the Cabinet itself, for instance through the systematic participation of the Minister for the Environment in all Cabinet committees that deal with economic development.

Third, economic and other forms of expertise should be used to reinforce the abilities of the Ministry of the Environment to help it fulfil its role in integrating environmental with other government policies: evaluating the economic impact of environmental policies and vice versa; maintaining a continuous working relationship with the State Planning Office and the various economic ministries (of Finance, Reconstruction and Housing, Agriculture and Forestry); and servicing the inter-departmental committees. Standing or *ad hoc* inter-departmental committees should be further established as the venues for integration. The environmental expertise of the State Planning Office should be strengthened and environmental considerations incorporated into major public-investment projects before approval by the Planning Office.

Fourth, to ensure policy integration in the country as a whole, the governor's office of each individual province should be strengthened with environmental expertise. Current laws governing co-ordination between the central government and municipalities and between municipalities themselves should be re-examined for their effectiveness, and associations of municipalities be created to improve co-operation between them.

Pursuing Sustainable Development

Implementing policies that promote sustainable development could be considerably strengthened in Turkey by institutional changes in the management of environmental resources, by improving both the existing mechanism for implementation (through monitoring and enforcing regulations) and the finance of environmental protection and conservation.

Improving the technical ability of the Ministry of the Environment will not be enough; institutional changes are required. Various options might be pursued to this end. One is to expand the scope of its current enforcement agencies and its supervisory role. The second is to transfer all regulatory and enforcement powers to the Ministry and enlarge its responsibilities for legislation and integration. Regional directorates of the Ministry can be created, as could agencies for managing river basins. Management councils for coastal zones could be established, with the Ministry as the main agency charged with the implementation of integrated policies, thus overriding administrative and institutional boundaries.

The existing mechanism for implementation could be strengthened by clearly defining the enforcement roles of the appropriate agencies and making them accountable to parliament and to local and regional elected bodies for their performance. The range of economic instruments used could be enlarged – their environmental application is currently rather limited – through more use of pollution charges, user-charges, resource pricing, fines and fees.[3]

The Environmental Impact Assessment Law should now be implemented as a matter of urgency, particularly where major changes in the use of land and industrial, energy and tourism developments are involved. Resource development should from now on be based on economic demand which takes account of the environmental cost of these developments. Mechanisms for public participation (through public hearings, for example) could be extended without undue cost or legal obstacles (by providing access to courts or legal appeals). The Environmental Information System, which is already in place, collecting environmental data, should publish relevant and timely information.

Financing pollution-control measures and environmental infrastructure (water-treatment and sewerage systems, for example) is crucial. Turkey should first aim at emphasising preventitive policies in order to minimise financing requirements in the future. Second, funds could be released for environmental purposes by abolishing uneconomic subsidies to industrial and tourist developments – which also contribute to pollution. Third, full financing of the investment required could be obtained through user-charges for environmental services by charging the long-run social costs of supply. The capital and operating costs of water and sewerage systems, for example, should be covered by charges that also take into account the depletion costs of water resources and the environmental costs of building the dams and pipelines involved. This would mean a substantial increase in present charges for water, sewerage and waste treatment.

The use of public/private partnership could be extended from transport projects to environmental investments (reforestation and sewerage, for instance). Alternatively, these public services could be privatised with government control over price and quality. The 'Polluter-Pays Principle' would have to be applied to new plants – including state enterprises. Turkey could also make fuller use of official international lending facilities for environmental investment.

□ □

In the aftermath of the Earth Summit in Rio de Janeiro on 'Environment and Development', Turkey could show an example in implementing a model of 'clean and green' development for countries experiencing rapid population and economic growth. ■

3. See Jean-Philippe Barde, 'The Economic Approach to the Environment', **The OECD Observer**, No. 158, June/July 1989.

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Somalia: The roots of tragedy

By Ian MacLeod

The horrendous images of war and famine in Somalia now flooding our living-rooms possess an urgency and immediacy that belies the long-standing problems there and, in fact, in neighbouring countries as well. Ian McLeod, who is reporting from Somalia for the United Nations Children's Fund (UNICEF), has been in a position to see the tragedy unfold in slow motion. From his point of view, the complicity of the international community is a key to understanding what has gone wrong—and what can be done to avoid such horrors in the future.

Almost the entire Somali population of between six and seven million has been severely affected by the civil conflict and drought. There is no central, regional or local administration which can realistically claim to be in control; no wage income system; no electricity; no communications; and little access to potable water, food or basic medical services.

The prolonged conflict and insecurity, along with poor rains, have devastated agricultural activity, the livestock sector and commercial trade. At least 1.5 million Somalis are at immediate risk and an additional three million require access to basic services and food. Child malnutrition rates are at previously-unheard-of levels: up to 95 per cent in many towns in central and southern Somalia.

Is there any hope?

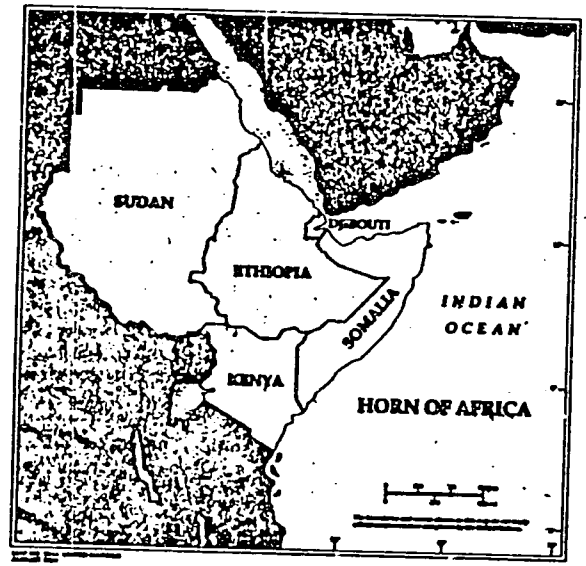
Against such a menu of disaster, is there any hope for Somalia? If so, then what lessons can we learn from the past to avoid a repeat of the situation in a few years?

The thaw in the Cold War may have provided the solution to the most blatantly obvious error of the past.

For 25 years Somalia was a pawn in the Cold War, strategically important because of its access to the Gulf of Aden, the Arab states and Ethiopia. While its allegiances shuffled from East to West, the government built up a massive stockpile of military hardware and the country survived on continued injection of foreign "development" assistance to prop up its limited export earnings. The recent changes around the world are likely to ensure that there is no repetition of such extravagant strategic assistance, at least in the short term.

Classic ruling style

A superficial examination of the former government's ruling style during this period is necessary to learn the second lesson from previous mistakes. It represented a classic example of the traditional Somali concept of power, political or otherwise, as a prize to be captured for the benefit of the individual and his clan. In effect, the traditional raids of rival clans and looting of livestock were reflected in the forceful appropriation of the national government and the distribution of jobs, contracts and other benefits to the president's Marehan clan.



The progressively intrusive security forces and adoption of "scientific socialism" saw leaders of other clans attempt to reduce the president's influence. However, the president was a master of using the clan system to his advantage. Even the mildest public dissatisfaction ended in generalized repression of the offending clan, and often in the arming of rival clans to attack and destroy their properties.

As the threats grew, so did the rewards to the president's clansmen, as he relied more on their support. Government positions and control of state-owned, but usually foreign aid-funded, business were prizes treasured by the president's circle of supporters. Despite being from a rural background, these Marehan and other supporters became further institutionalized in Mogadiscio and other large towns.

This led to an extreme inequity in the distribution of wealth between urban and rural areas. The excessive concentration of wealth, power and development in Mogadiscio and corresponding impoverishment of rural areas led to a marginalization of large sectors of rural youth in the less favoured regions, and to an acceleration of urban migration.

The rural-urban disparity was exacerbated by official development programmes supported by donors. Some 81 per cent of development investment during 1987-1989 was for Mogadiscio and other favoured regions, which covered under 45 per cent of the population.

The growing inequity in wealth distribution was a significant contributing factor in the rural unrest and outbreak of civil conflict. By the end of 1990, around 95 per cent of Somalia's negotiable assets were controlled by residents of Mogadiscio.

Such a scenario again points the finger at the international community—both East and West—for taking or allowing such a blinkered approach to development assistance. Some critics say that if donors had been more responsible, the conflict which has led to the acute nutritional emergency could have been avoided, or at least minimized.

What lessons can we learn from the past to avoid a repeat of the situation in a few years?

If this is true, then surely donors must become more accountable for the direction in which they channel development assistance. A simple statement, oft repeated. . .but how often heeded?

There is certainly no prospect for major development programmes in Somalia at present. However, despite the necessity of addressing the needs of severely malnourished people with emergency aid, the international community must ensure that it takes a responsible approach to attacking one of the major underlying causes of the nutritional emergency and mass displacement —a lack of household food security.

While massive injections of food aid may provide wonderful television, a "life-saving package" of basic medical supplies, specific food for malnourished children and provision of potable water is essential at the household level. A malnourished person is a sick person: food alone will not prevent mass deaths in Somalia.

The increased media attention being given to Somalia and co-ordinated strategies of UNICEF, the World Food Programme and the International Committee of the Red Cross indicates that such an integrated approach will be realized. It then becomes the responsibility of the international community to continue to remember Somalia, the mistakes of the past and the lessons from previous nutritional emergencies in Africa.

Ultimately, it is in the interest of the donor community to support interventions that promote household food security. The re-establishment of agricultural productivity and the livestock industry will reduce the potential of a "dependency" syndrome developing, particularly amongst the large displaced population. By providing an incentive for the displaced to return home to productive activities and thereby reducing the need for continued huge inputs of food aid, a causal factor in the security and geo-political situation will also be eliminated.

'Responsible' assistance

The proposed methodology for this "responsible" development assistance is far from complex: targeted food aid allied to provision of seeds and tools, basic veterinary services, resettlement support, and low-cost primary health care, nutritional support and provision of potable water. Food aid is the necessary prerequisite to the success of such a development or rehabilitation strategy, at least until the first harvest or livestock reaching an adequate level of health.

Unfortunately, many thousands of Somalis will perish before such an integrated programme can be properly implemented. It is only in the past weeks that many of the interior regions of central and southern Somalia have become accessible. However, now that they can be reached safely, pre-positioning of seeds and tools and forward planning can commence—if the commitment and funding are there.

Donors must be accountable for the direction in which they channel assistance.

So there is some hope for Somalia, if the international commitment remains. If the use of Somalis in the Cold War games and the blinkered approach to development assistance mean that the international community contributed largely to the current disaster in Somalia, then surely it must also bear the responsibility for ensuring that the country is given the opportunity to move forward. Apart from a commitment to providing large amounts of targeted resources and funding, a willingness to learn from the mistakes of the past is essential.

But if neither is forthcoming and the world forgets Somalia as quietly as it was remembered, will anybody really point the finger of blame? If so, at whom, and for how long?

Fortunately there are many highly skilled and committed Somalis who will continue to devote their lives to assisting their people in the struggle for survival and development, whether the world continues to support Somalia or not. ■

Ian MacLeod, an Australian national, is a UNICEF information officer based in Mogadiscio.

(The views expressed in this article are not necessarily those of UNICEF.)

Jim Hoagland

Stumbling Into Africa?

LONDON—Europe's former colonial powers have long viewed America's flickering involvement in Africa with a jaundiced mixture of suspicion and amusement. President Bush's sudden decision to put American troops in Somalia has created a new set of Euro-reactions, dominated this time by warmness and puzzlement. These are appropriate responses.

U.S. intervention in Somalia is New Age intervention, an invasion for selfless purposes only. It does not fit the stereotype of America as interloper that is dear to nations that tried to conquer Africa before going home in exhaustion and disillusionment. America's quick embrace of African independence three decades ago rubbed salt into Europe's open wounds, which have still not completely healed.

But in Somalia there can be no suspicion by the old-timers that Americans are trying to elbow Europeans out of mineral rights or other economic advantages monopolized by colonial settlers. And the situation is too horrific and dangerous for there to be any amusement over stereotypical American innocence abroad.

Behind the public applause, Europeans seem skeptical.

There is instead concern that America is stumbling into Africa's vast store of troubles without having thought through the consequences and without realizing that patience is the Dark Continent's principal weapon against foreign invaders. One feared consequence is a lessening of U.S. attention and commitment to Europe at a crucial moment in the escalating crisis in the Balkans.

Bush caught Britain, France and the rest of Europe flat-footed by committing a division-plus of determined warriors to establish "a secure environment" in Somalia so its terrorized and starving population can be fed.

Like President-elect Clinton, London and Paris were notified, rather than truly consulted, and then invited to come along for the ride.

French President Francois Mitterrand overrode the advice of his defense minister, Pierre Joxe, and immediately said yes. Determined to show that France is a major player in the new military era of peacemaking and peace-keeping, Mitterrand authorized a 2,000-man contingent to join the U.S.-led task force.

Britain is lending four air cargo planes. But London is sending no troops, and the British press is predicting that Americans will quickly learn how heavy and unrewarding can be the "white man's burden" (Kipling's phrase about American intervention in the Philippines).

British Defense Minister Malcolm Rifkind explains that Somalia represents an international division of labor in this new era. "We have nearly 2,500 troops in the former Yugoslavia" while America has none, he pointed out to me a few days ago. "We are fully stretched with existing military commitments."

Britain also participates in peace-keeping missions in Cyprus and Cambodia, and has nearly 15,000 troops committed to Northern Ireland.

Behind the public applause for Operation Restore Hope, other European officials seem skeptical that it can be ended as quickly and easily as President Bush and his political spokesmen have indicated.

French commanders are telling their units to expect a minimum stay of three months and expect it to take four to six months to establish a secure environment for the distribution of relief.

Defense Secretary Dick Cheney's stated criteria for ending American involvement is the ability to turn over a kinder, gentler Somalia to "normal U.N. peace-keeping forces." This means the already overburdened United Nations will have to create, fund and field a force that would get the Americans off the hook. Cheney's sudden faith in the intention and ability of the United Nations is a marker of the changed times in which we live.

I detected no questioning by officials in London and Paris of U.S. motives or of the proposition that an American division, aided by French and other troops, will be able to rout the gangs of Mogadishu and Baidoa with ease. The gunmen will probably fade into the desert, or into Ethiopia or Kenya if they are chased and outwait this latest expeditionary force that has come to separate warring clans for their own good.

Because Europe colonialism failed does not mean that America, with a much more limited and laudable agenda, will fail in Somalia. The risks Operation Restore Hope poses—and the allied concern that America will be distracted from the rapidly deteriorating situation in Bosnia—are manageable, as long as they are recognized and anticipated.

Bringing peace and food to Somalia's people may require more time and resolve than Americans expect today. European advice to Americans to think seriously about what they are getting into as they go in is sound and friendly caution that comes not from envy or spite, but bitter experience.

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THE WASHINGTON POST, December 6, 1992

John Lewis

A Short-Term Commitment Is Not Enough

The situation in Somalia is unlike anything else in modern history. I recently traveled to Somalia with several of my congressional colleagues. We saw suffering, misery and starvation on a scale that is incomprehensible to those who have not seen it with their own eyes.

Perhaps the most dramatic moment of my visit was meeting a mother who carried her toddler daughter in her arms. The child had literally withered away. There was nothing left to this little girl but skin and bones. She barely had strength to move her head or her limbs. I looked at her, and I was stunned. How could this be? How could this happen? I still think about that little girl, and I wonder if she survived. If she did, it would be a miracle.

I was deeply moved by that little girl and by the many children I met. I was moved not only by their suffering but also by their spirit and their ability to smile and laugh in the midst of all this desperation. When we reached out to them, they reached back. For them, and for all the Somalis, I am driven to find a way to put an end to the suffering.

I returned from Somalia believing that the United States can and should take a leadership role in the United Nations to help solve this tragedy. Therefore, I supported President Bush's decision to send U.S. peacekeeping troops as a part of an international force. I believe we have a moral obligation to help the people of Somalia. I also believe we should not back away from committing ourselves to work with the United Nations in helping to restore the government in Somalia.

We cannot just put out the fire. We must also rebuild the building. As much as I hope that our troops will be able to restore order and then turn over the longer-term peace-keeping duties to other international forces, I believe that our commitment and attention to Somalia cannot lessen after U.S. troops leave. The United States must take the lead in the United Nations by supporting the presence of peace-keeping troops and by bringing warlords and clan leaders together under U.N. aegis to work out a political solution.

The country is in chaos. There is no government, no sanitation and no order. Young boys with machine guns who belong to no particular group roam the country. Multiple clans are fighting each other, and different warlords control different parts of the country. No one is safe.

The situation had deteriorated ever since Siad Barre, dictator of Somalia for 21 years, fled the country. Barre used animosity between clans to strengthen his rule. The damage from this divide-and-conquer strategy and from the ensuing chaos will not be easy to solve.

Over and over again we heard from relief workers that the most important problem in Somalia is the lack of security for the humanitarian relief effort. Food and supplies cannot be safely transported to the people and places in need. Relief workers risk their lives every day just to feed the starving Somalis because there is almost no security for them.

The United Nations must restore order to Somalia. With the end of the Cold War, the United Nations is entering a new era. Somalia represents the type of problem the international community will face in this new world. I believe it is appropriate that these problems be solved collectively by the community of nations rather than by an individual country.

Unfortunately, the United Nations has been slow to respond to the crisis in Somalia. U.N. agencies are not effectively coordinating their relief efforts, and private relief organizations have expressed frustration with the lack of U.N. leadership. The United Nations is having difficulty expanding its responsibilities. As the only remaining superpower, the United States must take a leadership role and work with the U.N. to help it develop the ability to cope with Somalia and similar problems elsewhere in the world.

If we simply allow the situation to deteriorate, I believe the whole region is threatened. Kenya, for example, is burdened with refugees from Sudan and Somalia as well as with its own drought victims. Several other countries in Africa face famine and civil strife. In addition, there is the threat that religious fanatics may gain a greater foothold in these countries that are in chaos.

Today the crisis is in Somalia. Tomorrow it could be Mozambique or the Sudan. However, if we can help the U.N. adjust to its post-Cold War role, it can respond to situations around the world before they reach these tragic proportions.

I do not take this position lightly. I know this is an important commitment by the United States, and every time a crisis in the world arises I do not necessarily want our young men and women put in harm's way. However, I believe U.S. involvement can make a difference in Somalia, and so we must become actively involved. What is happening in Somalia is an affront to humanity. When people are denied food and shelter, when their human rights are violated, none of us can stand by. An estimated 300,000 people have already died. Another 1.5 to 2 million are at great risk. We cannot stand by while hundreds of thousands of people—including the very young—suffer and die.

There are no easy answers. However, the United States, working with the community of nations, can and should help the people of Somalia. The threat to human dignity there is a threat to all of us. We are one community—the world community. We cannot let this continue to happen.

The writer, a Democratic representative from Georgia, returned on Nov. 21 from leading a congressional delegation to Somalia.

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THE JOURNAL OF COMMERCE, December 2, 1992

Bringing Somalia Back to Life

By MILTON ALLIMADI

President Bush's offer to commit as many as 30,000 American troops under U.S command to a multinational force in Somalia gives the United Nations an opportunity to resolve a conflict that has turned the Horn of Africa into a killing field.

Such an operation is a much-needed measure to restore law and order to a country that has gone out of control. But let's not fool ourselves: The United Nations rescue mission will not be a quick one. The task goes far beyond getting food to hungry people; if that were the only problem, a series of air drops of supplies would be sufficient.

Instead, the mission is to bring back a legitimate government and restore order to the east African nation. Somalia, sadly, is no longer a sovereign nation with its own government in charge. Economic activity has ceased, income is virtually non-existent.

What remains of the nation is under the dominion of two warlords — Ali Mahdi Mohammed and Gen. Farah Aidid — whose followers are impeding international relief efforts.

The promise of the U.N. intervention is that it may establish secured zones that ultimately could extend to cover most of Somalia. The warlords, trapped in the ruined capital city, with no one to subjugate and no food supplies with which to exert their "sovereignty," would then either disappear or meet the justice they deserve at the hands of Somalis.

Last January, the two warlords who now terrorize the country drove former dictator Mohamed Siad Barre from power. Ever since then they have feuded over which of them is the rightful successor.

For months, the U.N. special representative there, Mohamed Sahnoun, pleaded with the warlords and their armed, teen-age followers to allow U.N. troops to protect relief shipments.

Frustrated with their intransigence and their disregard for human life, Mr. Sahnoun finally charged that the United Nations itself was not doing enough — an outburst that cost him his job.

Nevertheless, Mr. Sahnoun's remark was well founded. He had worked in Mogadishu, the besieged capital city, under fire. His comments were perhaps unusual for a diplomat; yet U.N. Secretary-General Boutros Boutros-Ghali himself said in August the West had ignored Somalia, and added that "sometimes you have not to be a diplomat."

Perhaps it was the plain talk from Mr. Sahnoun that opened the eyes of the world to the need to deal directly with the warlords. The United Nations must not repeat its glaring mistake of coddling the warlords and the U.S. should not allow itself to be a part of any operation that bestows legitimacy on them.

Instead, the world body should unequivocally declare a trusteeship over any territory that U.N. troops are able to secure. The secured territories could then be safely supplied with food and medicine. Somalis who surrender their arms could be issued identification cards and admitted into secured zones, where their safety from both warlords and starvation would be guaranteed.

Secured territories can become more than shelters and feeding stations. They can include schools, clinics and eventually administrative agencies run by Somalis. In effect, the seeds of a renewed, indigenous government can be planted in U.N.-protected territories.

This alternative is far preferable to requiring the prospective multinational force to grovel before two warlords who have seized control of the country. Imagine, for example, the absurdity of asking representatives of a multinational operation to present their credentials to local warlords who can readily be accused of genocide.

Certainly, these two dictators and others like them will complain that their national sovereignty has been violated. But if national sovereignty means the power to deny starving citizens access to food and relief supplies, then the United Nations should be proud to override it.

Putting the United Nations in charge of secured territories may lead many of the youthful gunmen to abandon the warlords. Many of them probably resorted to banditry for lack of alternatives: Some have no family left and most have no prospect of other employment.

And what of the likely military opposition of the warlords? Would a U.N. gambit to secure certain territories lead to even more bloodshed? Probably not. With their light weaponry, the warlords would be no match for well-equipped and well-trained U.N. troops, should they be foolish enough to venture into the free zones.

To ensure the peace, the United Nations also should secure Somalia's territorial waters and airspace, thus curtailing the flow of weapons into the country.

Such a mission in Somalia could restore not only that nation but, in a sense, rescue the United Nations itself. Despite recent successes — the organization won a Nobel peace prize for its peacekeeping effort in Namibia — the United Nations has bogged down.

In Cambodia, for example, its elaborate peacekeeping plans leading to free elections are threatened by the intransigent Khmer Rouge. And in the former Yugoslav region, Serbian forces repeatedly have foiled attempts to solve the bitter ethnic and religious conflict.

Now, in Somalia, the United Nations has another chance. It should seize the opportunity to restore both Somalia's independence and its own position as world leader and peacekeeper.

Milton Allimadi is a special correspondent for The Journal of Commerce.

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Why the U.S. Is Destined to Fail In Somalia

By ROBERT J. BARRO

The best thing that can be said about President Bush's decision to send troops to Somalia is that his worst policy error is no longer in the domestic arena.

Until now, we had been operating under the reasonable principle that military intervention was justified only in the interests of national security. Reasonable people could differ about whether this principle was broad enough to rationalize the U.S. involvement in Vietnam, Grenada, Panama and Iraq, but no one has yet advocated the Somali mission on the ground of national security. It signals instead the American ascendancy to a position of world policeman/welfare agency – in effect, an extension to the international scene of the kinds of governmental responses used for domestic emergencies like the San Francisco earthquake, the L.A. riots and Hurricane Andrew.

The famine in Somalia is not unique. It is a recurring problem that applies also to other African countries, such as Ethiopia, Sudan, Liberia and Mozambique. As Amartya Sen has stressed (see his 1989 book, "Hunger and Public Action," with Jean Drèze), famines do not typically stem from a shortage of food, per se, but rather reflect a governmental breakdown that is often accompanied by civil war. The problem in the short run represents a failure of government to provide resources for society's neediest. More important, in the long run it involves the absence of the rule of law, civil order and economic freedoms that can provide the foundation for free markets and economic development.

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The cure for Somalia and many other poor countries is not simply a short-term mission of mercy, but rather the installation of a central authority that would ensure political stability and property rights. But there is no evidence that an effective domestic government can be imposed by an external authority. Britain probably performed this role best – even if not out of altruism and with substantial conflicts – during its now unfashionable colonial days. The U.S., however, does not have the will or the ability to play this game. Consider our failure to provide law and order and the basis for economic development in many of our own cities.

Even less plausible is the reliance on international organizations, which have mainly promoted socialism and corruption in Africa. It is ludicrous to imagine that the U.S. will be able to "hand-off" authority in Somalia to the United Nations – the ultimate socialist enterprise – which would then provide efficient, pro-development administration.

The potential for mercy missions is vast because it includes all the world's poor countries. Somalia is indeed one of the poorest, tied for third with Tanzania in 1990 at a per-capita income of $540, just ahead of Ethiopia and Chad. (I use estimated values of per-capita gross domestic product that adjust for cross country differences in purchasing power.)

The full list of places with per-capita incomes below $1,000 in 1990 – that is, less than 5% of the U.S. level – consists of 25 countries with a total population in 1990 of 330 million, only seven million to eight million of whom reside in Somalia. Twenty-one of those poorest countries are in sub-Saharan Africa, and the others are Haiti, Afghanistan, Burma and Nepal. If we expand the income level – say, to $1,500 – then we add 1.15 billion people who live in India, Bangladesh and eight more sub-Saharan countries, including Nigeria.

Amartya Sen has argued that India – with 850 million people – has democratic institutions that would never tolerate famine. But it is hard to be optimistic even here with the recent civil strife and the government's long-term failure to encourage economic development. We are fortunate that China, with 1.1 billion people, has been performing relatively well. Even so, the overall population of countries that are potential international welfare clients is at least 1.5 billion.

The interrelated topics of economic development and improved government in the lesser developed countries are key issues. Indeed, they are a priority in the research agenda of many economists who are studying the determinants of economic growth. But the importance of these problems does not mean that it would be useful for the U.S. and the other rich countries to divert a lot of their resources toward the poorer countries, even if they were willing to do so.

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To paraphrase Czech Prime Minister Vaclav Klaus, the role of foreign aid and foreign advisers in promoting economic development has been vastly overrated. If the local people will not provide the necessary leadership and framework for economic growth, improvements in living standards will not occur.

Although the intervention in Somalia was a bad decision for the U.S., it is a brilliant political move for George Bush. He will be credited with a magnificent humanitarian gesture and will likely achieve some temporary successes in eliminating hardship. At the same time, Mr. Clinton will face a political dilemma that ranks in difficulty with Jimmy Carter's Iranian hostage crisis.

A quick U.S. exit will leave the unfortunate Somalis with their familiar long-term problems and be viewed as politically incorrect, whereas a continuing involvement will become increasingly unpopular. (On the other hand, the preoccupation with foreign policy may divert Mr. Clinton's attentions, which is surely lucky for the domestic economy.) The only way out would be for Mr. Clinton to establish a useful permanent American presence in Somalia – a naval base and military installation. In fact, if that was the true rationale for Mr. Bush's intervention, then I take back everything that I said in this article.

Mr. Barro, a Journal contributing editor, is a professor of economics at Harvard.

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THE MISSION IN SOMALIA

The US Had to Act

Moral leadership, not self-interest, was paramount

By Andrew Bard Schmookler

A NUMBER of those who question our sending American troops to help save 2 million Somalis from starvation ask: How does this crisis on the Horn of Africa concern our national interest? This is the wrong question. It may have been right in the old world order of international anarchy. But this habitual way of thinking is now the greatest impediment to our creating a new, far better kind of world.

For the past year – as thousands have perished from the rule of the gun in Somalia and in the former Yugoslavia – the world community, including the United States, has committed on a global scale the same sin that three decades ago this country contemplated with horror in the matter of Kitty Genovese.

Ms. Genovese, as many will recall, was a woman murdered in New York in the early 1960s. The crime provoked national outrage because of the failure of a number of bystanders to do anything to rescue the woman – even to call the police – during her prolonged agony. They didn't want to get involved. Her plight, in their view, was not any of their concern.

Perhaps the time has come, now, when we can afford to recognize that every person on the planet is one of us.

Their inaction raised the question: What kind of society have we become?

Now that the cold war is over and we are no longer involved in a global chess game, there are probably billions of people that no longer concern us. They can no longer serve as pawns in our struggle against a superpower rival. Neither Somalian starvation nor the "ethnic cleansing" of the Bosnians are central to narrow calculations of our national self-interest.

But if this is the way we decide what concerns us, what kind of society are we? If it is a sin of omission to let our neighbor perish within our societal borders, why is it less a sin for nations to stand by as a whole people – be they Somalis or Bosnians – are wiped out?

Why is it politically dangerous for an American president to risk a handful of American lives to save many thousands of lives of people from the other side of the earth?

It may be a matter of *boundaries*. In a world where it has frequently been a matter of "us" against "them," we have been brought up to feel a responsibility for someone who is "one of us." Perhaps the time has come, now, when we can afford to recognize that every person on the planet is one of us.

Why now? The very circumstance that makes the world less infused with our immediate self-interest now allows us to bring to the ordering of the planet our higher, selfless interests. With the end of the cold war it becomes possible for the brutal play of anarchy in small arenas like Somalia and Yugoslavia to be overwhelmed by an order of justice imposed by the world community.

How little it would take to save so many! The bullies of Mogadishu will surely retreat in the face of a genuine organized force. And for all the talk of "quagmires," I am convinced that had the world community displayed genuine resolve, instead of mere rhetoric and hand-wringing, the Serbians could have been deterred from their onslaughts. Gunships could have protected Dubrovnik, and airpower could have stopped the assault on Sarajevo.

Crippling habits of thought are also revealed by that recurrent question: Is the US going to be the world's policeman?

No. A *Pax Americana* would not be a new world order, but a new version of the old game of power.

It is in the interests neither of our nation nor of the world for us to impose our will on weaker countries. Not the US alone, but the world community as a whole must work to substitute justice for the rule of unrestrained force.

The rest of the world, however, is also mired in old habits, and the world community will evidently not move without leadership. No one is better situated to lead than the US, by virtue of both its military and its moral power.

The US can appeal to its fellow nations to join – through the United Nations – in paying the relatively small price it will take to bring salvation to some of the world's most defenseless people and a more benign moral climate to civilization as a whole. At last, now, revealing one of the under-appreciated characteristics of the lame duck presidency, President Bush has exerted such leadership in behalf of Somalia.

The millennium is not at hand. At this point in history, for example, the world community will not force the Chinese to end their tyranny over Tibet. The price of imposing justice would be too high. But it would be a big step forward if we could put just the smaller warlords and tyrants out of business.

Never before in history have the possibilities for significant movement toward a just world order been so great. What a tragedy it would be to squander that opportunity simply for lack of moral courage and vision.

Kitty Genovese's death under the indifferent gaze of her neighbors was a formative event of my youth: I promised myself I would never be such a bystander. At this formative moment in the history of the international system, I hope that our nightly viewing of the dying of Somalis and Bosnians can similarly crystalize the resolve of the world community.

■ *Andrew Bard Schmookler is the author of several works concerning world order, the most recent of which is "The Illusion of Choice," just published by SUNY press.*

Good Motives Aside, The Mission Is Likely to Fail

By Margaret Calhoun

AS Simon Barber of Johannesburg's Business Day suggests, Americans appear desperate for some action designed to remove from their television screens visions of emaciated African babies and mothers that threaten to spoil their Christmases. In a characteristic style-over-substance, media-driven gesture, President Bush has launched an ill-conceived plan with no stated strategic objective that may recklessly risk American casualties.

Americans imagine the United States to be on a mercy mission in Somalia. Will they support Mr. Bush's gesture when US soldiers are killed and wounded?

Somalia is only one of a number of famine-plagued African nations. Famine and civil conflict in sub-Saharan Africa's largest country, Sudan, cost 250,000 deaths in 1988. Two million Sudanese remain in danger of starvation, more than are at risk in Somalia.

Feeding the hungry is, at best, a short-term solution. Following a two-track program to deal with the crisis, the US Agency for International Development and its Office of Foreign Disaster Assistance are preoccupied solely with food relief, while the State Department is responsible for handling the political impasse. There is the thorny political question of northern Somaliland, formerly a British colony, which declared its independence from southern Somalia, once an Italian colony. A resolution of the complex political problems is the key to the humanitarian crisis and should be the US's primary emphasis.

At present, looted food, amounting to 80 percent of overall humanitarian food supply, is sold at a 500 percent price markup, while merchants hoard food to inflate prices for the Somali middle class who can afford it. Food is also sold on the international market for weapons. Food relief thus exacerbates the fighting, by providing those with arms the means to fortify their weaponry.

The backdrop to this imbroglio is a feud between two former members of the United Somali Congress, each belonging to rival sub-clans of the Hawiye clan, which helped oust strongman Maj. Gen. Mohamed Siad Barre from power in January 1991. Mr. Siad Barre's government once was backed by the US, seeking to offset Soviet support for Ethiopia's Marxist dictator, Mengistu Haile Mariam.

Siad Barre disrupted the traditionally decentralized government and homogenous society by sowing dissension among clans and dispensing political favors to his own Marehan sect. After Siad Barre's departure, the country slipped into anarchy. Two Mogadishu-based warlords, Gen. Mohamed Farah Aideed, a former ambassador under Siad Barre, and Mohamed Ali Mahdi (who professes to be Somalia's president), continue to slug it out in the capital.

While few Africa analysts object to urgent humanitarian aid when feasible, some believe the US should not attempt forcibly to solve Somalia's problems. African intellectuals like Ghanaian economist Dr. George Ayittey, an American University professor, vehemently protest the treatment of Africa by the West as patronizing and racist. Africans must grow up, he urges, and learn to help themselves.

Why, he asks, doesn't the Organization of African Unity try to resolve the Somali crisis? Dr. Ayittey maintains that many of the arguments Westerners use to justify intervention in Somalia are the same ones European powers gave for colonizing Africa.

Michael Clough, director of the World Policy Institute and an adviser to President-elect Clinton, argues in his book "Free at Last," on Africa policy after the cold war, that "the main effect of international involvement in the post-independence era has been to assist African rulers to consolidate their power and insulate themselves from the demands and pressures of civil society.... Africans are neither hopeless nor helpless."

A cogent case can be made that long-standing aid reduces the accountability of governments for their own mismanagement – delaying needed reforms and allowing them to ignore basic human needs. Consider Ethiopia's deposed tyrant Mengistu, who squandered $150 million to $200 million to celebrate his 10th anniversary in power. His celebration coincided with the receipt of millions of dollars worth of international food donations, which either rotted on docks or fed his brutal army, while his people continued to starve to death.

THE same critics railing now about starving peasants and blaming the US for the reign of Siad Barre will undoubtedly be demanding that the US overthrow whoever becomes his successor. Moreover, if the US appears to select the next Somali strongman, it should expect that he will be destined to be contemptuously labeled a US puppet. However well-intended Bush's initiative, the lack of concern of Somali warlords for the plight of their starving countrymen, coupled with the proliferation of Soviet AK-47s in the country and readiness to use them, does not bode well for the country's future.

Unlike Iraq, Somalia is an inappropriate testing ground for high-tech Pentagon weapons yielding minimal American casualties. Enemy forces will be mostly teenage boys and multiple rival gangs with Russian arms whose unscrupulous commanders have opposed a UN peacekeeping mission and authorized attacks on relief convoys.

The rules of engagement are yet to be decided: Will American forces be restricted to firing when fired upon, or handicapped by political restraints as they were in Vietnam? Seldom broached is the delicate subject of whether US Marines would feel comfortable in a defensive deployment mode which parallels Beirut in 1983 and poses equally dangerous risks.

■ *Margaret Calhoun is senior Africa analyst at International Freedom Foundation in Washington.*

COLUMN RIGHT/
TOM BETHELL

In Somalia, the U.S. Leaps Into the Unknown

■ Bush's open-ended dispatch of troops without debate may cost Clinton his domestic agenda.

It seems extraordinary that a mission as large, complex and unprecedented as the U.S. intervention in Somalia should have been launched with so little debate or discussion. Characteristically, President Bush told the nation about his plans only after the details had already been worked out. Once again the United Nations has shown itself to be a remarkably pliable institution—willing to do America's bidding so long as the appearance of U.N. control is maintained.

Among Bush's aides, it has been reported, the belief is that this military action could give the President a way to leave office in glory. There is much talk of America finally acting in a "noble cause," of an intervention that is for once "high-minded." People who talk this way—and they tend to be liberals—have apparently forgotten that the same language was used a generation ago, with respect to Vietnam.

President-elect Clinton has also declared his support for what he called a "clearly defined humanitarian mission." Perhaps he felt that he had little choice. But if problems lie ahead, they will hurt him more than Bush. It is now recognized that getting into Somalia is likely to prove easier than getting out.

Images of tearful dockside farewells may well become the hallmark of the Bush Administration. The mission to Somalia has of course been driven by images—harrowing photographs of starving children in a barren and hostile landscape. It is impossible not to be moved by them. Their impact is such that it is equally difficult to think of reasons why we should not undertake a rescue. House Speaker Thomas S. Foley noted that Bush acted "in circumstances where he had very little choice, without grave humanitarian consequences resulting."

But surely the United States should be particularly wary of committing itself under such emotional circumstances. Unintended consequences are certain to ensue when the military is used in unprecedented ways. Because no organized opposition is anticipated, we are told, there is no reason not to proceed. The idea, a strange one, is that armies can safely be deployed when they are in no danger of encountering rival armies.

The mission is not well defined, contrary to what Clinton said. For how many weeks will American soldiers be expected to stand guard over Somali food lines? Jeep-driving teen-age gunmen will no doubt have disappeared into the scrub by the time the GIs arrive. Weapons will no doubt be buried. Food convoys will get through, and the problem will seem solved—until pressure mounts to bring our troops home. Maybe by then the U.N. will be able to take over, we are told. Perhaps we should now be asking what took them so long.

'Unintended consequences are certain to ensue when the military is used in unprecedented ways.'

Liberals have been notably enthusiastic, particularly about the prospect that the U.S. military may now be transformed from a fighting force protecting the national interest to an armored care agency, performing missions of mercy wherever desired. They should be more circumspect. One or two conservatives of my acquaintance, suspected in the past of "isolationist" sentiment, have even indicated a muted, Machiavellian enthusiasm for this latest show of federal activism. Central governments have shown signs of collapsing in various parts of the world, and some small-government enthusiasts would like nothing more than to see the federal government follow suit here. It is already greatly overextended. Some hope that with one more foreign intervention, one more display of compassionate activism, the Feds might finally tumble into terminal bankruptcy and disarray.

Some liberals recognize the danger of an overextended federal commitment. Alice Rivlin, former director of the Congressional Budget Office and a possible member of the Clinton Administration's economic team, has even suggested that the federal government should relinquish its interest in education, restoring it to the states. For the most part, however, liberals continue to demonstrate what the Hoover Institution's Thomas Sowell has called an "unconstrained vision" of government.

Clinton was derided during the campaign for his lack of foreign-policy experience, but like Ronald Reagan he recognized that domestic policy holds the key to presidential success. When he is sworn in next month, not only will he be commander in chief, but he will already find himself saddled with an overseas commitment, which at that point might not look quite as straightforward as it does now.

Nothing could be more distracting to Clinton's domestic agenda. If more such engagements are to be added to his plate, this agenda will surely be postponed. A country that is dispensing free health care abroad is unlikely to be able to afford it at home.

Tom Bethell is Washington correspondent of the American Spectator.

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THE WALL STREET JOURNAL FRIDAY, DECEMBER 4, 1992

Peace in Somalia May Require New Colonialism

Potomac Watch

By Paul A. Gigot

President Bush's swift decision to send 28,000 U.S. troops to save lives in Somalia is a welcome if surprising change of heart. It'd be even more consequential if it meant a renewal of what, in more optimistic days, Mr. Bush once called the New World Order.

In immediate terms, of course, Mr. Bush's deployment serves a noble purpose. The Somali warlords, ragtag but vicious, are denying aid to the starving. Only a military presence can cut through the chaos to prevent a tragedy. And only the U.S. has the diplomatic and military clout to cut through the timidity of the United Nations. The Africans have provided even less leadership in their own neighborhood than the Europeans have in Bosnia. If the U.S. does nothing, nothing happens.

The immediate U.S. purpose is humanitarian, not strategic. There is no national interest in Somalia of the sort that must usually be at stake to warrant U.S. military intervention. Yet at some point, especially in today's world of TV cameras and instant communications, a humanitarian purpose does warrant the risk of lives. Just because we don't intervene everywhere when people are starving doesn't mean we shouldn't intervene anywhere.

In World War II, the U.S. decided not to bomb the rail lines to Auschwitz (to borrow from writer Joshua Muravchik's analogy) because we couldn't be sure what was happening. But with satellite pictures, we would know and be obliged. In Somalia, we know and the world knows. There is some cost in both stature and conscience for doing nothing. That cost, I suspect, is what finally caused Mr. Bush to override his more cautious military advisers.

we would know and be obliged. In Somalia, we know and the world knows. There is some cost in both stature and conscience for doing nothing. That cost, I suspect, is what finally caused Mr. Bush to override his more cautious military advisers.

What's less obvious, and more worrisome, is whether Mr. Bush intends this deployment as part of any broader strategy. Martin Fitzwater, the White House spokesman, says the sole military purpose is to open airports, secure highways and deliver aid – then get out by Jan. 20. "There will need to be some kind of follow up U.N. presence," he says, with notable ambiguity.

But Sen. Sam Nunn (D., Ga.), who may be Bill Clinton's secretary of state, is right to ask: "How can you pull" U.S. troops "back with the tragedy that may ensue after they leave?" The liberals now cheering for Mr. Bush to "intervene" to soothe their consciences have ignored this point.

The Boston Globe wants the U.S. to intervene but avers that "under no circumstance should the United States seek to be the arbiter of Somalia's future." What does the Globe think we are doing now? Does it think Somalis will be happier if they are left to the whims of teenagers with machine guns? Some liberals want the U.S. to become, literally, the "world's policeman" they've long decried; they just don't want it to act like a superpower.

A more realistic, if radical, intervention is suggested by historian Paul Johnson in National Review magazine. He writes that "up to now" the U.N. has failed in Africa "because it treats symptoms, not causes." It treats famine but not the underlying political disorder.

Mr. Johnson recommends – and predicts – that "the Security Council, using one or more advanced powers as its agents," will begin "moving into the business of government, taking countries into its trusteeship for varying periods, and becoming itself an architect and exemplar of honest, efficient administration." This, he says, "is plainly needed in Somaliland now."

There is a word for this: colonialism. It would be vastly different from 19th century colonialism in part because it'd be multilateral. Still, it is a taboo word, especially among liberals, and it would require a better U.N. than we now have. But something like it may be the only policy that can prevent more such tragedies in Somalia, and maybe elsewhere in Africa.

President Bush

The more fundamental point here is that military force is supposed to serve political ends. Gen. Colin Powell's theory of using massive force and then getting out quick is designed to achieve military success but can leave the political goals hanging.

This is what happened at the end of the Gulf War, when the military's (and President Bush's) impulse to declare victory left Saddam Hussein in power. A chance to create a more peaceable, democratic government in Iraq was abandoned – and with it the chances for a stable Middle East. Maybe the warlords of Somalia, or the Serbs now "cleansing" Bosnia, were paying attention to that abdication.

Mr. Bush might tell us why the rules of post-Cold War intervention differ in Somalia from Bosnia. Bush officials say it's because it's easier (better terrain, etc.). But no intervention is cost-free, as witness Beirut. It's a measure of how little Mr. Bush has explained any of this to the nation that some Democrats think (too cynically) he moved in Somalia now to pre-empt having to act if tens of thousands of Bosnians starve this winter.

Jeane Kirkpatrick says that, like Mark Twain reading the dictionary, she looks at the world's current disorder and searches for "a plot." The former U.N. ambassador is (like all of us) looking for a way to explain, and a strategy to cope with, what is happening from Bosnia to Russia to the Horn of Africa. Before he leaves office, this most unrhetorical president still has a chance to explain how he thinks the plot should unfold.

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Exit ideological wars enter ethnic conflicts

Mr. Andrew Natsios, Assistant Administrator of the Bureau for Food and Humanitarian Assistance, United States Agency for International Development (USAID), was in Rome recently for the 33rd meeting of the CFA, WFP's governing body, and was interviewed for the Journal by Francis Mwanza.

With the Cold War now over, do you foresee a decrease in emergencies arising from civil conflicts?

As we move away from the Cold War, a lot of countries will be moving towards democratic systems of government and free market economies. These changes will inevitably cause disorder. That means there may be civil strife and convulsions in the political system that could cause the requirements for emergency food aid to increase. This has been the case in the last three years and we think it will get worse.

Why?

The kinds of conflicts we are now seeing in Yugoslavia, in Armenia and in certain African countries are going to increase because the Cold War tended to depress ethnic, religious, racial and national internal conflicts in favour of ideology. Now that this ideology is gone, we are likely to see ethnic conflicts all over the world rise. So there will not be international wars, there will not be threats of nuclear exchanges, but there will be localized wars and civil strife that will require more emergency assistance.

With the end of the Cold War, has the friction between American foreign policy and food and development policy ended?

During the Cold War, because the containment of the expansion of Soviet power was a central focus of American foreign policy for 45 years, the issue of geopolitics was not unimportant. It was, in fact, a powerful motivating force that affected each year how we allocated foreign assistance, including food aid.

The end of the Cold War has profoundly affected American foreign policy. The conflict between foreign policy and foreign aid has diminished.

WFP

The Commonwealth of Independent States (CIS) seem to be stealing the limelight as far as foreign aid is concerned.

In terms of food aid, we are sending 500 per cent more grant food aid to Africa than to CIS. This year we sent 100,000 tonnes of food aid to CIS, worth about US$165 million. To Africa we sent US$615 million of food, 1.6 million tonnes. It is true, however, that the Russians have bought a lot of food commercially from the USA.

How crucial is food security?

Nothing is more destabilizing than food insecurity. During the Sahelian famine of 1983-85, 11 of the 13 governments affected were overturned by coup d'etats *because their governments did not respond adequately to the drought. It can be very destabilizing politically, to have a drought or a famine. In this respect, I believe that WFP does not have just a logistical role to play in terms of the development portfolio, they have a politically stabilizing role to play in countries undergoing political and economic structural changes.*

After 30 years of aid to Africa, the continent still appears to be in dire straits.

Through the Development Fund for Africa, USAID has, each year for several years, increased by US$200 million the amount of development assistance to Africa. Our commitment to Africa has been growing on the development side; but on the relief side, it has grown more rapidly because of the deteriorating political situation. While we regard this as being of central importance, there must be some analysis done as to why things are deteriorating rather than improving.

The answer, it seems to me, lies in the political decisions made by many countries to move towards an autocratic political system and socialist centralized market system. Those two decisions, I think, were disastrous for Africa. People are paying the price now.

Political stability and changes in the economic structure are essential in overcoming Africa's problems. In the absence of these central issues, we are going to see more chaos and the GDP and per capita income will continue to decline.

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You have just visited drought-hit southern Africa. What is your assessment of the situation?

The drought in southern Africa is more serious and more severe in many respects than the Sahelian drought of the mid-eighties. More people are at risk, the total number of tonnage required to meet the needs is greater and the devastation that it has caused economically is greater.

For example, in Zimbabwe the World Bank estimates that between nine and 10 per cent of the GNP will decline this year over last year, as a direct result of the drought. In pure economic terms, this drop in GNP will be catastrophic for Zimbabwe. It will also have a terrible consequence for humanitarian relief.

In Mozambique, we are going to have a serious problem moving food into Government- and Renamo-held areas because of the fighting and lack of trust between the warring factions. We must arrange the same sort of food corridors that we had in Ethiopia, Sudan and Angola during their civil wars. We have not done that yet and there is a danger of widespread deaths in Mozambique unless food corridors are put in place very quickly.

That is not a problem, fortunately, in Zimbabwe, Malawi or Zambia In fact, these countries are unusually stable and there is no civil conflict or insecurity. This is in contrast with the Horn of Africa, where we have had 27 relief workers killed in the past eighteen months.

We do, however, have a logistical problem, but WFP is moving to put logistical systems in place. There is also a problem with pledges at the moment.

In the Horn of Africa the situation appears desperate.

No issue has concerned me more than what is happening in Somalia, where the greatest loss of life has — and continues — to take place.

WFP/David Orr

A father and his starving child in Somalia. USAID sends food aid through WFP, which is responsible for coordinating food aid in Somalia.

This raises the question of donor fatigue.

It is not fair to say there is donor fatigue in the resource sense or in terms of our staff not wanting to do work; in fact, they are working harder than they did before. It may be that the media is fed up with covering emergencies.

How can we break the circle of drought and famine that seems to run in Africa?

In the last 10 years we have undertaken field experiments in Zimbabwe aimed at genetically improving the drought-resistance of sorghum and millet, particularly for Zimbabwean and Zambian conditions. In the next four months enough seeds will be produced to plant 600,000 hectares of sorghum in the next planting season in Zambia and Zimbabwe. If there is another drought, the seed will still grow because it is drought-resistant. This is crucial because if there is a second year of drought, we believe it will be absolutely devastating.

How does growing sorghum help when people have changed their eating habits and have moved away from it?

We must convince the farmers that for their own protection against drought they have to grow sorghum in addition to maize and millet.

What role does the UN play in the so-called New World Order?

We envision the UN will play a much greater role than it has in the past in settling disputes, in providing services to poor people and in stimulating economic development. The role of WFP is particularly important. ♦

THE LOS ANGELES TIMES, December 20, 1992

COLUMN RIGHT/
JEANE KIRKPATRICK

After Feeding Somalia, What Is Our Role?

■ Boutros-Ghali's ambitious agenda for the U.N. may not be ours; we must decide—fast.

With U.N. Secretary General Boutros Boutros-Ghali requesting that U.S. forces disarm rival Somali warlords in addition to delivering food to starving Somalis, with him asking the Security Council to commit thousands of military and civilian personnel and $330 million for operations in Mozambique during the next year, and with him looking toward establishment of a new U.N. operation in Angola, it is critical that the U.S. government think carefully now about how far it and the United Nations should go in committing armed forces and taxpayer money to the solution of serious internal problems in Third World countries.

Boutros-Ghali's expansive new plans raise questions that have never been confronted by member states. Should the secretary general be permitted to set international priorities? Should the United Nations involve itself in members' internal affairs when the U.N. Charter clearly says it should not? When does a "peace process" become an intolerable interference in the internal politics of a country?

How far can the U.S. government legitimately go in committing American resources to international operations that have no clear relation to the national interest? At what point is the consent of Congress required? How can Americans get a voice in this? These are important questions made urgent by the secretary general's burgeoning agenda and by current discussions about what the United States and the Security Council committed themselves to in undertaking to prevent mass starvation in Somalia.

The Bush Administration believed it made a commitment to deliver food by all necessary means. The secretary general believes the U.S. government made an open-ended commitment to create conditions for political reconciliation and establishment of a central government.

Boutros-Ghali has asserted that the countrywide disarmament of contending Somali factions is a prerequisite to establishing the "security" that is needed for humanitarian operations in Somalia.

But the U.S. government does not believe it made a commitment to pacify Somalia. And the Security Council resolution authorizing the operation is dismaying in its loquacious ambiguity.

Clearly, disarming warlords is a big step toward eliminating competing centers of power in Somalia. It might make the establishment of peace and a central authority easier. But, by weakening traditional indigenous authority structures, it might intensify the anarchy that already afflicts the country.

'When did the American people decide that U.S. foreign policy should be conducted through the United Nations?'

One thing is certain: Disarming Somali warlords would involve the United States deeply in Somalia's internal politics—without the consent of either the Somali or the American people. It would give the United States (and the United Nations) wholly new responsibilities for nation-building in Somalia for which we are almost wholly unequipped and unsuited.

Feeding hungry people is one thing. Establishing the prerequisites for a viable central government is quite another. Food can be delivered by an external power. But a viable government is the product of people who will live under it.

Try as we might, the United States cannot create a modern state and a modern political culture in Somalia. It is, moreover, doubtful that the United Nations will be able to significantly speed the process of political modernization in Somalia—or Mozambique or Angola.

The United States and other members of the Security Council should think long and hard about the failures of colonialism and of so many foreign-aid programs before they undertake the management of countries that are culturally, politically and geographically remote. They should review the literature on political modernization and remember that accepting the limits of U.S. power to remake a distant country was surely one of the most important lessons of Vietnam.

The United States and other members of the Security Council should also consider carefully about where deep U.N. involvement in the internal affairs of nations can lead. How should the countries that are to receive such assistance be chosen? By whom? How can the costs be controlled? How can costs be allocated among the member states? When did the American people decide that U.S. foreign policy should be conducted and scarce resources allocated through the United Nations rather than the U.S. government?

These questions must be confronted now, before precedents are established. They are not easy for the Bush Administration. They will prove even harder for an incoming Administration committed to good works and elected on a platform of greater attention to domestic problems.

Jeane Kirkpatrick, a former U.S. ambassador to the United Nations, writes a syndicated column in Washington.

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Said S. Samatar

How to Save Somalia

What is needed is a program that combines the political and economic power of food with the moral authority of elders.

The Bush administration's offer to send up to 30,000 military personnel to Somalia as part of a U.N. effort to ensure safe delivery of humanitarian aid has the elements of a creative bluff. It is a bluff because Mr. Bush and his advisers surely know that there is no need to deploy that many troops in Somalia; as few as 5,000 could do the job. It is creative in that it signals to warlords and others that the United States finally means business in Somalia. The mere talk of U.S. troop deployment has already prompted Gen. Mohammed Faarah Aidid, strongest of the warlords, to pledge cooperation. The prospect of facing an American force is likely to put the fear of God into lesser warlords.

Somalia provides the United States with immense opportunities to prove its leadership to small countries. But the intended projection of so large a force rests on some dangerous misconceptions. The first is that Somalia as a country has gone completely to hell and is under the sway of random violence and mass starvation. In fact, these horrors are occurring only in a limited portion of Somalia, notably in the triangular corridor in the southwest between Mogadishu, the capital, and the regions surrounding Baidoa and Kismayu. The rest of the country is relatively peaceful and well governed by an alliance of traditional elders and local leaders that has reemerged in the wake of the collapse of the central authority.

It is unnecessary and imprudent to intervene militarily in those parts. What is needed there is immediate humanitarian aid and long-term economic assistance. These efforts can easily be integrated into distribution systems that already function well.

A second egregious misconception is that Somalia is a country crawling with warlords. In the entire country there is only one—namely, Gen. Aidid—worthy of the name. And even he does not exercise supreme authority over a horde of followers whom he can deliver either to the field of battle or to the negotiating table. Only so long as he can lead looters to the next village for booty can he count on their support. The moment he is deprived of the power to raid, his opportunistic followers are likely to desert him. The other, smaller warlords can be easily defeated.

A third misconception is that the warlords operate on their home terrain and enjoy the support of the local community. This is not the case. The triangle of death is an occupied region, infested by pastoral marauders from other parts of the country. They are considered oppressive conquerors by the local people. U.S. intervention is likely to be considered a liberating force. Local people are certain to join in ejecting the unwelcome marauders.

While the task of pacifying and stabilizing Somalia can be achieved with relative ease, several possible missteps must be avoided. One would be any American move that gave Somalis the impression the United States was about to recolonize their country. Ridiculous as this may sound, Somalis, with their bitter experience of colonial occupation, are born xenophobic paranoids. The United States must impress upon the Somalis that it has no hidden agenda, but only a humanitarian interest.

A second challenge is that of political Islam. A devastated country such as Somalia tends to spawn messianic movements, and political Islam, abetted by the fundamentalist regimes of Sudan and Iran, is a force in Somalia to be reckoned with. Muslim fundamentalists last summer seized the whole of the northeastern region. Although they were eventually repulsed, they presumably are waiting to return and cause trouble.

A massive infusion of U.S. personnel could offer the mullahs a windfall propaganda opportunity to inflame religious passions against Americans by claiming that the country is threatened with a Christian invasion. To prevent this, moderate religious leaders must be part of the peacemaking process from the very start.

The third danger concerns the risk of U.S. troops' being perceived as advancing the cause of one or another of the combatants. This could spring a deadly trap on Americans by inspiring several warlords to band together in an alliance against them.

The key to avoiding all these risks starts with food. In Somalia, food is power—economic and political—and its imaginative use to reward the cooperative and punish the recalcitrant can create a powerful stimulus for peace. The other key is the institution of elders, the Somalis' time-tested indigenous instrument of governance.

The Somali disaster is directly traceable to a tragic mismatch between moral authority possessed by the elders and senior notables of the clans, and physical coercive authority usurped by self-made warlords. To restore political and moral equilibrium, it is necessary to revive traditional institutions of governance and in particular to re-empower the elders. What is needed, therefore, is a program of action that combines the political and economic power of food with the moral authority of elders.

To achieve this, the intervening force should establish security zones in the death triangle. The traditional elders of the region should be reassembled, and food distributed mainly, if not entirely, through them. They should then be encouraged to raise their own police force with expatriate technical advice. The new police force, under the strict control of the elders, can be trained and equipped to take full responsibility for the region's security, allowing the foreign forces to withdraw relatively soon. This could go a long way toward rehabilitating the country within a time frame politically acceptable to Americans.

The writer, a Somali national, is a professor of African history at Rutgers University and managing editor of the Horn of Africa Journal.

THE WASHINGTON POST, December 2, 1992

William Raspberry

Let It Be Somalia

Edwin Dorn knows all the reasons why the United States should beware of getting involved militarily in Somalia. As a military policy analyst at the Brookings Institution, he's even supplied some of those reasons to journalists interested in a more complete assessment of the risks and benefits of sending troops to that desperate country.

There is, at the top of the list, the prospect of our getting bogged down in a distant, indeterminate action—unable to achieve a lasting solution and unable to leave because of the certainty that our leaving would mean a return to chaos.

There is the question of priorities. Why is Somalia, already in ruins, a more compelling target of U.S. action than Liberia, Angola, Haiti or a half-dozen other places where our intervention might *prevent* chaos?

There are questions of money (Why not use our tight resources to feed the hungry in America?), of appropriateness (Who appointed us to settle all the world's disputes?) and of timing (Why, during the waning days of the Bush presidency, should we saddle President-elect Clinton with an open-ended problem?).

There are, in addition, the questions Dorn can't quite bring himself to ask: Isn't it likely that Somalia is already beyond saving—either as a sovereign country or as a population? Don't the effects of starvation at some point become irreversible, so that an infusion of food becomes little more than a life-support system for people—children in particular—who will never get well?

Still Dorn says: Yes. Send the troops. This week, if possible.

"The American people don't want to just sit by and watch hundreds of thousands of people die of starvation when something can be done to prevent it," he says in tones that suggest *he* doesn't want to just sit by. "Any military operation entails risks, but here the risks are relatively minor compared to the potential for saving lives. I don't see how we can *not* do it."

But it must be done carefully. "We need to work out a multilateral intervention strategy under U.N. auspices, with a carefully delineated U.S. role," he says. "Our role ought to be limited to security and logistics—go in, secure the port at Mogadishu or Berbera, then secure transportation links between the port and the major distribution centers, escorting food convoys and protecting the goods. In the process, we might also help to establish relief centers, but primarily as a matter of logistics."

What America must avoid, he insists, is any attempt to restore government in Somalia. But what of the fact that without the restoration of some semblance of government, the "emergency"—and therefore the need for American troops—will prove permanent?

"Restoring civil order is a long-term proposition," says Dorn, "and the U.N. or some multinational force may have to be involved in that. But for now, we need to agree that our participation will have a finite scope—say, three months or at a maximum six months, and then a reassessment. Why? First, to guarantee the American public that we're not being dragged in mindlessly; second, because we're in the middle of a [presidential] changeover, and Bush wouldn't want to commit his successor for a long period of time.

"We could do six months and then pass the responsibility on to the Canadians or Indians or to some multinational contingent. Getting it started will require some heavy lifting, and we have the logistical capacity for that heavy lifting. Maintaining the situation should prove less arduous."

And what of all the reasons that militate against our getting involved militarily in the first place? What, for instance, of the contention by some relief workers that they are about to work out arrangements with the Somalian warlords to get the food to those in desperate need of it—and that U.S. military presence might make things worse?

"It's a judgment you have to make," says Dorn. His own judgment that distribution is likely to remain a problem is supported by Catherine Bertini, executive director of the World Food Programme (under the auspices of the U.N.'s Food and Agriculture Organization).

"We've been operating an average of 17 flights a day into Somalia, in addition to ships and air drops," Bertini said in an interview. "Reports are that as much as 80 percent of the food that's brought in is looted [by members of the warring factions vying for military control of Somalia]. A boat of ours was shelled even after we had reached an agreement [with one of the warlords]. We welcome the [U.N.] secretary general's decision to ask for military support."

The seemingly reasonable question of priorities may not be a question at all. Says Dorn:

"Why Somalia? If there are any countries the U.S. needs to make amends to, they are Angola and Mozambique, because we supported insurgencies in those countries. Angola has more legless people per capita than any place on Earth because Jonas Savimbi, whom we and South Africa supported, used land mines in his fight to overthrow the government.

"But we don't see pictures of starving Angolans or Liberians. There is, primarily as a result of videotapes, political and public sympathy for doing something to help in Somalia. It's not a choice of Somalia or one of these other places; the real choice is Somalia or no one."

Let it be Somalia.

AFRICA NEWS, November 9 - 22, 1992

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Bishops Appeal for Action to End Sudan Deaths

UNITED NATIONS

by Karen Gellen ■ Africa News Service

War and famine in Sudan will turn Africa's largest country into "another Somalia" unless the international community intervenes. That warning was brought to the United Nations by two prominent Sudanese bishops who say they are seeking to pierce a wall of silence surrounding a widening disaster.

Paride Taban and Macram Max, representing the Sudanese Roman Catholic Bishops Conference, are calling for strong international pressure to end their country's bloody civil war. In a meeting with UN Secretary-General Boutros Boutros-Ghali, the clerics stressed the urgent need for a full-scale relief effort to avert widespread starvation.

Their alarm is being echoed by relief workers in Sudan. Jean-Luc Siblot, an official of the UN World Food Program, says the situation for the 5 million people in the south of the country, where the latest round of fighting has persisted for the past nine years, has "never been worse." Up to a million people now face death from hunger, he told Cable News Network late last month. Amid the mounting death toll, Siblot says, there is "chaos everywhere."

Food has become a key weapon in the war between the government in Khartoum, the capital, and the rebel Sudanese Peoples' Liberation Army (SPLA), which controls large stretches of territory in the South. Relief flights to those in desperate need can only take place when clearance is obtained from both warring sides – and each frequently has balked. Because of the war, private aid agencies are unable to maintain personnel in the embattled region.

Last month, three UN workers and a journalist died under still unexplained circumstances in rebel-held territory in the South. And the government is believed to have executed two Sudanese employees of the U.S. government and another employee of the European Community in Juba, the largest southern town.

The bishops charge that the Sudanese government's effort to impose Islamic fundamentalism on the country by force is leading to a form of "genocide." Max calls the government's practices a "shameful and degrading example of apartheid." Although the clerics charge the government's principal target is the mainly black population of the South, which largely practices Christianity or traditional African religions, the bishops stress that moderate Arab Muslims in the North "are also being persecuted."

According to Bishop Taban, who is president of the Sudan Council of Churches, the world is largely unaware of the disaster in his country. Much of the population in the South is "locked up as if in a zoo," he says. "But it's worse – at least in game parks in places like Kenya, people drive by the animals in cars – our people are never seen by any other human beings."

The most severely affected people, Taban says, are those trapped in areas under neither government nor rebel control. Their condition is appalling, he says. "Millions are isolated, reduced to wearing leaves from the trees. Many haven't tasted salt in 10 years – they have been returned to the Stone Age. Thousands are dying of disease and hunger, and no help is allowed to reach them."

Vast numbers are homeless, living in camps as internal refugees, Taban says. In one small area just over the Kenyan border, the Sudan Council of Churches is caring for 16,000 Sudanese orphans between the ages of six and 15. And near the town of Torit, the bishops' parish, there is a camp housing 250,000 uprooted people.

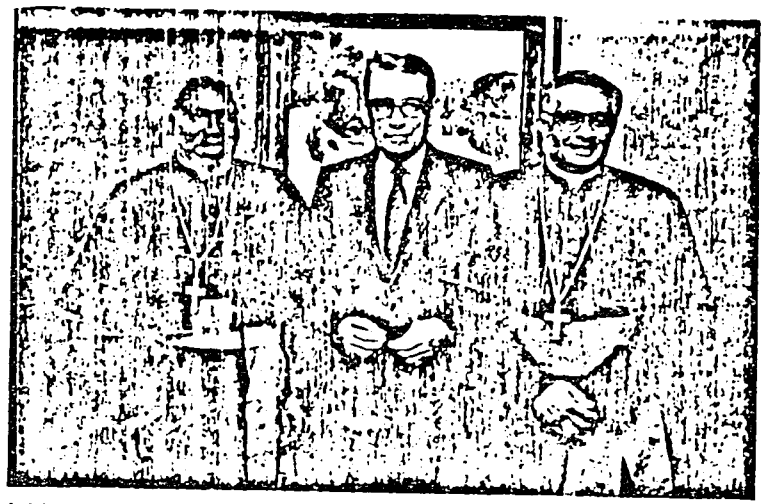
The bishops say the government has systematically expelled foreign church workers who were aiding the population and is closing local Sudanese church parishes. "They are tightening the noose every day," says Bishop Max. "They have even expelled the sisters of Mother Theresa of Calcutta. In one case they ran a bulldozer right through a church."

The expulsions not only have thwarted relief efforts, but they also have removed foreign witnesses to the suffering and repression, the clerics say. At the same time, the government is recruiting other foreigners to fight in the South. Fundamentalist university students from Pakistan and Iran, says Taban, have joined what the Sudanese government terms a *jihad*, or holy war, in southern Sudan. He says: "There are Muslims in Juba now who have long beards and are ethnically unlike any Moslems we've ever seen in Sudan. They are fighting and playing a security role in special areas such as the university in Juba."

When the Sudan Council of Churches lodged a protest with the Pakistani government about the role of its citizens, Taban says, Karachi denied giving aid or official sanction to the fighters, whom it terms "volunteers" or "mercenaries." Taban says Khartoum is also receiving financial aid from the Iranian government and is using the money to buy weapons from China.

The bishops hope their visit to the United States will help build pressure on Khartoum to cooperate in helping stem the immediate suffering and, ultimately, to negotiate with the SPLA for an end to the war. They point with satisfaction to the resolution adopted a few weeks ago by the U.S. Senate that condemns the Sudanese government's "consistent pattern of gross violations of internationally recognized human rights."

The resolution demands that Sudan allow "unrestricted" and "unconditional access" to international relief organizations and guarantee the safety of aid workers. The statement condemns what it terms a "cruel campaign" to relocate some 750,000 internally displaced southerners and westerners from the outskirts of Khartoum to "inhospitable camps far from the city" and criticizes the government for forcibly displacing tens of thousands of Nuba-speaking people from their ancestral homes, destroying villages, and "killing hundreds of civilians."



Left to right: Paride Taban, UN Secretary-General Boutros Boutros-Ghali, Macram Max.

"Now we finally have something in our hands," Taban says. "We're carrying that statement around like a newborn baby."

The bishop also welcomed last month's official pronouncement by the Vatican on human rights in Sudan. Pope John Paul II spoke publicly on the issue for the first time during a meeting with a delegation of Sudanese bishops. But the bishops want the church to take the further step of breaking off relations with Khartoum. While in Rome, Taban says, the bishops questioned continued Vatican contacts with a government "that is slaughtering its own people, because that kind of diplomacy means fearing a government more than fearing God."

The bishops say they hope their session with the UN secretary-general may boost their efforts to get a hearing in Khartoum. "We're very grateful to have had our photo taken with Boutros-Ghali," Taban says. "Now someone in the Sudanese government may give us an answer instead of simply throwing our letters in the trash."

At the United Nations, the bishops discussed efforts to open relief routes in the South with Jan Eliasson, the undersecretary-general for humanitarian affairs, who recently visited Sudan. Eliasson won the agreement of both the government and the SPLA for flights to 21 new areas, but large stretches of the region are still out of reach of aid deliveries.

In addition, Bishop Taban warns, a further destabilizing factor now pushing Sudan toward a tragedy of the dimensions of Somalia is the splintering taking place within the SPLA. In rebel-held areas, he says, the SPLA historically has provided a modicum of order. But the movement now is split into three contending factions, and this could be a prelude to the kind of deadly "warlordism" seen in Somalia, the bishop fears. ■

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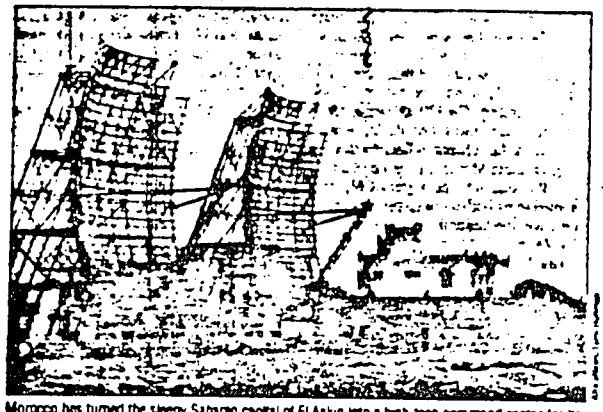

Morocco has turned the sleepy Saharan capital of El Aaiun into a high-tech command center for its bid to annex the former Spanish colony.

Impasse Clouds Saharan Peace Plan

UNITED NATIONS
by Karen Gellen ■ Africa News Service

One year after a United Nations-negotiated cease-fire in Western Sahara, the peace process appears to be unraveling, prompting concerns that fighting will resume. The world body's plan to supervise a referendum in the former Spanish colony is far behind schedule, with no sign of an agreement on voting procedures between the Saharan independence movement, known as the Polisario Front, and Morocco, which claims the territory.

Meetings held here in mid-September between the UN Secretary-General Boutros Boutros-Ghali and the two rival parties to the peace pact have reflected the increased tensions. "We're back to square one," says Bachir Mustafa Sayed, chief negotiator for Polisario. The Saharan official says the United Nations "did not fully commit itself to its own plan" and is allowing Morocco to scuttle the accord. Those charges were punctuated September 22 with a warning from the movement's top leader, Mohamed Abdelaziz, that Morocco's stand "conjures up the specter of a return of the war." Moroccan Foreign Minister Abdellatif Filali denies the charge, saying that Polisario is to blame

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Liberian Vote Under Fire

MONROVIA, LIBERIA
by Cindy Shiner ■ Africa News Service

Former U.S. President Jimmy Carter has called for a new diplomatic initiative to salvage a West African peace plan for Liberia. An outbreak of fighting that ended a 20-month-long truce has threatened implementation of the plan, which calls for internationally supervised elections.

After a visit here in early September, Carter asked United Nations Secretary-General Boutros Boutros-Ghali to send a small observer mission, unarmed and numbering no more than 20 people, to help get the peace process back on track. The observers, led by a respected international figure, could reassure contending parties during the critical pre-election period, Carter said.

The latest fighting was started by the United Liberation Movement of Liberia for Democracy (Ulimo) which in August inflicted substantial casualties on the country's largest armed group, the National Patriotic Front of Liberia (NPFL), led by Charles Taylor. Ulimo is made up of elements from the old Liberian national army of former President Samuel K. Doe, whose overthrow Taylor sought when he launched the war nearly three years ago.

Fighting was halted in late 1990 by the intervention of a West African peacekeeping force, known as Ecomog. Since then, Liberia has been a divided nation, with an interim government administering the capital Monrovia, under Ecomog protection, and Taylor controlling most of the countryside.

Ulimo appeared on the scene about six months after Ecomog enforced the truce, staging raids on NPFL positions from bases inside neighboring Sierra Leone. A primary Ulimo aim appeared to be revenge for the casualties Taylor's forces inflicted on Doe's troops during the initial conflict.

Until recently, Ulimo had little impact on the situation. "People did not take us seriously," says Joseph Taylbior, the group's secretary-general and one of its founders. "But we are proving that we are a very determined organization and we are capable of liberating our country."

Ulimo's offensive, begun in August, has driven the NPFL out of long-held positions in the southwest of the country. The objective, Ulimo says, is to force Taylor to comply with the peace plan and disarm his soldiers.

Taylor has accused Ecomog of arming Ulimo and says the interim government is giving the insurgency quiet support.

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Efforts Intensify to End Sudan Agony

WASHINGTON, DC
by Reed Kramer ■ Africa News Service

Now that months of mounting suffering in Somalia has pierced the world's consciousness, concern for another crisis in the region is increasing among international relief officials and observers.

War in Sudan, between the Islamic fundamentalist-led government and rebels fighting for autonomy for the largely Christian and animist south, is raising the likelihood of mass starvation.

"I'm deeply worried about the fate of the people of southern Sudan," U.S. Assistant Secretary of State for Africa Herman J. Cohen said at a Senate hearing on September 23. Cohen said he is "very pessimistic" about the prospects for a solution to the civil war.

Sudan, Africa's largest country with a land mass about the size of the United States east of the Mississippi River, has a population exceeding 25 million – the fifth largest on the continent.

Since the current conflict erupted in 1983, several hundred thousand people have died from the almost continuous famine that has accompanied the fighting. With the war intensifying, some 3.7 million people are in need of urgent aid, United Nations officials believe.

Some of the worst affected are the 300,000 inhabitants of Juba, the south's largest town, which is controlled by government troops but surrounded by an aggressive rebel army. In recent months, relief flights to Juba have been suspended due to the fighting. But the most immediate threat Juba residents are facing, according to eyewitness accounts, is from increasingly edgy government forces.

"The local people are suffering greatly at the hands of the army and the security police," says Sister Nancy Lyons, a Maryknoll nun who was working in Juba until she and other foreigners were expelled in August. "Many, many men from the town have been arrested, many have been tortured and executed," she says.

On September 22, the State Department announced that a Sudanese employee of the U.S. Agency for International Development was executed in Juba after being convicted of treason by a military tribunal. Another Sudanese national who worked for the U.S. government and two more who worked for other international organizations may have suffered the same fate, U.S. officials said.

Interviewed during a visit to Washington, Lyons and Marilyn Norris, another Maryknoll sister, said they thought they were forced to leave because the government wants no witnesses to the "horror" that is taking place. Amnesty International says government forces recently executed at least 300 unarmed civilians and prisoners in Juba and arrested hundreds more.

The current crackdown in Juba began after several major assaults on the town by the Sudan People's Liberation Army (SPLA) in July. Until that time, government forces

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for the stalemate.

The immediate dispute is over Rabat's intention to include the Western Sahara in nationwide Moroccan local elections scheduled for this fall. The Saharan group says the vote is meant to pre-empt the referendum on the territory's future that is central to the UN plan. In a letter sent to world leaders, Abdelaziz argued that the Moroccan vote "can have no other objective than the pure and simple burial of the peace plan." He appealed for international pressure to ensure Morocco's cooperation in the peace process.

A day earlier, Morocco's Filali, told the General Assembly that Morocco has cooperated with the UN team in Western Sahara. He expressed hope that "realism will prevail over obstructionist tactics" employed by the other side.

To support his point on Moroccan compliance, Filali cited a report on the UN's Western Sahara operation issued by the secretary-general in mid-August. Although the United Nations blames Morocco for most of the cease-fire violations recorded by monitors stationed in the territory, the report appears to support voter eligibility criteria introduced by Morocco.

Under the peace plan negotiated last year by Boutros-Ghali's predecessor, Javier Pérez de Cuéllar, Saharans are to be given a choice between independence and integration into Morocco. The conflict over how the voter roll will be determined has been the main obstacle to the holding of the referendum, originally scheduled for last January.

Morocco has been trucking large numbers of its citizens into the former Spanish colony, which it has occupied since 1975, in preparation for the UN-supervised polling. The 120,000 new residents are legitimate voters, says Rabat, because they come from Saharan families that have migrated into Morocco over the years.

Polisario says the original UN plan, agreed to by both parties, specifies that only the families and descendants of the 74,000 or so Saharans counted in a 1974 Spanish colonial census will be eligible to vote. But the front's UN negotiator concedes that Pérez de Cuéllar, during the final days of his tenure, had "opened the door" to Morocco's importation of voters.

In an annex to the agreement, says Bachir Sayed, the former secretary-general expanded the criteria for eligibility to include anyone who can claim Saharan lineage. That approach, Sayed argues, removes Saharan nationality from "time and space," and enables Morocco to call voters from the entire Maghreb region. Sayed says that in his September talks with Boutros-Ghali, the secretary-general told him the UN has "no teeth" with which to enforce Moroccan compliance with other aspects of the peace plan.

In the past, Polisario has been supported by the Organization of African Unity, and Western Sahara was admitted to the continent-wide organization in 1984, over Morocco's objections. But the Saharan issue appears low on the agenda African countries have brought to the current UN session. The stalled peace operation in Western Sahara received only a bare mention, for example, from the foreign ministers of Angola and Zimbabwe – countries that have been strong Polisario allies – when they addressed the General Assembly on its opening day. And Morocco currently sits on the 15-member Security Council, a position that gives Rabat added clout in the UN's political horse trading.

As a counterpoint to the UN talks, Morocco has welcomed with fanfare a group of high-level defectors from Polisario. Eight former officials of the front appeared September 15 at a Rabat press conference, where they declared the independence movement dead. The session was chaired by Brahim Hakim, who served as the Saharan foreign minister for a decade before being replaced in that post in 1985.

The group said Polisario has run out of weapons, allies and popular support. According to one of the movement's founders, Salek Fadli, former Polisario backers including Algeria and Cuba, are no longer able to provide aid. "Cuba is in distress, shipwrecked, and Polisario is floundering along," he said Cuba has given Polisario no aid since 1991, except for educating Saharan students. One participant in the press conference, Fadel Maa el-Ainane, had been Polisario's military attaché in Cuba.

The eight defectors echoed long-standing Moroccan claims that tens of thousands of Saharan refugees living in camps just across the Algerian border were being held against their will by Polisario. Mohamed Takillah, who said he had been security chief for the camps, told reporters that the refugees "want to see trucks coming to take them home, to the kingdom of Morocco."

Asked at the UN to comment on the defectors' claims, Bachir Sayed denied Polisario had been receiving weapons from Cuba and disputed a claim by Fadli that the guerrillas were nearly out of fuel, tires, batteries and spare parts. He said Polisario retains its ability to fight again if a collapse of the UN plan makes armed struggle necessary. But the front understands that it "cannot defeat Morocco militarily," Sayed said. For us, he said, "the political solution is an imperative." ■

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defending Juba included many southerners, who are easily distinguishable from lighter-skinned northerners. The Maryknoll sisters say that after the attacks, southerners were removed – with many arrested and apparently executed – because of suspicions they were SPLA sympathizers or supporters. Most residents of Juba are supportive of the SPLA, the sisters say.

Local people told the Maryknolls that many of the replacements for the southerners are Iranian. U.S. officials believe Iran has been supplying the Sudanese government with arms and training but say there is no confirmation that Iranian troops have joined the fighting in the south.

Sudan's problems, like Somalia's, stem partly from superpower rivalries during the Cold War. The countries of what is called the Horn of Africa, which also includes Ethiopia and Djibouti, were considered strategic by both the United States and the Soviet Union. Competition for influence led to shifting alliances, to support for dictators who dismantled local administrations and social structures, and to massive arms buildups that are fueling the power struggles in Somalia and Sudan.

Sudan, the top recipient of U.S. aid in sub-Saharan Africa during the post-World War II era, was led during much of the period by Gaafar Muhammad Numeiri, an authoritarian military ruler who seized power in 1969. Numeiri survived more than a dozen efforts to oust him before losing control to rival soldiers in 1985.

Initially, Numeiri reached an accommodation with the rebellious south, granting a measure of autonomy. But in the early 1980s, in an attempt to shore up his shaky political base, he adopted an increasingly strict version of Islam. He finally imposed *Sharia*, or Islamic law, on the entire nation, sparking resumption of war with the south.

Although peace talks began earlier this year, under the sponsorship of Nigeria and the Organization of African Unity, the current Sudanese regime, led by General Omar al-Bashir, has pressed the effort to Islamicize the country and stepped up measures to defeat the SPLA militarily. The government offensive has weakened the SPLA, which has also suffered an internal split.

The government's "holy war" has been expanded to non-southerners, including the Nuba peoples in the country's mountainous central region. Many of the one million Nuba are Muslim, but the SPLA has recruited among them and has operated from bases in the southern Nuba mountains, adjacent to the SPLA stronghold in southern Sudan. In response, the government has waged what the human rights group Africa Watch has termed a "campaign of horrifying dimensions" against the Nuba.

The worsening situation in Sudan remains largely unreported, in part because of the government's successful efforts to fend off bad publicity. Access to Sudan by journalists and other outsiders is severely limited.

Prompted by rising concern among aid workers and the U.S. government, Jan Eliasson, the United Nations undersecretary for humanitarian affairs, traveled to Sudan in early September. In the capital, Khartoum, he sought government consent to resume relief flights to the south. After arranging a brief cease-fire with the SPLA, Eliasson also stopped in Juba to assess aid requirements. Following the trip, which included talks in Nairobi, Kenya, with both factions of the SPLA, Eliasson announced agreement on restarting the airlift of food to Juba and 20 other southern sites.

Meanwhile, there are indications that long-delayed peace talks may resume. Nigerian mediators have visited Khartoum to discuss holding a second round of peace talks between the government and the rebels in October.

Tiny Rowland, head of Lonrho, a British conglomerate with extensive interests throughout Africa, held talks in September with SPLA leader John Garang and with al-Bashir. Rowland, who has also been a central player in the Mozambique peace talks, told the *Financial Times* of London that a cease-fire agreement in Sudan will be reached "very soon." ■

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The Ulimo action is the first serious challenge Taylor has faced since Ecomog forced his troops out of suburbs around the capital and imposed the cease-fire in 1990. The West African intervention blocked NPFL's advance towards Doe's headquarters, allowing a splinter rebel faction, led by former Taylor aide Prince Johnson, to get there first. Johnson's men captured Doe, then tortured and killed him.

Taylor nurses a deep distrust for Ecomog, saying it is a Nigerian-inspired effort to keep him from becoming president of Liberia. As West African leaders have groped for negotiated solutions, Taylor has resisted, agreeing to proposed peace measures only when pressured strongly by those he regards as friends, such as the government of neighboring Côte d'Ivoire.

An accord signed over a year ago, in the Ivorian capital Yamoussoukro, binds all the Liberian parties to accept West African-supervised elections, tentatively scheduled for November 30. The latest fighting, and signs of heightened tensions between Taylor and Ecomog, appears to have set back that timetable.

In early September, the NPFL detained over 500 West African peacekeepers, seizing their weapons and vehicles. When Carter arrived in the country, he demanded their release as a condition for meeting Taylor. A contingent of about 300 was freed, but the remaining 200 were held for another ten days before being returned to Monrovia.

Taylor denies that he was using the soldiers as a shield against attack. "We are not terrorists and we do not hold hostages," he said in a radio broadcast. He said the soldiers' weapons were seized because he feared that the Ecomog soldiers would hand over the sophisticated arms to Ulimo.

Under the peace accord, Ecomog was to deploy its forces throughout Liberia, and all armed factions, including the NPFL, promised to disarm and place their combatants in camps.

"We are not here to conquer ground," says Major General Ishaya Bakut of Nigeria, who is field commander of the peacekeeping force. "We're here to conquer the minds of the people, to disarm and encamp."

But the Ecomog deployment has faced repeated delays and Ecomog forces have been denied free movement in Taylor-controlled territory. In May, the NPFL killed six Senegalese soldiers sent by Ecomog to the north when they refused to surrender their heavy artillery.

"It's very embarrassing for us as Liberians," says Lamine Waritay, information minister for the interim government, headed by President Amos Sawyer. "This is an excellent opportunity for the sub-region to tackle the problems of the sub-region. But Mr. Taylor and the NPFL have taken it upon themselves to embark on a systematic program of discrediting Ecomog," he says.

"We are taken as a warring faction and not as a peacekeeper," says Lt. Col. Ajyei Mensah, a Ghanaian staff officer at Ecomog headquarters. "Any time Ecomog personnel are moving to Charles Taylor's area, the peacekeepers are escorted by the NPFL."

The NPFL has organized demonstrations against the West African presence. And, according to informed observers, merchants in several areas have been prohibited from selling food to the soldiers, and residents are urged not to house them.

"As a peacekeeper, you have to exercise restraint to avoid any shootout," said Col. Alex Ackumbo, commanding officer of Nigeria's Eighth Battalion. "That is what we are doing."

Liberia's civil war made refugees of over half the country's 2.6 million people. Although many Liberians who fled the country have been returning, the latest fighting has created as many as 100,000 new refugees, relief workers say, including people from Sierra Leone as well as from Liberia. Poor roads in the border areas make it difficult to get food to those who have fled their homes.

Those who are hungry enough and strong enough journey to Monrovia, where the population has more than doubled to one million since 1990. Another 30,000 refugees and homeless people have flooded the capital in the weeks since the Ulimo offensive began.

Mohammed Eskayhadi, refugee chairman at the Congo Town refugee camp outside Monrovia says he and hundreds of others walked more than a week to reach the capital. "We are suffering a lot from the NPFL soldiers," Eskayhadi says. "The commandos take all our belongings. We only arrived here with one shirt, one trousers." ■

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NEWS ROUNDUP

Warring Factions Edge Peacekeepers into Liberian Conflict

ABIDJAN, IVORY COAST

by Cindy Shiner ■ Africa News Service

As a West African peacekeeping force tries to avoid being drawn into fighting between armed Liberian factions, regional leaders are attempting to breathe new life into the stalled Liberia peace process.

Three West African soldiers were killed in a battle on October 3 between Charles Taylor's National Patriotic Front of Liberia (NPFL) and a rival rebel group on the outskirts of the capital Monrovia. Several rebel soldiers also were killed.

West African commanders say Taylor's forces and rebels from the United Liberation Movement of Democracy for Liberia (Ulimo) are trying to involve them directly in the Liberian conflict. They say Taylor, who claims the West Africans are backing Ulimo, wants to discredit the peacekeeping force. Ulimo seeks West African help in defeating Taylor's forces, these sources say.

Meanwhile, Benin's President Nicéphore Soglo, who heads the Economic Community of West African States that created the peacekeeping force, called Ecomog, has proposed a meeting of Liberia's warring factions. However, the idea has not been endorsed by the region's other heads of state, who have met repeatedly over the past two years to hammer out peace accords among feuding Liberians. According to official sources, these leaders say they want the factions to adhere to agreements previously negotiated.

Taylor, who controls most of Liberia's economy and countryside, ignored a regional mandate to disarm by August 31 or face sanctions. But he has said he will not give up his weapons until Ulimo stops attacking his troops.

Liberia's interim government, which controls the capital, Monrovia, under the protection of the African peacekeepers, says West African leaders have shown little inclination to enforce their own edicts against Taylor. Lamini Waritay, interim minister for information, says officials in Monrovia hope for "a more vigorous implementation of the [peace] accords." Maj. Gen. Ishaya Bakut, Ecomog commander, is ending his tour of duty and returning to Nigeria. The interim government hopes his successor will be more forceful with Taylor.

"We have tried to disavow the use of force," Waritay said in a telephone interview, but if Ecomog decides to take action against the NPFL, "I don't think many people will be opposed."

Many of Ecomog's 7,000 soldiers deployed in the Monrovia area have stopped wearing their white peacekeeping helmets, replacing them with combat helmets. Searches of vehicles at roadblocks throughout the capital have been increased.

Ulimo, composed of the remnants of the army of former dictator Samuel K. Doe, who was killed in 1990, launched an offensive against the NPFL in August, saying that only force would make Taylor disarm and demobilize. Since then, each side has accused the other of killing innocent civilians.

No formal confirmation of the alleged attacks is available. Earlier this month, the interim government reported eyewitness accounts that Taylor's forces had killed over 300 people in an attack on Ulimo. But Ulimo's secretary-general, Joseph Taybior, said only 15 to 20 people died.

Ecomog imposed a cease-fire in Liberia in November 1990, ending almost two years of fighting among the NPFL, a splinter rebel group led by Prince Johnson, and the Liberian army.

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US Reaffirms Its Policy Toward Liberia

Leonard H. Robinson, Jr., Deputy Assistant Secretary for African Affairs

Statement before the Subcommittee on Africa of the House Foreign Affairs Committee, November 19, 1992

As you know, Assistant Secretary [for African Affairs, Herman J.] Cohen returns from Africa tomorrow. In his absence, I am pleased to have this opportunity to review recent events in Liberia. I want to start with a clear articulation of US objectives in Liberia:

- A negotiated settlement under the leadership of ECOWAS [Economic Community of West African States];
- Full disarmament of all Liberian warring factions;
- The return home of nearly 1 million displaced Liberians;
- Free and fair internationally monitored elections; [and]
- The establishment of a unified government based on respect for human rights, democratic principles, and economic accountability.

I am saddened to report that conflict has again broken out and continues today in that tragic country. The cease-fire brokered by ECOWAS—which had held successfully for 21 months—began to break down in August of this year, as the United Liberation Movement (ULIMO) pushed forces of Charles Taylor's National Patriotic Front (NPFL) out of two southwestern counties. On October 15, the cease-fire was shattered when the NPFL launched premeditated, surprise attacks on the West African peacekeeping force, known as ECOMOG, which is protecting Monrovia. Fighting continues on the outskirts of Monrovia as ECOMOG re-establishes its defensive perimeter around the city, while the NPFL continues to resist ECOWAS calls for encampment and disarmament of the Liberian warring factions.

Good faith and extensive efforts to resolve the conflict peacefully have foundered against the NPFL's refusal to implement the agreements that Charles Taylor signed in Yamoussoukro [Cote d'Ivoire] and Geneva. I will not dwell on the climate of violence which led to the unfortunate deaths of thousands of Liberians, the destruction of almost all US facilities in Liberia, and the outflow of half a million refugees who still do not feel they can return to Liberia. Weapons remain plentiful throughout the country, and many Liberians live in fear. In some areas, the NPFL has become essentially an internal army of occupation, sustaining an environment of brutality and coercion and prolonging the misery of the Liberian people. The revolution against Samuel Doe, supported by most Liberians, has become bogged down in a bitter struggle for personal power while the interests of the nation suffer.

None of the Liberian warring factions is blameless for the resumption of hostilities. Elements of every warring faction demonstrated a willingness to resume hostilities in the buildup to the current crisis. No factor contributed to that climate as much as the intransigence of the National Patriotic Front. As the undisputed leader of the NPFL—which controls some 90% of Liberian territory—Charles Taylor bears primary responsibility for the implementation of the peace plan. Only he can determine whether to create the conditions for free and fair elections throughout the country; he has chosen, instead, to seize on a variety of excuses not to.

Charles Taylor and his allies in Burkina Faso have essentially repudiated the ECOWAS leaders who devised the Yamoussoukro IV agreement calling for encampment and disarmament of combatants followed by free and fair elections. The United States and ECOWAS remain open to cooperation with the NPFL, and we recognize that Taylor has legitimate security concerns. But Charles Taylor must find a way to work with ECOWAS and discontinue his verbal and military attacks on the regional organization. Continued resistance to disarmament portends continued conflict.

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The record of Charles Taylor and his undisciplined and unpaid troops in recent months includes:

- Repudiation of the April 7 Geneva accord within hours after he signed it;
- The execution of six captured Senegalese ECOMOG soldiers and the humiliation of 625 ECOMOG troops sent upcountry to supervise encampment and disarmament;
- The murder of five American nuns and harassment of other noncombatants, relief workers and expatriates; and
- The conscription of boys as young as 10 years old, at least some of whom are reportedly drugged before being sent to battle.

I want to pay a special tribute to the five gallant nuns of the Precious Blood Order, who made such a tragic sacrifice in a country whose people they had devoted their lives to serving—in full knowledge of the dangers to which they were exposing themselves.

In the weeks preceding the October 15 attack, Taylor imported tons of new weapons, then motivated his young troops to storm the city with promises of unlimited looting once they took Monrovia. At the same time, the NPFL lobbed dozens of shells into the crowded city, causing many civilian casualties. After suffering some initial setbacks, the ECOMOG forces repulsed the NPFL and are re-establishing security for Monrovia. ECOMOG attempts to strike at NPFL lines of supply upcountry have also resulted in some civilian casualties. We have expressed our concern, and ECOMOG has assured us that such collateral damage is unintentional. The declared purpose of the peace-keeping forces is, first of all, to defend themselves and disrupt the NPFL's ability to attack Monrovia and, second, to convince Charles Taylor that military victory is not possible; he must return to a negotiated settlement, disarm his troops, and give the Liberian people the chance to select their own leaders through free and fair elections.

Much of the progress of the past year in reaching a political settlement has been undone, but we must not lose sight of what ECOWAS accomplished through intervention and negotiation. The dispatch of a six-nation West African peace-keeping force in August 1990 demonstrated unprecedented African determination to take the lead in regional conflict resolution. ECOMOG ended the killing, separated the warring factions, allowed relief assistance to flow to avert starvation, and established a cease-fire and framework for peaceful negotiations. In a country where anarchy reigned, ECOMOG provided order and a bastion of security in Monrovia, and hundreds of thousands of Liberians flocked to the relative safety of the city. ECOMOG troops won the support of the populace and acted with restraint and professionalism during the 21-month cease-fire. ECOMOG remains virtually the only force in Liberia unblemished by serious human rights abuses and is the one military force not motivated by personal aggrandizement. Clearly, the ECOMOG troops would like to return to their home countries; but ECOMOG remains critical to peace, free elections, and regional stability.

Although the dispatch of peace-keeping forces to Liberia was a decision taken by the ECOWAS governments on their own initiative, we have supported this effort from its inception. In addition to more than $200 million in humanitarian assistance to victims of the Liberian conflict, we have provided a total of $8.6 million in assistance to ECOWAS directly and $18.75 million in FMF [Foreign Military Financing] and Department of Defense drawdown authority to ECOWAS member states to support ECOMOG. Their effort has been endorsed by the organization of African states and the United Nations, but ECOWAS countries have borne the vast majority of the expense of fielding the peace-keeping force in Liberia.

It is imperative that this effort succeed. A precipitous ECOMOG withdrawal from Liberia would lead to resumption of warfare and probable humanitarian catastrophe. A bloody takeover by force would deal a setback to democratic aspirations throughout Africa and lead to the conclusion that might makes right. Dissidents throughout the region—many of whom maintain connections to Charles Taylor—would be encouraged to take their battle into the street rather than work through the political process. If the ECOWAS effort fails in Liberia, the organization is unlikely to venture into the difficult realm of peace-keeping and conflict resolution in the future, and pressure will build rapidly for direct US or UN intervention.

We have made clear to ECOWAS states that we do not believe a military solution is possible in Liberia. ECOMOG has a responsibility to defend Monrovia and respond when it is attacked, but fundamental problems such as the proliferation of arms, ethnic hatred, human rights abuses, and refugees will not be resolved through force of arms. Ultimately, Liberians must learn to get along with each other and with their neighbors in the subregion. Aggression must not be rewarded, and no one who comes to power in Liberia through force or fraud can expect normal relations with the United States.

In addition to material support for ECOWAS and humanitarian support for Liberians, the Administration has stood ready to help support demobilization of all Liberian factions and help ensure that proposed elections are genuinely free and fair. To assure real progress, however, comprehensive disarmament is necessary. Our experience in Angola, Cambodia, and elsewhere amply demonstrates that peace without disarmament is tenuous at best. This is especially true in Liberia, where proliferation of guns is accompanied by indiscipline, drugs, and widespread human rights abuses.

In closing, Mr. Chairman, I want to leave no doubt about US policy in Liberia. We support ECOWAS. As the principal regional body, ECOWAS has the mandate and the interest to take the lead in reaching a peaceful solution. We want to see ECOWAS develop as a mechanism for conflict resolution in the region. ECOWAS has established a record of restraint and professionalism sorely needed in Liberia. Its peace-keeping effort is endorsed by the OAU [Organization of African Unity] and the United Nations and offers the only cost-effective alternative to the overstretched UN peace-keeping option. As demonstrated by our continuing support of the ECOWAS mediation process and our ongoing humanitarian assistance, we continue to meet our obligations to the Liberian people, while recognizing that the historical relationship between our countries has changed irrevocably. Only the United States remained in

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Liberia when all other embassies shut down during the war. Our assistance to the peace process and the Liberian people is greater than that of all other donor countries combined. Our desire to see peace restored is unconstrained by strategic necessities or a desire to rebuild expensive facilities. We have repeatedly said we will work with the winner of a free and fair election, whoever that may be. But our policy of evenhandedness must not obscure the facts. NPFL aggression sparked the current tragic round of fighting. All of the warring factions must realize that aggression will not succeed and [that] only disarmament will end the nightmare for the Liberian people. With the support of the Liberian people, the United States, the OAU, ECOWAS, and the United Nations, good-faith negotiations by all the parties will not fail. ■

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War Could Resume in Disputed Saharan Desert

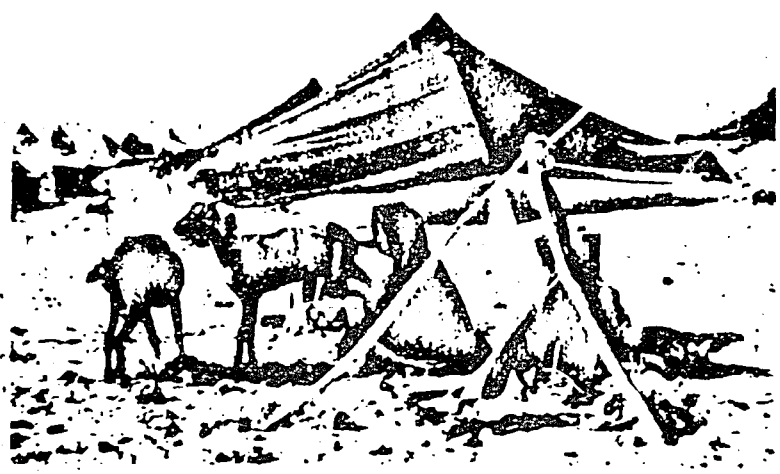
TIFARITI, WESTERN SAHARA

by Chris Simpson for Africa News Service

The Polisario Front independence movement in Western Sahara says it is ready to resume hostilities if Morocco reneges on its promise to go along with a United Nations-supervised referendum to determine the territory's future.

More than one year after the signing of a cease-fire agreement, Polisario is frustrated at the long delays in implementing the UN peace plan and at what it sees as the world body's indifference in the face of persistent provocation from Morocco. Polisario leader Salem Ould Salek spoke for many Saharans when he remarked in Algiers on October 4 that Rabat has led the peace plan into an impasse and that Polisario is ready to fight its way out of it.

Although Polisario has not given up on the UN, it is evident that its patience is wearing thin. The peace plan called for a vote last January, allowing Saharans to choose between independence and union with Morocco, which forcefully annexed the former Spanish colony in 1976. The ballot has been postponed indefinitely, due to disagreements over voter eligibility. Each side says the other is intransigent on the issue.



Polisario says Morocco has led a UN-supervised peace plan into an impasse.

Visitors to the recent Festival of Saharan Youth at the Saharan camps near Tindouf, just inside the Algerian border, encountered widespread disappointment and frustration among the tens of thousands of refugees who fled the Moroccan invasion. Amidst the festivities, the traditional singing and dancing, the military parades and the children's displays, there is real anger at what is seen as the UN's hypocrisy.

"Iraq invaded Kuwait and there was an all-out war over it. Morocco annexed the Western Sahara and nothing happened," complained one embittered Saharan. The refugees know that Western Sahara is now a back-burner issue, not urgent enough for international civil servants to lose sleep over.

Although the Organization of African Unity has backed Polisario's call for Saharan self-determination, no powerful UN member has made an issue of the stalled peace process. Saharan refugees believe that Morocco's King Hassan II has effectively outmaneuvered the United Nations by moving in tens of thousands of Moroccans and asserting their right to vote as descendants of Saharan families.

The king also has forged ahead with a constitutional referendum, which includes Western Sahara as a Moroccan province.

The refugee camps are located in Algeria, which has steadily supported the Polisario cause. But no one knows how Algeria, pressed by its own constitutional crisis, would respond to a resumption of the war. And there is no real evidence that Polisario is poised to return to guerrilla warfare.

Polisario's top officials reiterate their commitment to the peace plan and their willingness to play by the UN rules. They say the cease-fire has been scrupulously observed, that every effort has been made to accommodate the UN peacekeeping force and that Polisario officials are ready to assist in the referendum process, provided an acceptable agreement on voter eligibility can be found.

But they warn that Saharan patience has its limits. If pushed, Polisario will fight, say the Saharan commanders and their troops.

So far, the monitoring of the cease-fire has been the only successful part of Minurso – UN Mission for the Organization of a Referendum in Western Sahara. UN Secretary-General Boutros Boutros-Ghali's latest report on the mission, released last August, praises the 300 Minurso military personnel who have been deployed in both Polisario- and Moroccan-controlled territory.

Whatever Polisario's reservations about Minurso in general, relations between the independence movement and the UN troops on the ground appear excellent. Minurso officers were honored guests at the recent youth festival. In conversation, the peacekeepers give every impression of enjoying their time with the Saharans, although they express concern at the lack of information about the peace process from diplomats.

The mood also is cheerful at Minurso bases in Polisario-controlled territory, 300 miles west of the Algerian border, where Russians, Chinese, Americans and other international observers patrol the surrounding area, checking on Polisario units and keeping the UN flag flying. The peacekeeping troops compliment Polisario's fighting forces for being friendly, cooperative and professional.

But for the Saharan combatants, camped out in the shells of buildings that were bombed by Morocco only days before the cease-fire in August 1991, conditions are considerably harsher than those enjoyed by Minurso, and the mood is markedly more serious. Here among the debris, the shells and the odd broken-down Moroccan tank, memories of the war are very fresh and very bitter. The enemy has not changed, nor has Polisario's objective of Saharan self-determination.

Despite the prevalent war-weariness, the atmosphere here suggests that Polisario's warning that fighting could begin again is more than mere posturing. ■

Chris Simpson is a British journalist who has just returned from a trip to Western Sahara and Saharan refugee camps in Algeria.

South Africa: A Time for Leadership

Herman J. Cohen, Assistant Secretary for African Affairs

Statement before the Subcommittee on Africa of the Senate Foreign Affairs Committee, Washington, DC, September 23, 1992

Thank you for this opportunity to appear before your subcommittee to give the Administration's views on the situation in South Africa. I welcome this opportunity to continue our fruitful dialogue on South Africa's transition from apartheid.

Two months ago today, I testified on this subject before the Africa Subcommittee of the House Foreign Affairs Committee. At that time, I expressed the Administration's deep concern about developments that led to suspension in June of talks within the Convention for a Democratic South Africa, or CODESA. Those talks, which had begun with such hope in December 1991, stalled over fundamental differences on basic issues such as rights for minorities, the degree of devolution of power to regional governments and local authorities, and the length of time for effecting a transition to a government based on a new constitution.

Following the June 17 killing of over 40 men, women, and children in the township of Boipatong, allegedly by residents of a nearby workers' hostel, the African National Congress (ANC) declared it would not resume the talks until the government addressed its demands for action to stop the violence and for concessions relating to the negotiations. Addressing this impasse 2 months ago, I urged all sides to take the steps necessary to get the negotiations back underway.

The Violence Must End

Tragically, this has not happened. The consequences of the continuing impasse are clear for all to see. Violence has continued unrelentingly, and the daily death toll mounts. Earlier this month, as we Americans were celebrating Labor Day, security forces of the Ciskei homeland mowed down with automatic gunfire hundreds of ANC demonstrators in the streets of its capital, Bisho. When the firing stopped, two dozen people lay dead, and over 200 were injured. These killings and those that now are commonplace every day in South Africa are senseless, and they must stop. It is time for South Africans to put aside posturing and brinksmanship and to resolve the few, albeit difficult, remaining issues that divide them. Fortunately, there are indications that South African leaders may be coming to that same conclusion.

A Return to the Negotiating Table

We remain convinced that negotiations offer the only viable means for South Africa's peaceful transition to nonracial democracy. Given the continuing violence and the related deterioration of South Africa's economy, we believe these negotiations must resume soon. There can be no return to the repression of the apartheid era, nor does armed revolution offer an alternative path to democracy.

The Bisho tragedy seemingly shocked all parties into recognizing the costs and risks of escalating violence. We, along with the international community and many in South Africa, placed the responsibility for the bloodshed where it belonged—on both sides. Subsequently, the two sides drew back from the brink and have made gestures toward restoring negotiations. President de Klerk made the dramatic offer of a summit meeting; ANC President Mandela accepted conditionally. The ANC has narrowed its previous preconditions to three "undertakings" by the government concerning bans on carrying traditional weapons, increased security at workers' hostels, and movement on release of individuals the ANC considers "political prisoners." The government, for its part, has accepted that violence is a major obstacle to restoring a constructive climate for negotiations, thus opening the way to addressing these issues that have been a major source of anger and frustration for the ANC.

Adding to this momentum is the growing recognition by all sides that every day of delay in the transition to a democratic South Africa contributes to further economic decline and makes eventual recovery more difficult. A further weakened economy is in no one's best interests. South Africa needs a strong, vibrant free-market economy if it is to redress effectively the appalling socioeconomic legacy of apartheid.

While the country thus appears to have weathered the most recent crisis, tensions remain high, and elements within the constituencies of the various parties remain restive. Before the summit can take place, there will have to be agreement on concrete steps to be taken to curb violence, most notably, bans on the public display of all weapons and securing hostels. These measures have been advocated by the Goldstone Commission and endorsed by the UN Secretary General's special representative. We are hopeful that agreement is within grasp on these issues as well as on the contentious issue of political prisoners.

President de Klerk, ANC President Mandela, and other South African political leaders must now once again demonstrate the decisive leadership so amply shown in the past. They must find common ground to resolve those issues which have blocked resumption of the talks. Their failure to do so can only result in more bloodshed as South Africa's transition to democracy is further delayed.

As leader of the government, President de Klerk bears special responsibility to take effective steps to address the continuing violence. We hold the South African Government ultimately responsible for the actions of the defense forces of the so-called independent homelands. The government must take steps to ensure there are no repetitions of the excessive and unjustified use of lethal force used by the Ciskei security force against ANC demonstrators on September 7.

Similarly, mass actions aimed at confrontations that add to the already unacceptable level of violence are clearly ill advised. This is particularly the case when mass action proceeds from the false premise that easy victories can be gained on issues already the subject of serious negotiations. The ANC must contribute to creating a constructive atmosphere for resumption of the talks. All South Africans have a fundamental right to organize peaceful protest and to be adequately protected while exercising that right. We are encouraged that the ANC recently decided to postpone marches into Bophuthatswana and Kwazulu, demonstrations that would have led to further bloodshed. We hope the ANC will seriously reconsider its tactic of confrontation with the homeland governments before rescheduling these marches.

Furthermore, we believe President Mandela and Chief Buthelezi must move decisively to address the enduring differences between the ANC and the Inkatha Freedom Party—differences that fuel much of today's violence. In this regard, and in the context of the other actions I have suggested, I hope that these two leaders will soon meet to begin bridging the gap that divides them, thereby giving a clear signal to their communities that their political objectives must be pursued through peaceful means. Inkatha and the ANC must encourage the basic right of all South Africans to pursue lawful political activity in all parts of the country—"no go" areas are not acceptable.

I realize these steps will not be easy, but these are critical times for South Africa—the future of the nation is at stake. I call on these leaders to rise to the demands of the occasion and make the necessary tough decisions that will enable South Africa to resume the path toward peaceful transition to non-racial democracy.

US Role

My thoughts today outlined the continuing role of the United States as concerned outsider. We have sought consistently to help foster a process which will facilitate a rapid, peaceful transition to non-racial democracy. We maintain an ongoing dialogue with South African leaders across the spectrum, urging an end to the violence and helping refocus attention on negotiations. And we continue our assistance programs with the objectives of preparing black South Africans for positions of leadership in a new South Africa and addressing the broad development concerns of the country's black population.

The United States has also supported strongly the involvement of the United Nations in South Africa. In July, Special Representative Cyrus Vance visited South Africa to assess how the United Nations could support the peace process. On the basis of his findings, the United Nations is now dispatching 50 observers to South Africa to cooperate with the existing structures of the national peace accord. Some of these observers are already on the job; the others will arrive shortly.

The Secretary General also has dispatched his special envoy, Virendra Dayal, to further facilitate efforts to restore the negotiating environment. The effectiveness of UN observers has already been demonstrated. In early August, they were instrumental in negotiating on-the-ground arrangements that successfully avoided bloodshed during an earlier ANC March on Ciskei. We expect the UN observers—as well as others to be provided by the EC [European Community] and the Commonwealth—will be an important resource in checking the violence. We are encouraged by the South African Government's willingness to accept and, indeed, welcome this international involvement.

Next Steps

The United States remains determined to do whatever we can to assist South Africa's transition to a free, non-racial democracy with a vibrant, market-based economy. Ultimately, however, the future of South Africa lies in the hands of the South Africans themselves. Only they can make and implement the decisions needed to heal the deep wounds left by decades of apartheid. Only they can take the steps to redress the socioeconomic legacy of apartheid. I have already set forth the steps that I believe must be taken by the major players to get the talks underway once again and to bring them to a successful conclusion.

In earlier testimony, I set forth several points which we believe are basic to a genuine democratic solution in South Africa. They bear repeating:

- A solution must include all relevant parties and promote tolerance in a country of great diversity;
- It should acknowledge the right of the majority to govern while assuring that all South Africans have a stake in their government; and
- It should ensure that government functions within an agreed framework which includes protection of the fundamental rights of all citizens, but it should avoid overly complex arrangements intended to guarantee a share of power to particular groups, an arrangement that would frustrate effective governance. Minorities have a right to safeguards; they cannot expect a veto.

In that same testimony, I urged South Africans to consider seriously the degree to which federalism might address many of the tensions inherent in their society. Subsequent debate has revealed that some in South Africa portray federalism as a facade for stripping the central government of most significant authority. It is just such efforts to corrupt the purposes of federalism and turn it to the defense of the status quo that have earned it the enmity of so many in the disenfranchised majority and stifled serious debate. All South Africans should understand that effective federalism is a framework fully consistent with strong, responsive government at the national, regional, and local levels with power and responsibility reserved for those levels most responsive to citizen needs and desires.

I remain hopeful [that] the negotiations will soon resume. All South Africa's leading parties remain committed to the negotiating process, realizing full well that it is the only viable alternative. I fully expect that once negotiations resume, the parties will build on the substantial progress they have already made. I firmly believe that the elements of a final agreement are within reach. ■

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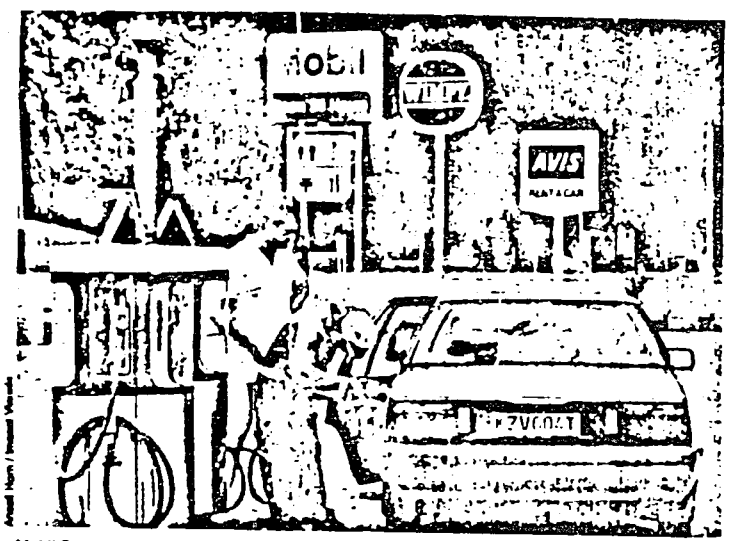


Mobil Corporation was a leading American investor in South Africa until public protests in the United States forced the company to sell its South African subsidiary in 1989.

Companies Ready for Return to South Africa

Conduct will Face Scrutiny by Sanctions Lobby

NEW YORK

by Karen Gellen ■ Africa News Service

Major U.S. companies are testing the waters for a plunge back into South Africa, despite the ongoing political turmoil there. Although most corporations are waiting for a green light from black South African leaders before actually investing, the corporate consensus seems to be that the time has come to prepare for doing business in the post-apartheid era.

Companies that pulled out of South Africa in response to demands by anti-apartheid campaigns, and those that never went in, are rushing to confer with the African National Congress (ANC), the country's largest political group, led by Nelson Mandela.

The South African-American Business Council, formed by a group of African American entrepreneurs last year during an ANC-endorsed tour of South Africa organized by the African American lobby TransAfrica, is seeking opportunities for cooperative ventures with black South African businesses.

The dozens of U.S. corporations that remained in South Africa also are positioning themselves for business in the near future under an ANC-led government.

In partnership with the Congress of South African Trade Unions (Cosatu), the country's largest labor federation, the ANC has drafted a "code of conduct" to guide corporate practices in South Africa. The draft calls for companies to guarantee fair labor practices such as collective bargaining and the right to strike, mandates equality of employment opportunity and environmental protection, and says that investment should enhance training and business opportunities, particularly for disadvantaged workers.

The proposed code has sparked a fierce lobbying effort, much like the one that accompanied the battle over sanctions in the 1980s. Some corporations are voicing strong opposition to any guidelines; others are entering into a dialogue with the ANC over the evolving policy; and some of the American groups that fought for sanctions are campaigning in support of the ANC and Cosatu code.

The debate surfaced last month at a forum on "Investment Opportunities in a New South Africa" at the World Trade Center in New York City. The event, attended by several top ANC officials and representatives of dozens of U.S. corporations, was part of a three-day conference organized by anti-apartheid leaders in the United States to discuss the transition to majority rule.

At the forum, the ANC's Don Mkhwanazi unveiled the draft code, titled the "Platform of Guiding Principles for Investors." He said the ANC would seek to enshrine the code in law when a new South African government comes to power. The issue of mandatory compliance – with the prospect of monitoring mechanisms in the U.S. – is troubling to some

COMPANIES from page 1

U.S. corporations, who say the ANC may scare off vital investment.

One leading corporate spokesman, Sal Marzullo, says that by proposing the code, the ANC is sending "mixed signals" to investors about the post-apartheid economic climate. A former Mobil executive, Marzullo heads the Industry Support Unit, which serves 52 U.S. multinationals that have continued to operate in South Africa in defiance of the pressure to withdraw.

"Why do you need a code of conduct when multinationals behave very well without one?" Marzullo said in an interview. U.S. companies have spent $450 million on housing, education, job training and other social programs in South Africa since 1977, he says, and the cost of doing business there is "already higher than anywhere else in the world."

Most of the programs Marzullo refers to were adopted by U.S. companies as an alternative to pulling out of South Africa when public pressure for sanctions mounted. That corporate strategy grew out of an initiative by Leon Sullivan, an African American pastor and a member of the General Motors board of directors, who promoted a set of "good conduct" principles for American companies involved in South Africa in the early 1980s before he became an advocate of sanctions at the end of the decade.

Marzullo warns that a new code will drive away investment and bring the economy to ruin. "South Africa took centuries to build and could be destroyed in a decade," he says.

William C. Dunning, a vice president of Caltex Petroleum, the largest U.S. company operating in South Africa, and another leading figure in the Industry Support Unit, is equally blunt. "Business doesn't like government getting into its business," he says. Caltex, a subsidiary of Chevron and Texaco, which operates a large refinery in Cape Town and about a thousand service stations throughout the country, is also the largest American employer in South Africa.

Dunning says the ANC needs to articulate a liberal investment policy that welcomes business and would, for example, enable foreign companies to repatriate 100% of their profits for the first five years. Otherwise, the Caltex executive says, South Africa will lose out to its neighbors, like Zambia, which he says has a "very liberal" investment code, and Namibia and Mozambique, which are actively courting companies.

But Marzullo and Dunning acknowledge that South Africa remains particularly attractive to investors. The country has a prime geographic location, a developed market economy, a "world class" infrastructure, abundant natural resources and a huge potential domestic market. Dunning notes that black consumers now make up more than 50% of the country's buying power, a figure certain to grow in the post-apartheid era.

Some companies, rather than resisting the idea of a code of conduct, are opting to work with the ANC and Cosatu to help shape the guidelines. Apple Computer, which withdrew from South Africa in the mid-1980s, has sent executives to South Africa twice this year and has consulted with Nelson Mandela and Archbishop Desmond Tutu, among others.

One initiative that the ANC's Mkhwanazi welcomes as "exciting and progressive" comes from the Executive Leadership Council, an organization of 100 African Americans who are vice presidents in Fortune 500 companies.

A leader of the group, Honeywell's Mannie Jackson, says U.S. business can either "put its head in the sand, or try to influence what the eventual code of conduct will be." The council has published its own proposed code, which Jackson says is being reviewed by 150 chief executives, together with each company's senior black employees. "We want to be involved on the front end," says Jackson, "in specifying future codes of conduct."

He says that as "the first generation of African Americans to invade corporate America," council members have unique insights to offer, particularly in "avoiding some of the mistakes we made in our own affirmative action days."

The council's draft code calls on U.S. companies to fund a nationwide Head Start program in South Africa, to prioritize the training of black professionals, to increase black membership on their boards to at least 30% by the year 2000, and to use mainly black suppliers.

Some anti-apartheid activists are critical of the Executive Council's approach. According to Sister Barbara Ayers, who earlier this year represented church investors at a conference on codes of conduct sponsored by the South African Council of Churches, Jackson's initiative could become a "critical diversion" from ANC and Cosatu efforts to promulgate a universally recognized code.

Unlike an earlier draft of the code of conduct prepared by Cosatu that focused exclusively on outside firms, the current ANC/Cosatu version is aimed at "all investors, domestic or foreign." The latest draft also adds provisions designed to enhance the development of black entrepreneurs, a provision that initially was resisted by the trade unions, whose focus is on labor rights and opportunities for workers.

According to Israel Skosana, who heads South Africa's largest black-owned corporation, the National Sorghum Breweries, black business accounts for less than two percent of South Africa's gross domestic product. Skosana says he founded his company – which uses only black suppliers and has 85% black management – by going door-to-door in black communities to sell tiny share holdings. There are now 10,000 individual stockholders in National Sorghum Breweries. He calls his company, which employs 4,100 mainly unionized workers, a "deliberate act of black economic empowerment."

Speaking on the World Trade Center panel, Skosana appealed to U.S. businesses to see National Sorghum as a model for promoting black entrepreneurial expansion.

While many companies react negatively to the prospect of a mandatory investment code, American anti-apartheid groups see the guidelines as a vehicle for continuing to pressure for change. But the activists say they are sensitive to South Africa's need to attract outside investors.

According to Richard Knight, research director of the American Committee on Africa (ACOA) in New York, who traveled to South Africa in October for discussions on the code with Cosatu and ANC officials, the guidelines are aimed at preventing abuses, not discouraging investors. South African trade unionists "are not expecting the same wages company would pay in New York, but they don't want to bring in sweatshop labor," he says. What they want is "quality investment" in the country, Knight says.

Donna Katzin, director of South Africa programs for the New York-based Interfaith Center on Corporate Responsibility, which has spearheaded the church-sponsored shareholder campaigns aimed at forcing companies out, says self-interest will lure many companies back. Clear, mutually understood terms for doing business will be an advantage, Katzin says, because they will contribute to limiting conflict and promoting the stability that multinationals view as essential.

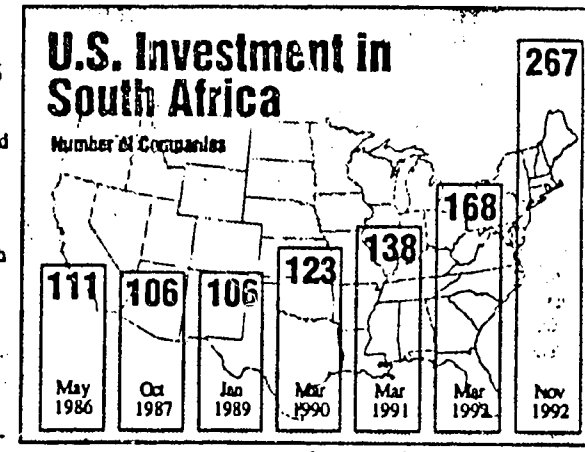
Anti-apartheid groups already are exploring ways to ensure corporate compliance with the code. Last summer, the ACOA was instrumental in securing the passage of resolutions supporting "socially responsible investment" in the post-sanctions era by both the U.S. Conference of Mayors and the National Conference of State Legislatures.

Action by those groups was seen as significant, because it was city councils and state legislatures that led the moves toward wider anti-apartheid sanctions in the United States during the last decade. Even now, almost 18 months after the Bush administration lifted the restrictive measures against South Africa adopted by Congress in 1986, leaving in place only an arms embargo, 26 states and some 100 cities are heeding the ANC's call to maintain sanctions until a multiracial interim government in installed.

But anti-apartheid groups concede that identifying infringements of a new investment code will not be as easy as fingering sanctions violators. The Investor Responsibility Research Center, a Washington, DC-based corporate monitoring group, says that measuring compliance will be tricky, since the draft proposals are stated as broad, social goals rather than as specific targets for such things as training programs.

Still, activist groups hope that the precedent of the successful sanctions campaigns will persuade U.S. companies that their behavior in a new South Africa will be closely scrutinized at home. "We may have to hold their feet to the fire," says ACOA's Knight, to ensure that corporations adhere to whatever code of conduct is finally adopted.

"South Africa is not just another place where U.S. companies are doing business," he says. "Because of the whole struggle against apartheid, people in this country have a special place in their hearts for South Africa." ■



Source: Investor Responsibility Research Center, Inc.

ANC/Cosatu Position Paper on Guiding Principles for Foreign Investors

Below are excerpts from a document presented to a conference of anti-apartheid activists meeting in November in New York.

Introduction

The apartheid legislative process that governs investment at present is a major obstacle to growth and development. In this context, the process of foreign investment needs to be assessed with care.

At present, the basic International Labor Organization Conventions do not apply across South Africa. Discriminatory practices are widespread, and the lack of transparency in government is hiding corruption and inefficiency and promoting political violence and destabilization. Measures to protect the environment are weak, weakly implemented or non-existent. Investment in such a context will, therefore, not automatically contribute to growth, development or the eradication of apartheid.

Guiding Principles

We therefore propose that any investment after the lifting of the policy of economic sanctions should be guided by the following principles:

- Workers' Rights – Companies should uphold workers' rights including the recognition of representative unions and their rights to bargain collectively, to strike, to picket peacefully; and strike breakers will not be hired.
- Investment should enhance employment creation.
- Equality of Opportunity – Companies will eliminate all discrimination on the basis of race, religion, sex, political opinion or physical handicap and will implement affirmative action programs.
- Environmental Protection – Investment must incorporate environmentally sound and clean practices and technology.
- Training and Education – Investment should enhance the productive capacities of South Africans and should, in particular, institute training and adult education programs for workers in consultation with the trade union movement.
- Security of Employment – Investment should contribute to the security of employment of South Africans.
- Empower Black Business – Companies should, where possible, adopt business practices which enhance the development of black business in South Africa.
- Implementation – Mechanisms should be put in place to evaluate the implementation of the above principles, including the disclosure of relevant information by companies.

Future Policies of a Democratic Government

It is our intention to have the above principles incorporated in the future policies and laws of a democratic government, and these will apply to all investors, domestic or foreign.

In the interim phase, we will campaign for these principles and will support the further development of codes of conduct along with other democratic formations. ■

Humanitarian assistance turns to democratic interference

To see how the world has gradually slipped from humanitarian assistance into what is often very uneasy democratic interference, we looked at Bernard Kouchner's book 'Le Malheur des Autres' (Other people's misfortune), published by Odile Jacob in Paris in 1991.

The writer, the doctor who founded Médecins sans Frontières and Médecins du Monde, was the French Government's State Secretary for Humanitarian Relief and is now Minister of Health and Humanitarian Relief.

Kouchner spent 20 years providing humanitarian relief in the midst of conflicts in Asia, Africa, Latin America and the Middle East, from Biafra in 1968 to Liberia in 1991, 'in the kind of places where people shoot first and then stretch out on the ground to die, crying for their mothers at the very moment when they have just killed their own neighbour's mother'.

His book, like everything else he has done, is a plea 'against the antiquated theory of national sovereignty hallowed as a defence for massacring people'. And now that intervention, which he believes to be a duty and in some circumstances a right, has become legally accepted international practice, he welcomes the fact that 'human suffering is no longer a silent by-product of politics and sovereignty, for countries have started taking other people's misfortune into account'.

Humanitarian interference

This made its first official appearance in 1987 at a Médecins du Monde-Paris-Sud Law Faculty conference. 'We had to leave ethics and target setting and fraternal international practice behind us and go boldy forward, "manufacturing law" on the legal terrain.

On 8 December 1988, the then State Secretary, on behalf of France, tabled Resolution 45/131 in the UN General Assembly, laying down a right of access to provide 'Humanitarian assistance to victims of disasters and similar emergency situations'. It was adopted unanimously.

The following day, 9 December, the USSR opened its doors to international aid for the first time — for the earthquake in Armenia. The following year, it was Lebanon, Sudan, Liberia and Romania.

The UN's first official humanitarian intervention was to help Kurds on Iraqi soil. 'Interference had at last won the right to exist as a means of conducting politics.'

None of this would have been possible had the UN Security Council not adopted Resolution No 688 of 5 April 1991, enshrining the right to humanitarian relief, recognising that the natural right of man came before the right of States and authorising a humanitarian force to move into sovereign territory to save lives.

The international community thereby asserted a right to take a humanitarian interest inside national boundaries — 'placing genuine curbs on a sovereignty which empowered a country to kill its own nationals. A code of ethics without frontiers was emerging.'

Interference — a right or a duty?

Can the duty to intervene become a right? Yes, it can, maintains Bernard Kouchner, provided it takes place under the banner of neutral, impartial organisations.

UN General Assembly resolutions 43/131 and 45/100 only provide for external assistance where the State to which the territory belongs cannot (or will not) provide the relief itself and the distressed populations can only survive with outside help.

What about the danger of military escalation? The right to intervene, Dr Kouchner maintains, does not mean using troops and the threat of armed intervention must only be used in the name of human rights as a last resort.

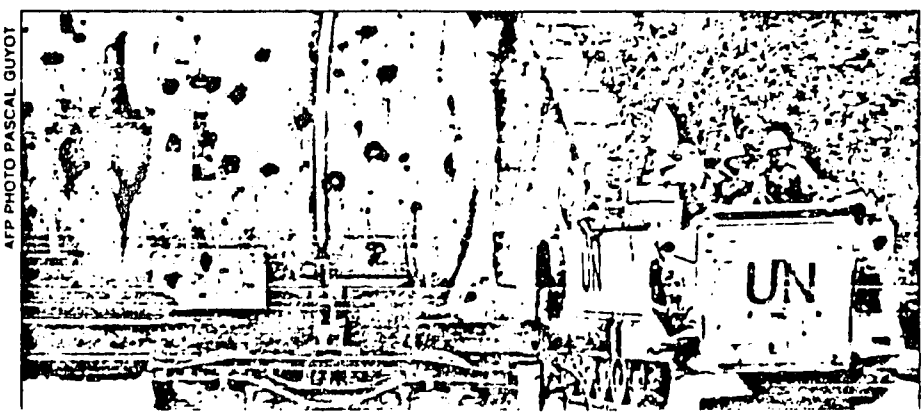
Since this book came out, humanitarian interference has gained ground, particularly in Somalia and what was Yugoslavia, and this dossier takes stock of it.

As the Kurdish leader Talabani put it: 'Politicians invent things, lawyers just take photographs.' Meanwhile, the international humanitarian movement has gone on working, going beyond States and policies, in the name of civil society. And since things are always out of hand somewhere, there are people who sit back and complain that humanitarian interference is an excuse for failing to carry out direct military intervention. In the *Le Monde* 'Images' column on 12 September 1992, Daniel Schneiderman talked about a television report on Bernard Kouchner's work in Somalia: 'In the middle of the programme, on came Bernard Kouchner, in a bottle-green safari suit, with dying children all around him. He was on his knees, his hands stretched out to an empty sky or stroking the little bodies for which all hope was gone. He shouted. He harangued us. He harangued the whole world, people going on holiday, people lying on their sofas watching the Olympic Games and people who could not care less about Somalia or have got it tucked away in a little mental drawer which they can open and shut as they like — very handy, that. "None of these children even has a sheet to be buried in," he shouted.

'We could only sit trembling there on the settee, looking at him kneeling in the dust. Shame is a chilly emotion.

'It makes you shiver. We wanted to rebel and shout back: "And what about you?" And what about you, Minister? Don't you have a child at school in a nice part of town? Don't you have a holiday home on a nice beach somewhere? Yes, but he was down there in Somalia repeating absurd, pointless gestures, knowing it was a waste of time, digging the desert up with a teaspoon. We were not. And all we could do was keep quiet. Keep quiet and weep.' ○ D.D.

A Bosnian walks past UN soldiers on an armoured personnel carrier in Sarajevo



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BROOKINGS NEWS

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EMERGENCY HUMANITARIAN OPERATIONS: LESSONS FROM AFRICA

FOR IMMEDIATE RELEASE October 5, 1992

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The international community – moved by graphic images of recent starvation and devastation in Somalia, Yugoslavia, Sudan and elsewhere – has been compelled to respond to humanitarian emergencies throughout the world. Media coverage of emaciated children and old women and men, combined with the inability or unwillingness of their governments to provide relief, has obliged the world to respond with an influx of humanitarian aid to those in need.

Unfortunately, such tragic conditions are not new, and they seem to recur with disheartening regularity. As speedy and effective response becomes recognized as a global responsibility, governments increasingly are perceiving the need to learn from nations that have experienced famine and international relief intervention. What can be learned from past experiences with humanitarian emergencies, and what can be done to end the cycle of crises?

In a new Brookings study, ***The Challenges of Famine Relief: Emergency Operations in the Sudan,*** Francis M. Deng, senior fellow in the Brookings Foreign Policy Studies program, and Larry Minear, codirector of the Humanitarianism and War Project in Washington, ask these questions and analyze the response to famine based on the Sudanese experience.

The problems of humanitarian emergencies, Deng and Minear argue, pose particular challenges to the international community. The breakdown of social order that makes international action compelling simultaneously makes effective action unusually difficult. Moreover, individuals at gravest risk are often the least accessible, and those who seek to reach them frequently place themselves at risk as well.

Challenges of Famine Relief analyses the underlying causes of famine, pointing out the role of policies and conditions beyond the mere lack of rain. Two case studies, the drought-induced famine of 1983-86 and the conflict-related famine of 1987-91, bring together the

empirical data and contextual analysis of earlier work by Deng and Minear. The book concludes by explicitly drawing out the lessons of the international experience in Sudan for future operations.

Common Problems and Pitfalls

Deng and Minear argue that the first problem common to both earlier emergencies relates to the external nature of emergency relief operations and the reluctance of national leaders to invite or welcome such actions.

The second problem is that of context, in which the preoccupations with short-term emergency aid supersede longer-term rehabilitation and development concerns.

Third, coordination among the diverse groups involved in relief operations, though essential to prevent unnecessary conflicts, is often resisted.

Finally, unless organized carefully, emergency operations are liable to reinforce dependency and inhibit the return to self-reliance.

Dismantling Barriers to Assistance

"The balance between sovereignty and suffering is shifting in favor of greater international sensitivity to the claims of those who suffer and greater impatience with the obstructionism of uncaring governments," the authors conclude. This in turn opens up the possibility of a wider range of humanitarian initiatives.

New institutional arrangements and reforms will be necessary for the international community to react more effectively to future emergencies. Drawing on experiences with the Office of Emergency Operations in Africa and Operation Lifeline Sudan, Deng and Minear recommend a number of changes:

- Establish a mechanism to ensure high-level international political review of humanitarian emergencies.
- Develop a code of conduct to encourage higher levels of professionalism among aid providers.
- Foster a stricter sense of proportionality and balance.
- Focus more attention on institution building and indigenous resourcefulness.
- Establish clearer authority for UN agencies to deal with armed insurgencies on humanitarian issues.

The relationship between relief and the search for peace is addressed by the authors in the conclusion of the book. Deng and Minear state that as a "moral imperative, providing aid cannot be compromised for political considerations. However, it can promote the prospects of peace, which is the ultimate solution to the tragedy of conflict-related famine."

As Maurice Strong, coordinator of United Nations emergency operations in Sudan from 1984-86, observes in his preface, "this well-researched, authoritative, and timely book will help to ensure that the memory and the lessons of the Sudan famine are not lost." These lessons, of course, are increasingly becoming global as emergencies in Somalia, Sudan, Yugoslavia, Eastern Europe, and the new states succeeding the former Soviet Union, force themselves on the international agenda.

Francis Deng held a number of posts in the Sudanese foreign service, including that of ambassador to the United States and Minister of State for Foreign Affairs. He prepared a study of the 1983-86 drought and famine for the United Nations Office of Emergency Operations in Africa, one of the two emergencies covered in the book.

Larry Minear codirects the Humanitarianism and War Project, a joint undertaking of the Refugee Policy Group in Washington, D.C., and the Thomas J. Watson Jr. Institute for International Studies at Brown University. Minear headed a team of African and American researchers who wrote a study on the 1989-91 conflict-induced famine and the Operation Lifeline Sudan intervention.

Financial support for *The Challenges of Famine Relief* was provided in part by the Carnegie Corporation of New York, the Rockefeller Foundation, and the Rockefeller Brothers Fund.

The Challenges of Famine Relief: Emergency Operations in the Sudan, by Francis M. Deng and Larry Minear. Published September 1992. 165 pages. Cloth, $26.95 (ISBN 0-8157-1792-x); paper, $9.95 (ISBN 0-8157-1791-1)

Charles Krauthammer

Drawing the Line at Genocide

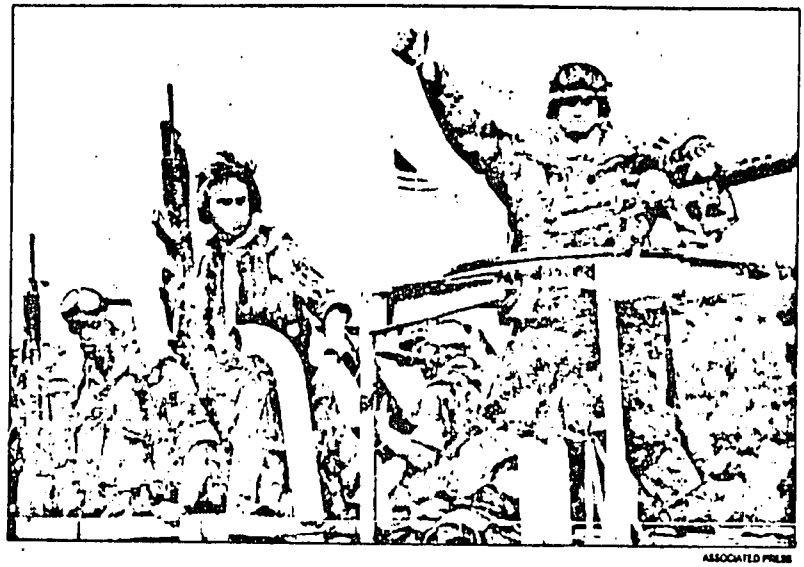
Two principles of humanitarian intervention.

As America launches the first purely humanitarian military intervention, the obvious question is: Why here? Why now? Why Somalia and not Bosnia? The question is important because unless it is answered, Somalia risks becoming either a dangerous precedent or just a farewell fit of conscience by a dying administration.

It is true, but insufficient, to say that TV pictures of starving Somalis summon an instinctive desire to do something. A government that is not reckless with the lives of its soldiers must enunciate some logic beyond instinct for risking those lives in a situation that does not remotely engage the national interest.

Why Somalia and not Bosnia? One wit put it this way: We don't do mountains. The first principle of humanitarian intervention is: It must be doable. Bosnia is not doable. The mountainous terrain, the heavily armed factions, the history of prolonged guerrilla war—all promise not just large losses but military failure.

The great insister on doability is Colin Powell. Reflecting the views of the military's Vietnam generation, he has established the Powell Doctrine: America will intervene if, and only if, it can win decisively and with minimal losses through the introduction of overwhelming force



ASSOCIATED PRESS

How do we know in advance where the introduction of overwhelming force will bring decisive victory with minimal losses? History offers a useful rule of thumb: where our opponent is isolated. An opponent with no patron or sanctuary cannot stand up to the world's superpower and will likely not inflict much injury.

Consider our recent wars. Vietnam was not isolated. China and Russia provided it with endless supplies and implicit sanctuary. Because of the threat of great power retaliation over Vietnam—say, Chinese intervention as in Korea or Soviet pressure at flash points elsewhere—the United States was reluctant to "go to the source" to unleash its full power on Hanoi. Iraq, on the other hand, was isolated. The gulf war could thus begin at the source and be won at the source with massive aerial bombardment of Baghdad and its military machine.

The isolation rule applies not just to wars but to police actions as well. Isolated guerrilla fighters are the most easily overcome. Hence the distinction between Somalia and Bosnia. In Somalia, the men with guns are scattered gangs. There is no national power behind them to coordinate strategy, organize supplies or provide sanctuary. In Bosnia, on the other hand, we would be facing Serbian guerrillas armed, equipped and protected by a real country with a real army and a huge arsenal.

The Powell Doctrine may err too much on the side of prudence. But in war that is probably a virtue. It takes only one great national disaster like Vietnam to sour a generation of Americans on even the most justified intervention. The only interventionist consensus sustainable in the United States over the long run is one founded on Powell's doability principle.

Doability, however, is only the first requirement for intervention. It must be not just doable but also worth doing. National interest is one justification for armed intervention. Is humanitarianism? At what point does a violation of humanitarian norms become so extraordinary as to justify, indeed morally compel, military intervention?

At the point of genocide. All such distinctions must be somewhat arbitrary, but since lines must be drawn, we might as well make them bright. Hence the second principle of humanitarian intervention: Only the ultimate crime justifies the ultimate sanction (military intervention).

Lesser crimes have a claim on our sympathies but not our soldiers. There are people being massacred in civil wars in Liberia, Mozambique and Bosnia. We feel some guilt about not intervening, but we understand that if we intervene every time murder occurs, we shall quickly exhaust ourselves. There are too many wrongs in this world for the United States to right.

Bosnia looms somewhat larger on the moral scale because of an attempt by some factions (the Serbs and Croats) to take territory by force and expulsion. The taking is cruel, often murderous. Nonetheless, expulsion is not extermination. Most obviously, it is at least in principle reversible. The Volga Germans and the Crimean Tartars expelled by Stalin have since been allowed to return to their homelands. That is not the case for the 15 million Germans expelled from Poland and Czechoslovakia after World War II, but even they have survived. Indeed, they are better off than many of the countrymen they left behind the Iron Curtain.

Ethnic cleansing is brutal, indeed barbaric. It is systematic land-grabbing. But it is not genocide. In Somalia, on the other hand, the issue is the physical destruction of entire populations, autogenocide to rival Cambodia's. The point is not intent. Serbian marauders may have more murder in their hearts than Somali gangsters, whose chief interests are money and power. But the Somalis have infinitely more blood on their hands. Genocide may not be the intent of those stealing food from the mouths of starving millions. But it is the effect.

One murder is a crime. A million murders is a crime against humanity. Genocide is the end not just of life but of history, memory, posterity. Why Somalia and not Bosnia? The suffering in Bosnia is heart-rending. But so too the suffering in Liberia. Shall we intervene there? Unless we are prepared for endless wars of altruism, we will have to draw a line. Drawing it at genocide satisfies the claims both of morality and prudence.

America will not stand by if another people are dying and there is a way for America to save them. This may not be the loftiest principle of humanitarian intervention, but it is better than all the rest.

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Bring the Green Revolution to Africa

By Richard Critchfield

BERKELEY, Calif.

Is there a way to stop the suffering of those Somalian and Ethiopian children who haunt our TV sets? Can something be done to end chronic famine in Africa?

Yes, says Norman Borlaug, the Iowa plant breeder who won the Nobel Peace Prize in 1970 after his high-yield dwarf wheat rescued Asia from famine. Dr. Borlaug advises governments in Latin America and Asia, including India and China, heads a foundation in Poland and is a science adviser to President Bush.

His remedy: put together all the data on African crops, including information on the use of fertilizer, control of insects and weeds and use of moisture. And then apply that knowledge to an African farmer's fields.

Since 1986, Dr. Borlaug, financed by a Japanese philanthropist, Ryoichi Sasakawa, has done this on more than 150,000 African farms. Yields have increased by an average of 2.5 times. Dr. Borlaug began with wheat and sorghum in the Sudan and maize in Ghana. Civil war ended the work in the Sudan. Even so, in March the Sudanese harvested 800,000 tons of wheat, up from 160,000 in 1986. Ghana's maize production is up 40 percent from 1986. Mexican scientists working with Dr. Borlaug are now operating in Tanzania, Benin and Togo and are moving into Nigeria and Ethiopia.

Once African political leaders and economic planners see how crop yields can be increased, Dr. Borlaug says, they need to make sure fertilizer gets to villages at least six weeks before planting, provide credit to farmers to pay off debts after harvest and insure a fair price. The job of persuading African leaders to do so goes to Jimmy Carter, who volunteered to use his prestige to back up the Borlaug team's field work.

In short, Dr. Borlaug would do in Africa what worked in Asia, where new government agricultural and economic policies combined with plant-breeding advances to create the green revolution. By crossing Dr. Borlaug's dwarf wheat with cold weather strains from Korea, China now produces more wheat than the U.S. and is the world's leading grain producer. India has quintupled wheat output since 1967, the year the Indians first planted his high-yield varieties widely.

A laureate from Iowa has doubled crop yields.

Two problems loom ahead in sub-Saharan Africa. One is its farming environment, a savannah of open grasslands, thorny bush and baobab and acacia trees, bordered by the Sahara and tropical jungle. Leached of its nutrients by thousands of years of heavy rains and never enriched by glaciers, the continent's red acidic soil badly needs fertilizer. Yet there are only two major fertilizer plants in sub-Saharan Africa, both in Nigeria.

Most farming is done by human muscle, mainly slash-and-burn cultivation with hoes, sickles and digging sticks — about 80 percent of it by women. Because the tsetse fly's parasites devastate livestock in many areas, just 18 percent of African farms depend on animal power. Only 3 percent use machinery. A family can only farm about about two and a half acres without an animal, so most farming is subsistence. The up side is that Africa is one of the few places left on the planet with plenty of unused, cultivable land.

One problem that Dr. Borlaug didn't face 25 years ago in Asia is the huge monolith of the World Bank, which through its affiliate, the International Development Agency, gives the lion's share of aid in Africa, money that keeps a lot of its governments going.

Senior officials of the bank, mainly economists or former academics who have never set foot in an African maize field, are wedded to policies like "structural adjustment," a buzzword in free-market strategies that entails drastically cutting budgets and inflation, privatizing industry, lowering trade barriers and encouraging foreign investment. Sensible enough in theory, this blueprint goes wrong in practice when the World Bank opposes fertilizer subsidies or argues that more research is needed before going whole hog the Borlaug way.

World Bank policies are a huge obstacle.

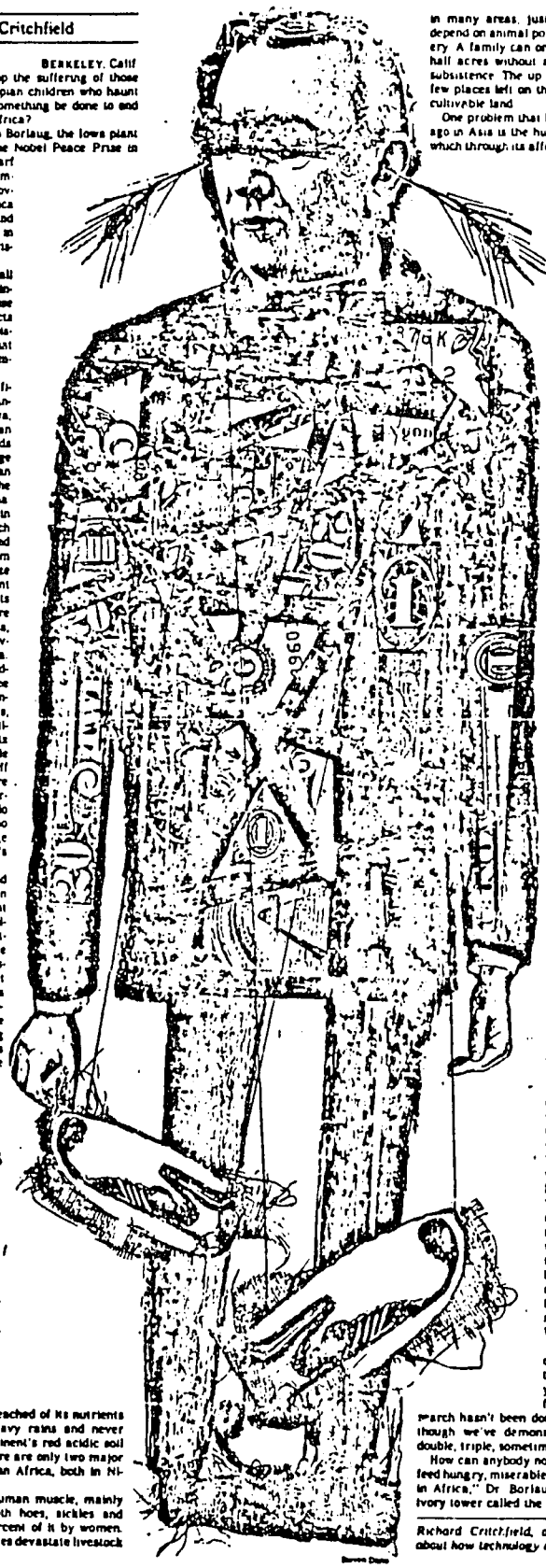
The bank also finances what it calls a "training and visit" system — sending local government workers to train farmers in 27 African countries. But their demonstration plots are too small to produce enough grain to be effective.

Africa's food crisis, which has been worsening since the 1983-84 drought, came just after the Ford and Rockefeller Foundations, the prime movers in Asia's green revolution, phased out their agricultural programs. Ford shifted entirely to social spending and Rockefeller to giving $8 million a year on molecular genetics and biotechnology, which combat insects and disease but don't directly increase yields. Also, the U.S. Agency for International Development has virtually opted out of agriculture.

In what amounts to global neglect when it comes to agriculture, Dr. Borlaug's African work is of tremendous importance. At a recent meeting with World Bank officials in Virginia, Jimmy Carter voiced his frustration. "God knows," he told the bankers, "if we can't do anything in agriculture, where people are starving to death, and getting worse every year, then I think the entire situation in Africa is hopeless. Dr. Borlaug's system works. I've been on the farms. I've seen it work. We need desperately for the World Bank to join with us."

Will it? Great bureaucracies have their own imperatives. "The World Bank says you can't justify our kind of field work because enough research hasn't been done," says Dr. Borlaug, "even though we've demonstrated clearly that we can double, triple, sometimes even quadruple yields."

How can anybody not support programs that help feed hungry, miserable people? "They've never lived in Africa," Dr. Borlaug laments. "They live in an ivory tower called the World Bank." □



Richard Critchfield, author of "Villages," writes about how technology affects culture.

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Reviving Zimbabwe's Reforms

By GARY N. KLEIMAN

Marking its twelfth anniversary of independence this year, Zimbabwe has little to celebrate. The worst drought in a century has created food shortages and a collapse in agricultural exports. With inflation and unemployment above 40%, opposition, both peaceful and violent, has grown against the one-party rule of President Robert Mugabe.

In a bid to reverse economic decline, the socialist-leaning Mr. Mugabe turned to the International Monetary Fund and World Bank for help in late 1990. In exchange for a three-year, $500 million credit, he pledged to enact structural reforms to shrink the budget deficit and increase growth. The poor rains have overwhelmed the adjustment strategy, and the regime has slowed changes when delay will only ensure man-made disaster for years to come.

When Mr. Mugabe assumed power in 1980, he inherited a well-developed industrial and farm sector and an advanced infrastructure for the region. A decade later, a heavy burden of inefficient state enterprises, bureaucracy and corruption has diminished the country from middle to low-income status.

The five-year structural adjustment program launched in 1991 signals the abandonment of socialist policy. To enhance international competitiveness, Harare devalued the currency 45% and removed trade and licensing controls. To improve fiscal and monetary performance, it pared the civil service, freed interest rates and began commercialization of government companies.

The reversal contradicts positions the ruling Zanu PF party has championed in three consecutive elections. Its traditional platform guaranteed education, health care, housing and jobs, all of which have become increasingly scarce.

On the question of land redistribution from large white to small black farmers, however, political leaders remain adamant. Earlier this year, parliament passed a resettlement bill providing for compulsory acquisition of commercial property for transfer to peasant tenants. The arbitrary measure angered foreign donors who were being asked for $1 billion through 1993 to support the Structural Adjustment Program. They nonetheless approved initial funding in a desire to foster a turnaround that could serve as a model for African recovery.

The land confiscation threatens to erode the output of white-held estates, which have spearheaded the country's agricultural strength against an otherwise weak economic background. Even before the drought, many operators decided in an act of defiance not to plant corn, the staple crop, for which they have been poorly paid under price ceilings. As a result, maize reserves have fallen altogether by 90% this year, forcing the government to seek emergency shipments. The imports will swell the balance of payments deficit above $1 billion, while GDP overall will shrink 9% with the loss of farm production.

The contraction occurs as Harare is locked into enormous debt service that already absorbs one-third of the budget. Despite the pleas of business executives, the Finance Ministry refuses to consider privatization as a means to alleviate the fiscal burden and boost industrial efficiency. Thus far, parastatal reform has been limited to raising the price of goods and services to consumers, which stifles needed demand and purchasing power.

On the financial front, interest rates have soared above 40% to keep pace with inflation. As part of a general monetary tightening, the central bank has closed its rediscount window, provoking a liquidity squeeze in the overnight money market. As a result, lenders have scrambled to access restricted offshore credit to meet minimum funding requirements.

Amid the depression-like conditions, the finance minister has also imposed a special 5% drought levy on companies and individuals and raised income tax rates to close an estimated budget shortfall of 10% of GDP. He described such measures as "the only way forward in these difficult times."

Not surprisingly, the Zimbabwe Stock Exchange in the past year has been the worst performer among all emerging markets tracked by the World Bank's International Finance Corp; it has plunged 70% and capitalization has dropped to its lowest in a decade. Only one major listing has occurred during the crash: The former chairman of the state postal and telecommunications monopoly floated a holding company whose shares quickly tumbled on news that his main overseas partner had gone bankrupt.

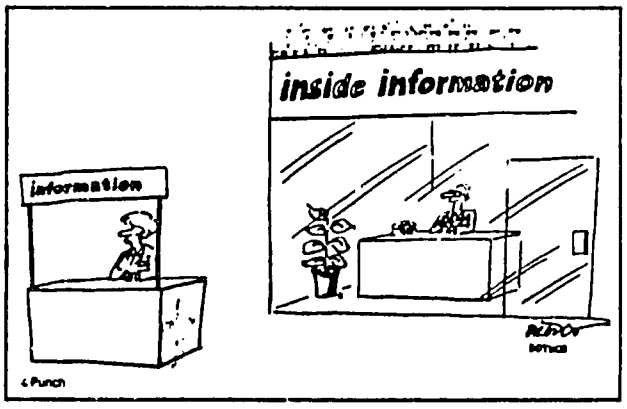
Local media controlled by the ruling party labeled the episode a "typical capitalist fraud." In the mid-1980s, the finance minister had accused the exchange of similar "corrupt practices" and shut it down for several years.

The current erratic course of structural adjustment invites continued questions about the authenticity and sustainability of Harare's conversion to free market-led expansion. Its hesitant stance is a formula for drift and deterioration, which only worsens the economy's vulnerability to drought and other unforeseen events.

Opposition groups like the Forum for Democratic Reform are now calling for a decisive shift to a market economy, while university students loudly protest fees that their families cannot afford. Living standards have fallen below pre-independence levels, and even the staunchest Mugabe supporters have begun to complain that they were better off under the white rule of Ian Smith's Rhodesia.

Mr. Mugabe, looking toward the end of his term in 1996 and his place in history, risks undermining both the economy and democracy with policies that will lead to continued hardship and disappointment. As he did in the fight for independence, he should inspire his people with actions that offer hope for a better future through salutary change and intense commitments. Until the structural adjustment program incorporates these elements, the odds are slim Mr. Mugabe can foster a legacy of prosperity for either his country or the continent.

Gary N. Kleiman is president of Kleiman International Consultants in New York.



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Ghana's Economic Miracle Called a Myth

The West African nation of Ghana has achieved economic growth rates that are among Africa's highest and exceed those of many industrial nations, including the United States and Japan. Ghana's boom began after Jerry Rawlings, a young air force lieutenant, seized power in a 1981 coup. Despite his radical, anti-imperialist rhetoric, Rawlings turned to the World Bank and the International Monetary Fund for help in turning the country's economy around, after two decades of corruption and mismanagement by previous military and civilian governments.

Six years of growth that have averaged over five percent annually has been cited as a factor in Rawlings' decisive win over four opponents in last month's first presidential election in more than a decade. But Rawling's critics say Ghana's economic achievements are not as impressive as the government and its foreign backers have suggested.

The following article by Kwasi Anyemadu, who teaches economics at the University of Ghana, is excerpted from a column published by the *Ghanaian Chronicle* newspaper.

ACCRA, GHANA

by Kwasi Anyemadu

The improved performance of the economy during the rule of the PNDC is the regime's proudest achievement.

There have, indeed, been improvements in the economy in many respects, but the economic situation is not as healthy as government propagandists claim. Sluggish growth in the agricultural sector is evident, so also is distress in the manufacturing sector. There also have been for some time now considerable strains on the macroeconomy, a fact concealed from the Ghanaian public and the world at large by falsification of economic data, or if you are not given to semantic caution, by plain, brazen lies.

Some reading this article will be im-

View Point

pressed by the contradictions inherent in a situation in which a regime, whose leader self-righteously claims that he and his men are the only people of integrity in the land, can be so deficient in candor with respect to matters of such vital importance to the people.

However well placed such moral indignation might be, this is not the main reason I have written this article. The main reason is that, irrespective of whatever short-term, tactical "justifications" there might have been for embarking on this disreputable venture of falsifying data, the efficient management of the economy is now being hampered by the gulf between the published figures and the reality on the ground. As would not be surprising to anybody, the policies which are appropriate are different whether the budget is in surplus, as it is officially claimed, or is in deficit, as is the real case; whether there is an overall balance of payments surplus and addition to reserves, as it is claimed, or whether there is an overall balance of payments deficit and a loss of reserves, as is the case currently.

Let me at this stage say something about the timing of this article. Ever since I became aware of the extent of the data falsification, I have labored under a serious crisis of conscience. Should I expose the falsifications or keep quiet over them and continue to be part of the cover-up? Would the short-term damage to the credibility of the country be outweighed by the undoubted long-term benefits of truth and transparency? During the election campaign, I resisted the temptation, which was sometimes very strong indeed, to speak out because I did not want matters of such national importance to be entangled in the web of partisan contention.

The actual timing of this article has been determined, to a large extent, by considerations related to my work at the University of Ghana. I teach a course on the economy of Ghana, and I know I cannot stand in front of my class and describe to my students a fiscal situation different from what is contained in published documents – national and international – without seeming incompetent.

I do not know when the data falsification or "creative accounting" began. It is possible that in the eyes of the perpetrators, there was some national interest justification. There were credits from the IMF and other donors to draw down. The release of each [disbursement] was, however, subject to criteria in the area of fiscal performance, money supply, credit, balance of payments, etc. It might have seemed that some creative "management" of the data was justified to ensure the continued flow of the vital foreign exchange inflows. At any rate, since the advisability of some of the conditionalities was debatable, not abiding by them in reality probably did not do much harm to the economy.

As this data falsification was done from year to year, however, the fiction depicted in the official statistics departed more and more from reality and came to hinder prudent economic management. For instance, in 1991, there was supposed to be an overall balance of payments surplus of $130 million and an addition to the reserves. In reality, however, there was no addition to the reserves but, on the contrary, a draw-down of accumulated reserves. Nevertheless, the 1992 budget also projected an addition of $140 million to the reserves.

If we had owned up to the true situation at the end of 1991, we could have instituted measures to restrain the demand for foreign exchange. The gap between the real situation and that depicted by the official statistics is even wider with respect to the fiscal situation. Workers and others who demand government expenditures ought to know the truth.

I am confident that if the truth is known to the general public and our collaborators in the multilateral financial institutions, it will inspire the same search for solutions that will arrest the situation and ensure that a sound macroeconomic situation is created on the basis of which accelerated growth may be generated. ■

BY LARRY DIAMOND

'THE SECOND LIBERATION'

Africa is undergoing a deep transformation from autocracy to democracy. But free and fair elections are only the start of building viable democratic structures. Strengthening democratic institutions such as the press and the judiciary, stamping out corruption, managing ethnic diversity, and, most of all, achieving economic growth are imperatives for good governance.

John Liebenberg

Three decades after independence, Africa has reached a critical historical juncture. Two profound historical trends converge to shape the fate of a half-billion people. One is grim. It is what a recent *Time* magazine cover story proclaimed "The Agony of Africa," epitomized by the cover photograph of a starving child crying over a parched land. This is the Africa of war, drought, famine, refugees, AIDS, "tribalism," nepotism, corruption, and economic ruin. It is the Africa of Somalia and Liberia, of Zaire slipping into chaos, of things falling apart.

But there is also a second, much more hopeful trend sweeping Africa today. It is the spread of a new wave of demands for democracy, springing deep from the grassroots of African societies. Since the democracy wave swept into Africa in February 1990, with the national conference in Benin and the release of Nelson Mandela and unbanning of the ANC in South Africa, the number of democratic regimes in Africa has increased from three to nine: Benin, Botswana, Cape Verde, the Gambia, Mali, Mauritius, Namibia, Saõ Tomé and Principe, and Zambia. Particularly striking has been the decline in highly authoritarian states—those which Freedom House terms "not free"—from 34 in 1989 to 21 at the end of 1991 (i.e., from about two-thirds of all African states to two-fifths).

Although it has joined the global democratic revolution quite late, Africa is now the primary arena of regime change in the world. According to Freedom House, of the 24 countries that improved their freedom status during 1991, 13 of them were in Africa. In addition to the nine democracies and the liberal semi-democracy in Senegal, another 20 or so countries in sub-Saharan Africa are experiencing moderate to strong pressures for democratic transition, and several of them (including Angola, Cameroon, Ghana, and Nigeria) may have freely elected democratic governments by the end of this year.

This democratic wave has been dubbed a "second African liberation" for the promise it carries of freeing African peoples from the tyranny, oppression, corruption, and gross misgovernance that have betrayed the promise of the first liberation since the early 1960s. Yet the democratic trend in Africa is still quite partial, fragile, and in many respects superficial. The newsletter of the Carter Center, *Africa Demos*, rates 13 of the 32 African regimes in

Larry Diamond is senior research fellow at the Hoover Institution and co-editor of the Journal of Democracy. *His latest book is* The Democratic Revolution: Struggles for Freedom and Pluralism in the Developing World.

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transition as having only an "ambiguous" commitment to democratization, one that is "at best precarious, at worse a ruse, and at most times, unclear."

Genuine democratization in Africa faces a number of very serious obstacles. To begin at the top, the sincerity of most incumbent African regimes is seriously in doubt. In too many cases, long-time autocrats like Félix Houphouët-Boigny in Côte d'Ivoire, Omar Bongo in Gabon, and Daniel arap Moi in Kenya appear intent on offering the form of democracy—elections—without the full press freedom, rule of law, administrative autonomy, and procedural guarantees that would render those elections free, fair, and meaningful.

Only truly free and fair elections can bring democracy. And as the experiences in Zimbabwe (1980), Namibia (1989), Benin (1991), and Zambia (1991) attest, international election monitoring can play a crucial role in strengthening the integrity of electoral institutions, deterring fraud and violence, promoting participation, and enhancing the legitimacy (internally and internationally) of the electoral process. The Zambian experience is also important as the first instance of large-scale domestic vote monitoring, which trained and placed more than 3,500 Zambians at polling sites around the country.

The international community has done much to stimulate democratization in Africa, and there is much it can do—if it is sincere—to see that democracy succeeds. The first imperative involves elections. Unless international donors insist on fully free and fair elections—monitored, as in Zambia, by both domestic and international observer teams, and bolstered by open, autonomous electoral procedures and a free press—democracy is unlikely to be forthcoming. International donors must also provide adequate funding and technical assistance for effective electoral administration and monitoring.

This is only a beginning. Even when elections are democratic and transfers of government occur, the new regimes inherit a weak institutional framework for democracy. Government bureaucracies may lack both managerial competence and sensitivity in responding to newly mobilized democratic publics. Legislators lack the staffs, resources, and experience to investigate and monitor the conduct of the executive branch. Judges, prosecutors, law schools, and human rights organizations are short of training, experience, and resources as they seek to construct a genuine rule of law. Newly elected local government officials need the training and staff support to function as a meaningful tier of govern-

ment, and the one closest to the people in a democracy.

These are great challenges of democratic institution-building. Increasingly, Western NGOs and democracy-assistance organizations are becoming engaged with them, but not on the scale that will be needed. These types of political assistance for democracy are currently so modestly funded (and yet so cost-effective) that support for them could easily be doubled or tripled within a year or two while hardly straining the budgets of Western governments.

Fair, legitimate elections, and stronger political institutions are essential, but they are not enough. Democracy, however authentic, does not ensure its own survival. Democracy must produce; it must govern. Missing from the first African liberation was not only real democracy in many cases, but also good governance—effective, responsive, and accountable management of public affairs. Good governance has been a major reason for the success of the only continuous democracy on the African continent since independence, Botswana. The new and aspiring democracies of Africa today will not make it unless they perform markedly better than their predecessors.

While strengthening democratic institutions will help to improve the effectiveness and responsiveness of government, it will not necessarily enhance accountability. For this task, press freedom and an independent judiciary are essential. Unless the press is free to expose wrongdoing and condemn abuses, there is little chance that official structures will muster the courage to act. Unless the judiciary is free from political pressure and manipulation, it will not be able to punish wrongdoing.

As with the judicial system, much can be done by the international community to strengthen the experience, professionalism, and resources of the independent press. Training in the general skills and standards of journalism, and in the specific techniques of investigative journalism, must be a high priority for improving accountability. With the explosive growth of independent publications in Africa, a serious effort would require advanced training for about 200 or more African journalists every year. This would require major investments in regional centers of excellence within Africa.

Given the pervasiveness and profundity of political corruption in Africa, radical new measures will also be needed to monitor the assets and conduct of public officials, investigate possible violations, and impose harsh penalties on corrupt officials. These "code of conduct" structures must be thoroughly autonomous—not made responsible to the executive or legislature branches they are to scrutinize. Nigeria has shown in its Second Republic and again in its unfolding Third Republic how the lack of autonomy and resources can utterly vitiate what seems on paper an elaborate and far-reaching code of conduct apparatus.

Because large-scale corruption—the kind that has been bleeding African treasuries dry—involves huge international payments and cash transfers, an international response is essential. This is now taking shape, in part, through a private initiative, Transparency International. Supported by a number of major international corporations and NGOs, it seeks to secure broad support from business and governments for a standard of conduct to promote transparency and accountability in international business transactions, to assist all parties to comply, and to investigate serious violations of the standard.

This mobilization of private actors for accountable government is a major step forward. But it needs to be strengthened by the development of non-governmental corruption-monitoring organizations within each African country. In a number of African countries, a viable basis for such groups now exists in civil society. Human rights and election monitoring organizations, as well as the informal coalitions of student, trade union, religious, environmental, and professional organizations that have toppled dictatorships, all have the potential to perform this role. They have the will, for they represent the first instance of popular groups coherently mobilizing in pursuit of the *public* interest, rather than the special interest of contending parties, factions, communities, or classes. What they lack are the training and resources, and these are what the international community can help to provide.

Staffed with well-trained lawyers, accountants, and investigators, and large numbers of educated and dedicated citizens, such corruption-watch organizations can break new ground in independently monitoring the assets of public officials; reporting evidence of bribery, suspect contracting, misuse of government assets, and unaccountable wealth of public officials; educating the public about the need to combat political and administrative corruption; and lobbying for changes in the law to enhance accountability.

Democratic governments in the West can also help to close off the huge movements of ill-gotten cash from Africa into their own banks and investment houses through a very simple device. As a condition of official assistance, they can require that all high-level African officials (presidents, ministers, legislative officers, central bank governors, etc.) sign a statement granting permission to any foreign bank or real estate or investment house to disclose any and all personal assets they may hold. Breaking this veil of secrecy is crucial if assets declarations are to be verified and accountability enforced. Western governments can blunt charges of "neo-colonialism" and set an example by requiring their *own* high officials to sign the very same release, underscoring that there are, increasingly, international standards of conduct to which all democratic officials must be held.

There are many other dimensions to good governance in Africa today. Space does not permit a comprehensive review, but two substantive challenges will clearly be paramount: managing ethnic diversity and regenerating economic growth. How can the international community assist Africa with these two imperatives for democratic development?

Ethnic peace in a democracy requires power-sharing and respect for group rights. As with many other dimensions of good governance, this is difficult to impose from

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the outside. But international donors can make it clear that they value power-sharing, minority rights, and broad distribution, and that regimes which blatantly violate these principles of ethnic conflict management will suffer in the distribution of official assistance.

In addition, Africa needs to do a better job of understanding and evaluating its great variety of institutional innovations and experiments. A regional Center for Federalism and Ethnic Conflict Management, perhaps sponsored by the OAU, would be an important step in understanding and disseminating around the continent what kinds of institutions and practices are most effective in managing ethnic diversity democratically.

Ultimately, the new democratic regimes will live or die on their economic performance. Already, Western pressure to adopt and maintain structural adjustment programs is bitterly controversial. Most economists agree that there is no alternative to structural adjustment; African economies simply will not develop if they defy the elementary laws of supply and demand. But how can structural adjustment, which imposes so much short-term pain on African societies, be reconciled with democracy, which requires that policies be responsive to the will of the people? This is perhaps the most poignant dilemma confronting the future of democracy in Africa.

If structural adjustment is to remain viable in Africa's new democracies, important changes will be needed, in both the short- and long-term. In the short-term, more aid is needed, both to relieve the massive, unpayable debt burdens and to cushion the pain of structural adjustment with programs of relief that do not undermine the market-oriented logic of structural adjustment. The sad political reality of the "New World Order" is that large amounts of new aid are simply not going to be forthcoming for Africa. But even with modest aid increases, a new bargain can be struck, with the following key elements:

- Debt repayments should be suspended altogether for those African countries that meet international standards with respect to democracy, accountability, and economic reform. The debt moratorium should hold as long as a country remains seriously committed to these goals. In addition, a country's debt might be permanently written off at the rate of 10 percent a year for each year it qualified. This would reinforce the above incentives, while rewarding with permanent debt reduction only those countries that stick with democracy and economic reform.
- Broad economic conditionality for aid should continue, but countries should be given much more flexibility in how they sequence and implement the basic goals of structural adjustment. Western and multilateral donors should avoid the arrogant and sanctimonious attitudes that so greatly aggravate the tensions surrounding conditionality. A little empathy would help.
- A new "political adjustment fund" should be established to help African governments cope with the social and political dislocation caused by structural adjustment. This would provide funding for poverty relief programs, and special development aid to improve public infrastructure and schools. This new assistance should be concentrated on those African regimes that have shown the most serious commitment to democracy, accountability, and economic reform.
- A new "democratic investment fund" should be established to encourage, facilitate, and help to ensure private, job-creating business investment in those African countries that meet the conditions for debt moratorium described above.

This is, to be sure, a tough bargain. It heightens conditionality, especially with respect to democracy and governance, but offers in exchange significantly greater political and economic assistance for those countries that meet the conditions. Many will object that the West has no right to impose such conditions, and that many African countries will not meet them. But Africans must face the reality that large, new unconditional aid transfers or debt cancellations—not to mention "reparations" for the African slave trade—are simply not in the cards. Unless Western publics see that their aid dollars are going to democratic and responsible governments, it is going to be difficult to maintain existing aid levels, much less to increase them.

Concentrating additional assistance on those governments that are serious about democratic governance offers the hope that the next decade of African independence will produce what the first three decades (with one or two exceptions) did not: some genuine African success stories. Every African democracy that turns the corner on economic reform will become a model and inspiration to its neighbors.

In the long run, the democratic pursuit of economic reform requires a much stronger intellectual and policy infrastructure, one which understands why market-oriented strategies offer the only hope for sustainable economic growth and which can articulate and distill that understanding for a wider audience. This requires the training of financial and economic journalists, of economics professors and teachers, of a new generation of economic technocrats, and the development of think-tanks and research centers sympathetic to democracy and market reforms but concerned to investigate how economic reforms can best be implemented in the African context.

This is, for the most part, a modest and long-term agenda. While it offers some new economic assistance in the short term for those countries most strongly committed to democracy and economic reform, its main emphasis is on political and economic institution-building. Its crucial training and institution-building components could be dramatically advanced for a cost of $100 to 200 million annually—a tiny fraction of what the West now spends on aid to Africa.

Everyone in the development business knows that building institutions is a slow and uncertain task. But if there is one lesson learned from the past three decades, it is that Africa will not develop economically unless it develops institutionally a capacity for democratic governance. With that capacity, the promise of Africa's second liberation will not be wasted. Without it, all the aid in the world will not suffice. ○

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News

Food Aid Keeps Millions Alive

MAQUEZE, MOZAMBIQUE

by Jennifer Griffin for Africa News Service

Women and children in tattered rags emerge from the surrounding bush to watch as a Red Cross plane loads sacks of food from this Mozambique air base. Red Cross trucks shuttle back and forth across the sandy airstrip, filling the plane that will fly 62 miles (100 kilometers) north into an area held by the rebel movement Renamo.

In an old farm warehouse next to barracks for government troops, Red Cross aid worker Christopher Wieser has organized another food distribution, this one for people from nearby villages. "We have to feed both sides," says Wieser, whose organization is the only group delivering food to Renamo territory.

Hundreds of barefoot, dusty people stand in the shimmering heat in a line that snakes around the warehouse. A man with a stick makes sure the crowd stays orderly. Waiting children play a cat-and-mouse game with him, laughing as he chases them away. A small boy in the line wears blue rubber boots. Although there's been no rain, the soles protect his feet from the hot sandy soil.

Women with babies strapped to their backs collect parcels that appear too heavy for them to manage on the long walks back to their homes. A few men wearing leather shoes stand alongside their wives and daughters, but even in those groups, women carry most of the loads. A blind woman with a walking cane hoists a bulging bag of corn meal onto her head without any assistance and heads back towards her village of Aito Changane, about a 5-mile (8-kilometer) walk away.

"Most men are in the army, in South Africa or dead," says Wieser.

The 16-year war waged by the rebel movement has killed over a million people and wrecked the country's infrastructure. Farmers were forced off their land by looting and attacks from both Renamo and government troops. Migrant work in neighboring South Africa is one of the few ways to earn income.

For many of Mozambique's people, a second year of drought has made an already desperate situation worse. Emergency food aid to the country has doubled this year. By the end of December, humanitarian groups expect to have distributed 400,000 tons of food to 3.1 million people, according to John Yale, director in Mozambique for World Vision, the California-based aid agency.

"As we speak, stocks are very low," says Joe Kessler of CARE, the U.S. agency that has coordinated the Mozambican government's relief effort. "But in the next five weeks, 160,000 tons are coming in."

The lack of an independent ability to sustain themselves has created almost total dependence on foreign aid. As though embarrassed by their plight, hungry people stream past aid workers, accepting their food parcels with barely a nod of acknowledgment.

"These people are ready to continue what they were doing before – farming," says Felice Dindo, head of the International Red Cross operation in Mozambique. "But this drought is pushing everyone to the cities." Shantytowns built of sugar cane have sprung up in every urban area where food may be available.

Dindo and other aid workers say that without the devastation from the war, most Mozambicans could have survived the drought. Being forced out of their villages means not being able to take advantage of any rains that come this year. "It's useless to give people seeds when they have no fields," Dindo says.

Sometimes the Red Cross center at Maqueze runs out of food before everyone receives a ration, but there are no signs of panic among those waiting their turn. People here, within reach of help, are among the fortunate ones in this war-ravaged land. "They know there is food coming," says Wieser, who pays his employees food for their work. "We'll probably run out today, but they know there will be more tomorrow." ■

AFRICA NEWS, October 26 - November 8, 1992

Okavango Fence Stirs Botswana Storm

GABORONE, BOTSWANA

by Peter Warren

Plans to complete a buffalo fence around Africa's last great wilderness, the Okavango Delta in Botswana, have caused a storm of protest from environmentalists and local people who cannot agree on its site.

At issue is the Okavango Delta itself – 5,800 square miles (15,000 square kilometers) of unique wetland and the world's largest inland waterway. The area supports a greater diversity of animals than virtually anywhere else on earth due to the concentration of habitats ranging from Kalahari sands, lagoons and forest and scrub, flood plain, and reed bed.

The fence – five strands of wire and one line of steel cable capable of withstanding a lateral impact of 25 tons (enough to stop a charging buffalo but not an elephant) – loops around the delta to the south and aims to close in the top before swinging on a meandering course up to Botswana's northern border.

Its ostensible purpose is to prevent contact between the buffalo of the delta, which carry foot-and-mouth disease, and Botswana's 3 million cattle. But its opponents see many other reasons for its construction.

The installation of the first stage of the 140-mile (226-kilometer) northern buffalo fence has become a bitterly divisive issue among environmentalists, big game hunters, locals and the Botswanan government, oddly provoking accord in some cases between usually opposing groups all wanting to dismantle the four-foot-high fence.

The depth of the passion is due to cattle. Botswana is cattle country and "buffalo fence" is a misnomer for cattle fence.

ter resources pouring into the Okavango Delta have long been a source of dispute between cattle and wildlife – a dispute temporarily settled in the wildlife's favor by the invasion of the area by the tsetse fly after 1825.

But with the country's cattle population at the limit of the land's capability to support it, the pressure on the delta as a wildlife and water resource is immense. For Botswana, cattle is big business. "They are money in the bank as far as Botswanans are concerned," says Seeido Liphuko, the country's secretary of natural resources.

Some 684,000 of Botswana's 1.5 million people are involved with beef and a further 456,000 want to be. The result of such belief in cattle in Africa's most stable democracy is that "cow power" is an enormous political factor. It is also one that could be considerably amplified in the event of a drought, according to Rick Lomba, the fiercest and most vocal critic of Botswana's conservation policy and its plans for the delta.

Pressure on the government to open up the Okavango is growing because the delta, whose headwaters are in Angola, where rains have been good, is at its highest level in 20 years. This has resulted in an almost mile-wide natural barrier to the cattle at a time when the rest of southern Africa is suffering a disastrous drought that is decimating Botswana's southern areas.

A U.S. citizen, filmmaker and conservationist living in South Africa, Lomba is a one-man crusade who lobbies the U.S. Congress and the European Community with his claims that Botswana intends to turn the delta into a giant ranch to the advantage of the cattle and to the detriment of the wildlife.

the difficulty of maintaining it in a swamp and the problems of joining a section that runs through perennial marsh, want it removed while an independent environmental impact assessment examines its effects on wildlife.

The reception of Lomba's views in Washington and the European Community headquarters in Brussels has been sufficiently sympathetic to prompt the Botswana government to finance a fact-finding team to study placement of the fence as well as Lomba's claims that it prevents migration of wildlife and the traditional use of parts of the delta by hunter-gatherers.

The real bone of contention lies in the Selinda Valley. Inhabitants of the rapidly growing villages of Beetsha and Seronga, which lie 25 miles (40 kilometers) outside the fenced delta, claim they are being denied access to traditional grazing areas. Safari organizers and conservationists claim that an area of great importance to the ecology of the delta is being threatened. Conspiracy theorists see a plot to provide cattle with access to 695 square miles (1,800 square kilometers) of land to the east of the Okavango River, giving commercial owners plentiful grazing along the banks and access to water.

As a result, the fence has been given as many proposed routes as the Channel Tunnel rail link between Dover and London, with conservationists arguing for a more northerly line, cattle farmers arguing for its siting further south, and Lord Wilmot of the local safari lobby demanding that it include the whole Selinda Valley to protect the river from over-grazing.

Cattle can only travel a maximum of about 7.5 miles (12 kilometers) from a water source and their wide mouths consume vegetation that otherwise could support a great diversity of wildlife.

Environmentalists recognize that with a projected explosion in human population, demands on land will increase. What they don't accept is the government's interpretation of where these various inter-

views were ignored by the government. "Visit the fence and you'll see destruction of giraffe and animals of the earth of all sorts," says one man, echoing the claims that the fence is interfering with wildlife migration routes – a charge that the Wildlife Department denies.

Though Seronga's villagers claim to understand the compromise and the need to conserve wildlife, they also hint at the political questions that lurk behind the issue of the fence. "Because of our democratic tradition, we think it should be a decision of the majority that decides where this fence goes," says the local councilor. His colleague, the village chief, is similarly political in his response. "All developments must look at the figures with regard to the population of people, wildlife and cattle. There should be a balance between us, but the balance should bear in mind our children and their need for space, for food and housing."

At Beesha, views on the fence are more forthright. An area which had reverted to hunting and gathering after the expansion of the tsetse fly, its people now participate in the cattle invasion which has pushed numbers from 3,000 to 15,000 in less than a year.

"We have been oppressed by the government in the siting of this fence. Most of the food that we gather is beyond the fence, so it is preventing us getting to it," says one resident. Among the chief criticisms of the Tshomarelo Okavango Conservation Trust is that fences create boundaries for people as well as animals. This point is conceded by Wildlife Director Nigel Hunter, although he maintains that rights laid out in the government's Land Use and Development Plan for the Okavango will solve the problem.

But another resident, who admits that he is a recent big cattle owner, stated the future pressures on the fence more clearly. "I'm worried that the grazing land will decrease. We are not against wildlife, but what we are saying is give cattle a fair chance in the grazing area. If you make the decision to remove cattle

First Cameroon Elections Marred By Fraud Charges

ABIDJAN, CÔTE D'IVOIRE

by Cindy Shiner ■ Africa News Service

Allegations of fraud in Cameroon's first democratic presidential election have thrust the central African country into renewed political turmoil, while its president of ten years appears poised for a new term.

Opposition leaders have accused the government of President Paul Biya of rigging the October 11 elections, and U.S. observers said there were "serious problems" with the conduct of the vote.

The Supreme Court rejected petitions by the opposition to annul the elections and the government has recalled its envoy to the United States, accusing Washington of meddling in Cameroon's internal affairs. Although they were not invited by the Cameroon government, 19 observers from the National Democratic Institute for International Affairs monitored the elections.

On October 21, the leading opposition candidate John Fru Ndi said an unofficial count of returns by his own Social Democratic Party showed that he had won more votes than the president. "Let the Biya regime know that we are ready to fight to the last m[illegible] to ensure that our victory is not stole[illegible] warned in what he called a "victory speech."

The government court put Biya ahead of Fru Ndi by about 200,000 votes, out of 2.8 m[illegible] votes cast. Neither candidate claimed to receive over 50% of the ballot, but election rules say the top vote getter can win with less than a majority. All results remained unofficial pending confirmation by the Supreme Court on October 25.

In response, angry opposition party officials withdrew from the vote commission to protest the government court.

"The results they are going to announce have already been decided," said Dorothee Kom, spokeswoman for Fru Ndi. "It is only a masquerade." She accused the government of loading the commission in its favor, giving 11 of the 13 seats to representatives from Biya's southern home region.

The state-run media contend the voting was fair and quoted U.S. observers as saying they were satisfied.

But the leader of the observer mission, James Tierney, denied the report. Among irregularities the group cited were Biya's hasty calling of the election, the government's refusal to reopen voter registration, last-minute changes to electoral laws to favor Biya and questionable validity of some voting cards.

Observers also said the government monopolized the official media for its campaign. They cite the example that Biya used 142 minutes of air time on the eve of the election, although all five opposition candidates had only 12 minutes combined. Biya also broadcast a campaign speech in French and English – Cameroon's official languages – the Sunday morning of the election when campaigning officially ended at midnight Saturday.

After the elections, Biya was embarrassed by the resignation of one of his ten provincial governors. George Achu Mofor, the brother of Biya's prime minister, quit as governor of the eastern province, charging that members of the ruling party, the Cameroon People's Democratic Movement, pressured him to falsify results. He also criticized the government's human rights record.

Cameroon is among dozens of African nations whose governments have yielded to cries for democracy over the past three years by legalizing opposition parties, holding national conferences or scheduling elections. The ethnically and ecologically diverse country is a microcosm of the continent, and its neighbors look to Cameroon for clues as to what they themselves could face as they prepare for the first free votes in their own countries.

Cameroon has colonial ties to Germany, France and Britain and is home to at least 200 separate ethnic groups, each with its own language. But within that diversity are divisions that prevented the opposition from uniting behind one candidate and consolidating its power against Biya. Five opposition candidates competed against him in the race for the presidency, and others dropped out at earlier stages.

Some opposition leaders called for a boycott of March's legislative elections, but not all of Biya's opponents followed suit.

Biya's two leading contenders were Fru Ndi, a 51-year-old bookstore owner, and Bello Bouba Maigari, 46, who once served as prime minister under Biya. Fru Ndi comes from English-speaking western Cameroon, and Maigari is popular in his native, and largely Muslim, north.

Biya was forced to legalize opposition parties last year after strikes and unrest left dozens dead. However, he refused to allow installation of a transitional government to oversee the election process.

The president was not always so controversial. Cameroonians cheered him when he succeeded authoritarian President Ahmadou Ahidjo in 1982 and promised to bring democracy. But his popularity began to decline after he cracked down on dissent following a 1984 coup attempt.

Further damaging his image were the country's economic woes. Economic growth had averaged eight percent into the 1980s, but world market prices for Cameroon's oil, cocoa, coffee, cotton and timber tumbled, and by 1988 the gross domestic product was falling as well. More than one-quarter of Cameroon's workforce was unemployed last year. ■

'Hairy Potato' and 'Super Cassava' Boost Crop Yields

New varieties of potato and cassava could help farmers in the developing world step up food production and reduce the use of dangerous chemical pesticides.

The "hairy potato" and the "super cassava" both won recognition on October 26 at the annual meeting of the Consultative Group on International Agricultural Research (CGIAR), held in Washington.

The hairy potato, which earned its name from the hair-like trichomes on its leaves, traps and kills pest insects as they try to eat or reproduce. CGIAR scientists said the new venus-flytrap-type potato could save the developing world much of the $300 million it spends each year on insecticides in potato production.

CGIAR honored the hairy potato's developer with its bi-annual King Baudouin International Agricultural Research Award for 1992. The International Potato Center (CIP) in Lima, Peru, shared the prize with Cornell University which helped develop the new variety.

The hairy potato's potent resistance to insects comes from its breeding with wild potato species that have high densities of trichomes. It is the first recorded instance of a wild species being used to produce an insect-resistant potato for human consumption.

The potato fends off a wide range of insects that rob developing world farmers of crops each growing season. Field testing in various countries have shown it resists everything from mealybugs to the Colorado potato beetle.

The hairy potato's developer, CIP, has led an international effort to develop safe, alternative pest-control practices for farmers since the early 1970s.

The CGIAR also praised recent advances in breeding of the super cassava, which scientists say could make it easier for Africa to end food shortages in some parts of the continent.

The high-yielding, drought-resistant cassava variety could double or triple current output in drought-prone areas of sub-Saharan Africa, CGIAR researchers said. The super cassava earned its name from its multiple sets of chromosomes which permit high yields.

Officials at the International Institute of Tropical Agriculture (IITA) in Ibadan, Nigeria, the super cassava's developer, said the new variety of root crop could boost African cassava production from the current 12 tons per hectare to 40 tons per hectare.

A native crop of Brazil, cassava is the world's most important root and tuber crop after potatoes. It is the main staple of over 200 million Africans and is grown extensively across Africa, from Senegal to Mozambique, but thus far only in limited areas of Southern Africa, which has been stricken by drought during the past year.

IITA officials said the cassava, an ideal crop for smallholder agriculture and semi-arid conditions, could help supplement Southern Africa's main staple crop, maize, in drought-stricken areas. □

World Bank photo/Y. Haider

African farmers, like this planter in Mali, could boost food production with new varieties of potato and cassava.

CGIAR Meets Funding Goals

The Consultative Group on International Agricultural Research (CGIAR) expects to come close to meeting its funding goals for 1993, according to a statement released by the World Bank-sponsored organization after its annual Washington meeting on October 30.

CGIAR also announced plans for a new research center, accepted a new member and solicited action to save threatened collections of plant germplasm in the former Soviet Union and Eastern Europe. It also stressed the congruence between CGIAR's goals and those of the United Nations Conference on Environment and Development's Agenda 21, the global action program for environment and development.

Several of the group's donors were not yet able to announce their precise pledges towards the funding requirements for 1993. But the CGIAR secretariat estimated the total of contributions to range between $254 million and $264 million of core program funding against total core requirements of $264 million.

The group accepted an offer by Indonesia to host the new Center for International Forestry Research (CIFOR) which will become CGIAR's 18th center and perform forestry research for developing countries. CGIAR also accepted Indonesia as a new member, bringing the number of developing country members up to eight of 30 member countries in the group.

CGIAR is an informal association of some 41 public-sector and private-sector donors jointly supporting a network of 17, soon-to-be 18, international agricultural research centers. The World Bank co-sponsors CGIAR along with the U.N.'s Development Programme and Food and Agriculture Organization.

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ERITREA

BY CAMERON McWHIRTER
AND GUR[illegible]LAMEDE

BREAKING AWAY

Eritrea will likely become the first country to secede from an independent African country after a UN-sponsored referendum in May. But after 30 years of war, the task now for the victorious Eritrean People's Liberation Front is to transform itself from a guerrilla army that governed large sections of the province into an administration dedicated to rebuilding the economy, repairing shattered infrastructure, absorbing hundreds of thousands of returning exiles, and attracting foreign investment.

This rainy season, Eritrea's highlands have been drenched with heavy downpours for the first time in years. Superstitious Eritreans have taken it as a good omen for the territory's approaching independence.

"People say that the rain was afraid of the bullets," said Asmerom Yosef, 34, a former refugee who returned to Eritrea after fleeing the civil war at the age of 18. "People say God was a refugee and has returned."

Yosief Tedla, 42—once a guerrilla, now a judge—stood in an Asmara street as ankle-deep water rushed past. "This doesn't ever happen," he said smiling. "We are flooded."

The rain, in contrast to decades of drought in parts of the territory, is welcome news as Eritrea prepares to become the first nation to ever successfully split off from an independent African country. Residents have labelled this burgeoning period "Dagmehntsa," which means "The Rebuilding" in Tigrinya, the dominant language.

Where secessionist efforts like Biafra (in Nigeria) and Katanga (in Zaire) fa[illegible] Eritrea—a trumpet-shaped ter-

ritory along the Red Sea—has succeeded after three decades of war. "Peace has finally come," said student Qalias Kiros, 22, as he walked along Liberation Avenue, Asmara's bustling main street.

Last year, Eritrean rebels overcame staggering military odds, defeating well-equipped Ethiopian troops and seizing Asmara. Meanwhile, Ethiopian rebels allied with the Eritreans took over Addis Ababa and overthrew dictator Mengistu Haile Mariam.

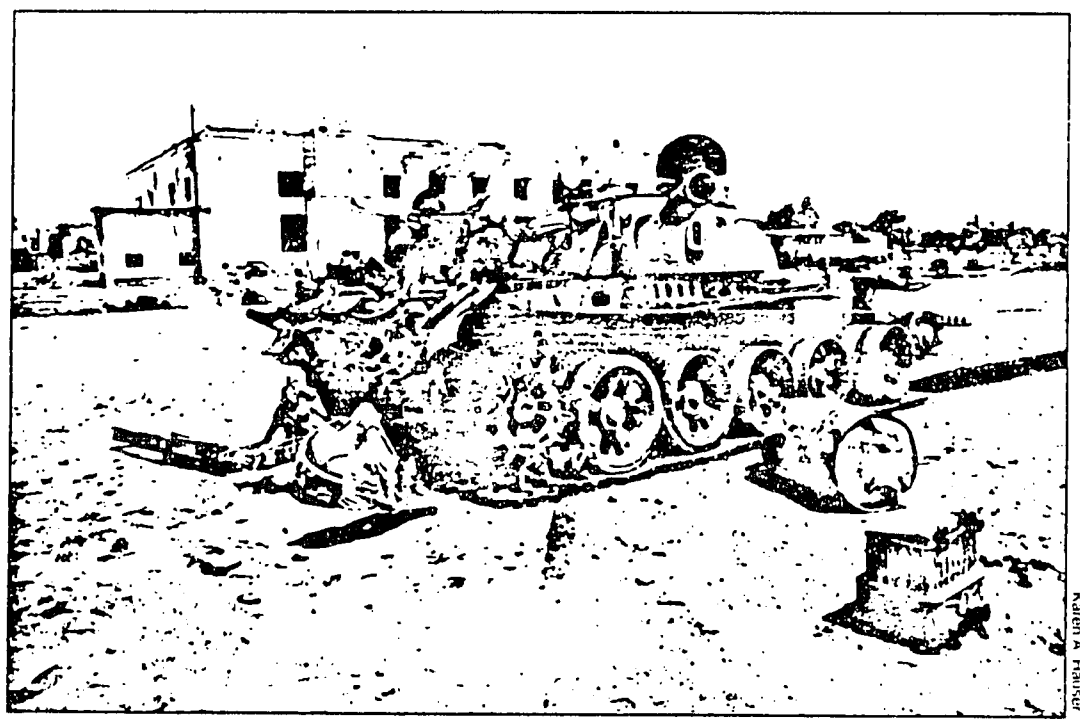
In a peace agreement worked out with the help of U.S. Assistant Secretary of State Herman Cohen, Eritrea has put off formerly declaring independence until voting in a United Nations-sponsored referendum scheduled for May 1993. No one doubts Eritreans will choose to break away from Ethiopia. "It's a done deal," said one Western diplomat.

But for the victorious Eritrean People's Liberation Front, the hard-won independence has brought about a new set of peacetime problems, including rebuilding a shattered economy, handling the return of war refugees, and walking a diplomatic tightrope in the volatile Horn of Africa.

"It's very fine to fight in the mountains against an enemy for years and dream of what you want," said Stephanos Danyon, a New York University-educated engineer who heads economic planning for the new government. "But it is another thing to have victory and begin to implement those things you have been dreaming about."

The biggest task facing the provisional government is rebuilding its shattered economy. For years, EPLF economists in mountainous rebel strongholds drew up plans for a future Eritrea. But actually taking over Eritrea's economy was a crash course in realpolitik, according to Stephanos.

Only 44 factories existed when the EPLF took over—and none of them were operating. The territory's key port of Massawa was crippled from the heavy fighting. Roads, bridges and railroads had all been damaged in the war. In addition, Mengistu had spent almost no development aid during his 17 years in power. In a territory where 80 percent of the population are farmers or nomads, years of drought and heavy fighting left many without any means of support.



"I don't think you can talk seriously about development now," Stephanos said. "We are in a recovery stage."

But here in the capital, signs of "Dagmehntsa" are everywhere, from freshly painted and repaired villas to new stores. Tekie Beyene, who heads the new government's investment center, said international companies have been asking about potential purchases throughout Eritrea. He said several oil companies have expressed a keen interest in building tourist hotels on some of the 200 islands Eritrea now controls in the Red Sea.

Tekie said the EPLF's goal is to hand everything over to the private sector, with the exception of private utilities and the ownership of mines. This attitude has attracted the attention of the World Bank, which sent its first delegation to Asmara in late August. "The idea is to privatize everything," he said.

Eritrea has also come out of decades of diplomatic isolation. For years, the EPLF fought against Ethiopia with almost no foreign support. With the exception of Sudan and some Scandinavian countries, no nation provided any substantial assistance to the EPLF or drought-relief efforts in the territory it controlled.

Since the takeover, world opinion has decidedly warmed. Saudi Arabia, Italy and other governments have already set up embassies. Although it does not officially have an embassy, the United States sent its first representative last month and opened an office of the Agency for International Development.

But diplomatic traps abound for the new country. Strategically located on the Red Sea across from the Arabian peninsula, Eritrea will now carefully choose its alliances. Its neighbor, Sudan, is trapped in a bloody civil war. Nearby Somalia has disintegrated into civil war and mass starvation. Ethiopia, once Eritrea's powerful ruler, appears to be slowly unraveling with ethnic rivalries. So

Cameron McWhirter is a reporter for Gannett Newspapers and Gur Melamede is a freelance reporter and photographer.

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THE THIRTY YEARS' WAR

Modern Eritrea is a fabrication of the Italians, who established it as a colony in 1890. During the second World War, British troops took over the territory. However after the war, Ethiopian Emperor Haile Selassie—an ally of Britain and the United States—claimed Eritrea as part of "mother Ethiopia."

After much debate, the United Nations set up a "federation" between Ethiopia and Eritrea. Increasing friction between the Emperor and Ethiopia led in 1961 to guerrilla war. In 1962, Selassie ended the federation by annexing Eritrea and proclaiming the territory Ethiopia's 14th province.

Under Selassie, as a means of assimilating Eritreans, local languages were banned and replaced with Amharic, Ethiopia's official language. Political organizations and trade unions were disbanded. Political leaders were arrested.

Fighting by various Eritrean rebel groups escalated throughout the 1960s. At that time, Ethiopian troops were armed with U.S. weapons and trained by U.S. and Israeli advisers. The U.S. set up a major military base outside of Asmara called Kagnew Station.

After the U.S.-backed Selassie was overthrown in a coup, Eritrean rebels almost took over the territory in 1977. However, the Marxist dictatorship of Mengistu Haile Mariam and its ruling council known as the Dergue—with the aid of the Soviet Union—drove the Eritreans back into the mountains.

Mengistu was accused of imprisoning and killing thousands of young men and women suspected of aiding the rebels. Huge offensives, using napalm and cluster bombs, were launched against rebel strongholds in western Eritrea.

In 1980, conflicts between the two main rebel groups, the EPLF and the Eritrean Liberation Front, erupted in civil war. The ELF collapsed and its remnants fled to Sudan. From that point on, the EPLF began a protracted guerrilla war from secure mountain bases near the Sudanese border.

Throughout the 1980s, heavy losses terminally weakened the demoralized Ethiopian army. At the same time, Mikhail Gorbachev became disenchanted with Mengistu and the increasingly expensive cost of keeping him in power. As Soviet military aid dwindled, the rebels steadily gained ground throughout Eritrea while Ethiopian rebels marched on Addis Ababa. Eventually, the Ethiopians controlled only Asmara and the port of Assab.

Under siege in the capital since 1990, a major portion of the Ethiopian army completely collapsed in 1991. Thousands of soldiers died in a desperate attempt to escape the drought by fleeing on foot to Sudan. Assab was taken by the EPLF two days later. The war was over by April 1991. ■

—C.M. and G.M.

far, EPLF leader Assayas Afwerki has stressed a strict neutrality in meeting with visiting diplomats.

Another huge problem facing the EPLF is dealing with estimates of as many as 1 million refugees living outside the territory. Only 3.5 million people live within Eritrea.

During the long years of fighting, an Eritrean diaspora spread across the globe. The 1984-1985 famine exacerbated the situation, driving thousands into Sudan. Today, United Nations officials estimate 250,000 to 500,000 live in Sudan's eastern region and in the capital, Khartoum. Thousands more are scattered throughout Ethiopia, the Middle East, North America, and Europe.

With the end of the war, these refugees—some of whom have been away for more than 20 years —have been coming home from as far away as New Zealand. The return has already begun to tax services. The antiquated telecommunications office has been working far beyond capacity, taking 20,000 to 30,000 international calls a night. Medical supplies have become sparse with increased demand outstripping supply.

Fighters of the Eritrean People's Liberation Front standing in front of the landmark Catholic cathedral in Asmara, the capital of Eritrea

The provisional government has begun the tortuous task of determining who is an Eritrean, a nationality that has never before existed. Thousands of exiled Eritreans have taken other nationalities through intermarriage and other means. Many have raised children entirely in developed nations.

"I would like to come back," said Tekeste Yohannes, visiting from his new home in Calgary, Canada. "Eritrea is my home. But my daughters, they cannot believe it here. They speak only English and listen to rock music. For them it is another planet."

Clamping down on national origin has already caused friction with neighboring Ethiopia, when EPLF officials expelled Ethiopians from its cities. Many have complained that they were married to Eritreans and claim the new citizenship. "Who is an Eritrean?" asked one U.N. official. "It's a real headache."

The EPLF faces many new headaches. But with seemingly strong support from the populace and growing recognition from the international community, the new government is cautiously setting up the new nation it fought so hard to realize.

"If we learned anything during the struggle, it is patience and relying on ourselves," Stephanos said. ○

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WASHINGTON
ECONOMIC
WATCH

A Digest of Development Policy Information

1875 Connecticut Ave. NW Suite 1012 Washington, DC 20009

(202)234-8701 fax (202)745-0067

FALL/WINTER 1992
ASIA

January 22, 1993

Dear Readers:

Welcome to the first edition of the 1993 series of Washington Economic Watch. We are pleased to announce that funding has been reinstated and quarterly production will resume in 1993. As in previous issues, WEW covers the important economic policy debates in Washington. This inaugural edition provides insight on issues of concern to developing countries, as monitored during the pre-election and transition period in autumn of 1992.

Herein you will find statements made by senior U.S. government officials, summaries of U.S. congressional hearings, press commentary, and excerpts from policy research and analysis published by Washington 'think tanks' and multilateral financial institutions. The material is organized according to six functional categories; within each are subject groupings, with policy statements generally appearing first and commentary and analysis following. Also included is a bibliographic listing of participating institutions. Please direct requests for publications to the respective organizations.

ODC has experienced a few administrative changes as well. Dawn Murphy recently joined ODC as the new WEW Coordinator to whom all future correspondence should be directed.

We look forward to an exciting year with the new administration in place and hope that this issue proves to be an informative resource for your institution.

Sincerely,

Christine Contee

Christine E. Contee
Director of Public Affairs
& Fellow

ODC

A Project of the Overseas Development Council

John W. Sewell, President

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ASIA

ASIA

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Strategy for Forest Sector Development in Asia

WORLD BANK TECHNICAL PAPER NUMBER 1
ASIA TECHNICAL DEPARTMENT SERIES

First printing August 1992

STRATEGY FOR FOREST SECTOR DEVELOPMENT

Executive Summary

i. This report recommends a shift in the focus of World Bank support for forestry in Asia 1/ away from reliance on public sector institutions, acceptance of poor quality technical standards and exclusive emphasis on narrow subsectors. Instead, the paper proposes that the Bank move aggressively to improve the climate for investment and policy reform and mobilize political commitment on the need for change through an iterative process of sector analysis, policy dialogue and targeted investment. This strategy, which builds upon efforts already underway, will help the governments of the region put into place the essential institutional and decisionmaking capability to resolve forest land use and allocation problems on an ongoing basis, mobilize and deploy investment and other resources in ways consistent with overall national development priorities, and equitably resolve the conflicts which will inevitably accompany forest development.

ii. These proposals are based on a review of the forest situation in the region which show that deforestation is proceeding at a pace of over 3 million ha per year at an economic cost of over US$8 billion, that fuelwood scarcities are becoming increasingly acute, and that loss of biodiversity is reaching unprecedented proportions. Two countries in the region, India and China, which have among the world's lowest per capita consumption of forest products, have already virtually depleted their natural forest resource. Other countries in the region, such as Thailand and Malaysia, which were once major exporters on the world market are now experiencing severe timber shortages which already threaten the viability of their export earnings and domestic processing industries. If present trends continue, within ten years the forest area of the region will have fallen to less than 50 percent of the original area and incalculable losses will have been incurred in the region's biodiversity. Above all, there is a growing crisis of confidence in the ability of existing forestry institutions to effectively and productively manage this important resource. International agencies, including the World Bank, have not proved very effective in improving this situation and need to review their approach.

iii. The report shows that this poor performance results from three basic and interrelated sets of problems; economic, institutional and scientific. Divergences between social and private costs are a central feature of forestry, virtually all environmental concerns can be characterized as examples of economic externalities. However, while management of external costs should be among the principal tasks of forestry institutions, those currently in place in Asia were designed to extract surplus from the land and to act as police forces. Finally, the scientific basis for forest management in the tropics is only just beginning to develop. Forestry lags badly behind agriculture and other sectors of the economy in producing and applying technological innovations that will allow for the sustainable utilization of the natural resource base.

1/ This report refers to countries covered by the World Bank's South Asia and East Asia and Pacific Regional offices.

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iv. The report recognizes the range of goals that motivates concern with forestry and highlights the need to make choices within a highly constrained environment. Pursuit of economic, environmental, social and global objectives in the face of limited land resources, growing populations, limited employment opportunities, and constrained budgets, has historically taken place at the expense of the forest sector. The policy framework in Asia, as in much of the rest of the world, has been overwhelmingly biased against forestry. Forests, and the goods and services they provide, are systematically undervalued by users and decisionmakers. Across the region policymakers have consistently sought to use forest resources for development purposes without providing for the costs of that utilization.

v. On the basis of an improved investment climate and with greater borrower commitment, the World Bank can assist countries in the region by enabling an increased role for the private sector in resource management and investment, in expanding the application of improved technologies and environmental safeguards, improving markets and resource rent recovery and in enlarging the role of local communities in forest management. The World Bank can help governments recognize the impact of policies and investment activities outside the forest sector and has already identified critical interventions that can help to stabilize the marginal agriculture that currently threatens much of the regional forest. The Bank continues to play a major role in mobilizing and allocating international transfers in support of conservation of globally important biological diversity.

vi. Priority areas of Bank investment in forestry are resource expansion primarily in the wood deficit countries of the region, including plantations and private farm forestry, improved natural forest management and industrial plantation establishment in countries approaching the transition to sustainable forest utilization, and above all in the restructuring of forestry institutions toward a greater emphasis on development, investment performance and public accountability.

vii. Any set of actions that the governments of the region and development assistance agencies attempt to undertake will inevitably fail to satisfactorily address all the concerns of all the actors interested in the forestry sector. The World Bank's support to the sector, and its analysis of sector and related issues needs to proceed from the premise that unless the fundamental constraints described in this paper are seriously addressed, <u>all</u> of the goods and services provided by the forestry sector are threatened. Work also needs to proceed from recognition of the fact that the forestry sector is continuously undergoing changes and development on the basis of its internal dynamics and impacts from other sectors and external factors. Because of this, it is impossible to attempt to immediately identify and resolve all the issues constraining forest development. An ongoing, iterative process of dialogue, analysis and investment is the only path to sustainable forestry.

ASIA REGION
STRATEGY FOR FOREST SECTOR DEVELOPMENT

A. Introduction

Forests are a dominant feature of Asia's environment and its economy. Approximately 635 million ha (34%) of the gross land area of the region is considered forest land, either closed or open, and the export revenue from forest products amounts to well over US$8 billion per year. Growing awareness of the importance of this sector coincides with significant and far-reaching changes within it. The rate of deforestation is estimated at 1% per year, and in just three countries alone the economic costs of deforestation are estimated to exceed US$8.3 billion per year (para. 18). Once dominant exporters such as Philippines and Thailand have virtually exhausted their forests, and India, historically self-sufficient has become a major importer. The few remaining tropical forests are rapidly diminishing under heavy population pressure. Fuelwood shortages have long been acute in many areas, and the region's biodiversity, found mostly in its moist tropical forests, is disappearing at unprecedented rates.

While forestry was once considered a source of industrial wood and land for development, the sector is now expected to contribute to broader economic, social and environmental objectives. The institutional framework for forestry development evolved in the era following independence when management objectives were extractive, when technology was stagnant, when the needs of the poor were neglected and when the ability of the state to deploy resources for development was unquestioned. As a result of this new awareness of forestry's potential, external development assistance to the sector has grown significantly in recent years, and now amounts to over $350 million per year. Development assistance has, however, failed to generate the capacity and commitment necessary for the sector to realize its potential to contribute to a wide range of important development objectives.

The forestry sector of Asia is marked by nothing so much as its diversity. Demands on the forest resource range from firewood, to fodder, to industrial wood, to hydrological services, to preservation of biological diversity. Asia's resources include untouched moist tropical forests, temperate forests, severely degraded pasture and wasteland, trees grown on private farms, and rubber, oil palm and coconut estates. These resources are controlled by national and local governments, by corporations, individuals and by traditional clans and kinship groups. The international community is expressing a growing interest in the management of the region's forests and is increasingly being expected to provide concessional resources for preservation and protection.

Many of the problems and opportunities, and much of the diversity, in Asian forestry are common to those found in other developing regions. Population growth, institutional problems, environmental degradation and systematic undervaluation of forest resources, have resulted in dramatic deforestation worldwide. Thus, the reforms and investments needed in Asia are not unlike those required in other parts of the world. However, the forestry sector in Asia is set apart by the size of its forest-dependent population, the location of its resources vis-a-vis rapidly expanding markets and trade

routes, the relatively larger role of forestry in its economic structure and the human resources that can be mobilized. Asia is also unique in having abundant accessible forest areas in close proximity to areas of rapid economic growth and forest scarcity. Given the level of overall development and mounting weight of demands on the sector in several key countries, the extent of reform over the next 10 years will determine the long-term viability of forestry in Asia.

This report reviews the current status of the forestry sector in Asia, proposes typologies for understanding the key problems facing decisionmakers, and analyzes a number of key issues in forest management. The report evaluates the Bank's contribution to forestry development in Asia over the past two decades and explores the assumptions, explicit and implicit, behind its investment policy. Based on the lessons learned, the report proposes a strategy for further Bank involvement in the sector and measurable indicators by which its performance can be assessed.

The proposed strategy focuses on building the institutional and decision-making capability for resolving land use and allocation problems on an ongoing basis, mobilizing and deploying investment and other resources in ways consistent with national development priorities, and resolving the conflicts that inevitably accompany forest development. Implementation of this strategy, already reflected in Bank work in Asia, will involve an expanded and ongoing program of sector analysis, reassessment of institutional mechanisms, accelerated application of existing technology, investment in new technology and long-term commitment by governments and donors.

TABLE 1 Forest Areas and Rates of Change in Asia
(000 hectares)

	Total Land Area 1/	Total Natural Forest Area 2/	Closed Natural Forest Area	Open Forest Area	Degraded Forest Area 3/	Rate of Deforestation (Total Closed Natural Forest) 4/	Rate of Deforestation (Total Natural Forest) (%) 5/	Plantation Area 6/	Annual Plantation Establishment Rate 6/
BANGLADESH	13,390	1,242	927		315	8	0.9	128	17
BHUTAN	4,700	2,370	2,100	40	230	2	0.1	7	1
BRUNEI	590	560	323		237	5	1.5	n.a.	n.a.
CHINA	932,640	142,777	97,847	17,200	27,730	670	0.6	12,733	4,552
FIJI	1,930	817	811		6	2	0.2	40	n.a.
INDIA	297,320	72,082	51,841	5,393	14,848	147	0.3	2,068	138
INDONESIA	181,160	158,155	113,895	3,000	17,360	400	0.3	1,918	131
JAPAN	37,643	13,690	n.a.	n.a.	n.a.	n.a.	n.a.	11,590	240
KAMPUCHEA	17,550	13,273	7,548	5,100	625	25	0.2	7	n.a.
KOREA	9,820	4,887	4,887		n.a.	n.a.	n.a.	1,628	67
LAO PDR	23,080	19,360	8,410	5,215	5,735	100	0.7	11	1
MALAYSIA	32,860	25,821	20,996		4,825	255	1.2	26	20
MALDIVES	50	1	0		1	n.a.	n.a.	n.a.	n.a.
MONGOLIA	156,500	13,863	9,528		4,335	n.a.	n.a.	n.a.	n.a.
MYANMAR	65,770	52,642	31,941		20,700	105	0.3	15	0
NEPAL	13,680	2,461	1,941	180	340	84	4.0	19	4
PAKISTAN	72,830	3,585	2,185	295	1,105	7	0.3	160	7
PAPUA NEW GUINEA	45,180	39,705	34,230	3,945	1,530	22	0.1	22	n.a.
PHILIPPINES	29,860	13,030	9,510		3,520	92	1.0	300	50
SOLOMON ISLANDS	2,750	2,480	2,423	17	40	1	neg.	17	n.a.
SRI LANKA	6,470	2,727	1,659		1,068	58	3.5	112	13
THAILAND	51,180	16,975	9,235	6,440	1,300	252	1.6	114	24
VIETNAM	32,540	21,190	8,770	1,340	11,080	65	0.6	204	29
TOTAL	2,029,493	623,693	421,007	48,165	116,930	2,319	0.5	31,119	5,295

n.a. Not Available
neg. Negligible

Sources: FAO (1988) An Interim Report on the State of Forest Resources in the Developing Countries
Data for China from Richardson (1990) and World Bank estimates, data for Japan from World Resources Institute (1992)

Notes:

1/ World Resources Institute (1992)
2/ Open and Closed Natural Forests and Degraded Forest Lands
3/Forest Fallows and Shrub Land
4/ Deforestation on Closed Forest Formations
5/ Recalculated from FAO (1988)
6/ Industrial and Non Industrial Plantations

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EDITORIAL/OPINION

Going to Market in SE Asia

By JOSEPH P. QUINLAN

Over the past few years, Asean, the Association of Southeast Asian Nations, has emerged as a key export market for U.S. companies. Indeed, the six-nation organization composed of Indonesia, Malaysia, Singapore, the Philippines, Brunei and Thailand is now the sixth largest trading partner of the United States.

Yet despite expanding trade links, many U.S. companies remain unfamiliar with Asean's commercial terrain and unaware of potential business hazards in the region. Multinationals going to market in Asean should carefully assess the following strategic variables:

• **Market size vs. market potential:** Asean promotes itself as a marketplace of 310 million people, nearly the same size as the European Community. The true market for U.S. goods and services, however, is much smaller once regional income disparities are considered.

Thailand, for instance, has a total population of 58 million, but the genuine consumer market is concentrated in and around Bangkok. There, average household incomes have risen sharply over the past five years and are now up to 10 times higher than levels in other parts of the nation. The bad news is that the capital accounts for just 14% of the total population.

Regional income disparities are just as pronounced in the Philippines and Indonesia. The combined population of the two nations exceeds a quarter of a billion people; however, the majority of these people are poor rural dwellers with little income or spending power for foreign goods.

Unfortunately, the wealthiest consumer market in Asean — Singapore — is also the smallest. The city-state's per capita income is second only to Japan in Asia, although Singapore's total population is just 2.5 million.

• **Labor:** Cheap and abundant labor was once a strategic endowment of Asean and, not surprisingly, a magnet for foreign investment. With the exception of Indonesia and the Philippines, however, Asean's days of inexpensive labor have passed.

Wages in Malaysia and Thailand have risen sharply over the past few years, with the pool of skilled and even semi-skilled workers all but dried up around the main industrial areas of Bangkok, Kuala Lumpur and Penang.

Malaysia's manufacturing sector, according to the Federation of Malaysian Manufacturers, is short some 50,000 workers, forcing the nation to import labor. Singapore, with the highest wages in the region, must also import foreign workers.

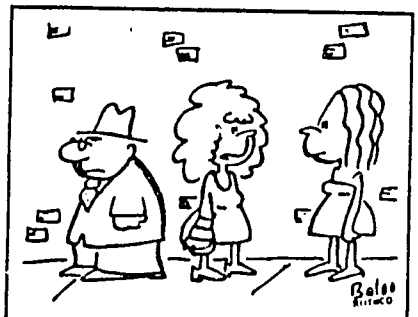
Labor problems in Indonesia are of a different magnitude. The nation has one of the largest labor forces in the world — 78 million people — although the majority of workers are generally unskilled and lacking in managerial capabilities.

Because educational standards and requirements have failed to keep pace with the rapid rate of industrialization, Indonesia is seriously deficient of engineers, scientists and other technical personnel required to advance to the next stage of development. Indonesia, moreover, is not alone — every other nation in Asean faces a similar problem.

• **Infrastructure:** Severe infrastructure limitations have raised the cost of operating in Asean, prompting some multinationals to invest elsewhere. Following five years of strong growth, the physical infrastructure of the region is straining at the seams — the roads are crowded, the ports are clogged and the airports are jammed.

Pollution and environmental degradation compound matters. The upshot is infrastructure gridlock, which threatens not only to strangle growth and trade, but also curtail new foreign investment.

The problem is the most acute in Thailand, where traffic crawls at an average speed of less than 8 kilometers an hour in Bangkok. In the Philippines, power shortages are all too common and frequently result in lost production.



"Gordon isn't into material things — he says they cost too much."

The only exception to Asean's underdeveloped and overtaxed infrastructure is Singapore, whose first-class port and airport rate among the best in the world.

• **Race:** Operating effectively in Asean requires that U.S. companies appreciate and be sensitive to underlying racial tensions between the majority Malay and the minority Chinese.

The latter are the captains of industry in Southeast Asia and dominate such sectors as banking, manufacturing, construction and retail. As a result, the Chinese control a disproportionate amount of the region's wealth — which, in turn, underpins anti-Chinese sentiment among Malays.

Race relations are particularly delicate in Indonesia and Malaysia. Indeed, in the past three decades, both Malaysia, in 1969, and Indonesia, in 1965-66, have seen racial frictions boil over into bloodshed.

Malaysia, to maintain ethnic peace, has gone so far as to legislate an economic affirmative action program to redistribute wealth along racial lines.

In Thailand and the Philippines, interracial marriages have helped ease tensions, although even in these nations the issue of race is never far from the surface.

• **Religion:** The role of religion figures prominently in Asean and should be recognized by multinationals as a powerful social force. In Thailand, for instance, Buddhism, the professed religion of 95% of the population, permeates nearly every aspect of social life and customs. Similarly, the Catholic Church is one of the most respected and influential institutions in the Philippines.

Islam is the third key religion of Asean, with Indonesia and Malaysia both Islamic nations. Indonesia, in fact, is the largest Islamic nation in the world although, to a large extent, Islam has been secularized by the Suharto government. In Malaysia, Islam is stricter and more pervasive in daily life.

Religion, race, infrastructure, labor and market size — all of these variables present unique challenges for U.S. companies operating in Asean. But by carefully analyzing each factor in the context of their own business, American companies can greatly enhance the odds of success in one of the world's fastest growing markets.

Joseph Quinlan, an international economist, writes often about Asia.

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TREASURY NEWS
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TREASURY REPORT SAYS CHINA, TAIWAN MANIPULATE CURRENCY RATES AGAINST U.S. DOLLAR

The Treasury Department, in a new report to Congress, concludes that both China and Taiwan continue to manipulate their foreign exchange rate systems to prevent effective balance of payments adjustment and to gain an unfair competitive edge.

Treasury's annual International Economic and Exchange Rate Policy report to Congress also reviews the outlook for the world economy and the U.S. current account position as well as recent developments in foreign exchange markets.

The annual International Economic and Exchange Rate Policy report is required by the 1988 Omnibus Trade and Competitiveness Act. Section 3004 of that law requires the Treasury Secretary to consider whether countries manipulate their currencies against the dollar for the purpose of preventing effective balance of payments adjustment or gaining unfair competitive advantage in international trade.

Treasury has concluded that China, which has a rapidly growing trade surplus with the United States, is manipulating its currency. "Chinese authorities continue to frustrate effective balance of payments adjustment by tightly regulating exchange markets. Given China's large external surpluses, such regulation is unwarranted," said Olin L. Wethington, Treasury assistant secretary for international affairs.

Taiwan also was cited in the report for manipulating its currency. Wethington said market forces in Taiwan don't play enough of a role in determining Taiwan's exchange rate against the U.S. dollar. "With continued large external surpluses, close to $90 billion in foreign exchange reserves, and a high growth rate, this economy doesn't need rigid, state-imposed foreign exchange restrictions."

In addition to assessing the exchange rate policies of major U.S. trading partners, the report reviews global economic developments. The United States remains concerned over sluggish global economic growth. While signs of recovery are evident in

the United States, the report notes economic performance remains weak in Japan and Europe. As a result, the U.S. trade and current account deficits are expected to increase.

Although the report did not conclude that Korea is manipulating its exchange rate, Treasury remains concerned that pervasive foreign exchange and capital controls constrain market forces and provide the potential for manipulation. Therefore, Treasury is continuing to press for liberalization of financial, capital, and foreign exchange controls in Korea.

180 World Bank Discussion Papers
China and Mongolia Department

First printing September 1992

China's Reform Experience to Date

Peter Harrold

SUMMARY

1. This paper attempts to provide an assessment of the successes and failures of China's reform experience since 1978. Such an assessment can now be done on an objective basis because of the passage of time and the availability of recent research results. However, in drawing broader lessons from this experience, it is important to understand clearly the initial conditions under which the reform was launched. Three factors are key in China in this regard: the absence of severe macroeconomic crisis at the start of the program, so that harsh stabilization measures could be avoided; the state of agriculture, with its good infrastructure but poor incentives; and the presence of Hong Kong, as a source of inspiration, expertise and investment.

2. As the reform program has developed in China, four distinctive features in terms of reform style have emerged:

(a) Gradualism and Experimentation. China has tended to spread changes over several years, and usually after considerable experimentation and adaptation. Its large size and provincial structure foster such experiments and make such an approach appropriate, if not inevitable.

(b) Partial Reforms. One of the distinctive features of China's reform has been the apparent success of partial reforms within sectors, notably the two-tier price system, which has created a situation in which marginal decisions are based on market prices, and market skills can be learned without economic dislocation.

(c) Decentralization. Decentralization of decision-making power to enterprises, individuals and local governments has been a key theme of reforms, enhancing microeconomic incentives and creating a strong interest group in favor of continued reform deepening.

(d) Self-Reinforcing Reforms. Reforms in one area created pressures for matching reforms in other areas, and policymakers have in general seen their interests served best by meeting such pressures with new reforms rather than by administrative protectionism, albeit sometimes with a considerable lag.

3. China's approach to reform has been demonstrably effective, particularly in terms of its impact in four distinct areas:

(a) Output and Welfare. GNP has grown about 50 percent faster during the reform period, especially in light industry and services. This has resulted in enormous improvements in consumption levels (more than doubled over the decade) and in the lifting of 160 million from poverty since 1979.

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(b) Productivity. The key to this has been that growth has come via productivity gains, which were close to zero in the 1949-79 period, but accounted for 3-4 percent per annum of growth during reforms.

(c) The Role of the State. The state used to dominate savings and investment, but now, most savings are generated by individuals and enterprises, and investment is financed by retained profits and banks. Even more dramatic is the changing role of state-owned enterprises, which accounted for almost all output in the prereform period, but now nonstate industry employs almost 100 million people and produces 45 percent of industrial output.

(d) Trade. The share of trade in GNP has risen from just under 10 percent in 1978 to over 30 percent in 1990, and there are over 20,000 sino-foreign joint ventures in operation.

4. The paper describes the most important reforms that have been carried out during this period. Despite the great progress achieved to date, the gradual approach means that much remains to be done, and reform priorities can be identified in six key areas: (a) enterprise reform, especially the question of ownership reform for the state-owned enterprises; (b) financial sector issues, especially the reduction of forced policy lending by commercial banks; (c) fiscal reforms, to replace the present revenue generation system with a diversified tax system; (d) external reforms, and especially reduced import protection; (e) further price reform, particularly for such distorted prices of raw materials and agriculture; and (f) social sector reforms, primarily those which improve labor mobility by converting nonwage benefits such as housing and pension rights, to wages. In addition, the government will need to be increasingly concerned in this decade with issues that affect the environment and with poverty alleviation, although these topics are not addressed directly in this paper.

5. The final issues addressed in considering China's reform experience to date are concerned with conclusions of more general applicability that can be reached, and the sustainability of the approach. Five key features of China's experience seem to have wider applicability: agriculture as an entry point for reform; the success of "marketization" of the enterprise sector, instead of privatization; the key role of changing the interest of the bureaucracy; the impact of developing exports at an early stage; and the role of the state in maintaining stability by looking after the most affected.

6. Given the lack of historical precedents for the Chinese approach, the question of its sustainability overtime must be addressed. On balance, it is judged that the approach is sustainable, because: (a) the Chinese reform has generated intensive development, and the consequent generation of true welfare changes; and (b) China has generally responded to the problems arising out of reform by deepening reforms, which suggests that deep crisis can be avoided via a process of continued incremental change. Nevertheless, the key to sustainability will be in how well China responds to the reform challenges still to be addressed.

G. Some Tentative Conclusions

87. The discussion of this paper has been concerned with the way that China has gone about its reform program, and the impact on the economy of these reforms. It is clear that the Chinese approach has worked well in the initial conditions under which it was launched. This is not to say that the outcome was optimal, and it must be accepted that other measures could have made the results even better. For example, it is now generally accepted in China that stronger monetary management in 1988 and more rapid price reform in 1990 would have improved matters. It must also be stressed that one of the key features of China's initial conditions was the absence of a need for harsh stabilization measures, and no simultaneous external shocks, such as the collapse of the CMEA which has so strongly affected the countries of Central and Eastern Europe. This said, five key features of the Chinese reform experience do seem to be key elements of success, which may have some more general applicability, irrespective of the issues related to the gradual approach, and to the special conditions that are unique both to China and its approach to reform.

Five Key Features

88. At the start of the reform program, China had a large and relatively well-developed industrial system, but was nevertheless fundamentally a rural economy. Moreover, as the discussion of initial conditions suggested, the agricultural sector was highly repressed, and was thus ripe to respond to reforms. These factors supported the appropriateness of the decision to use agriculture as the entry point. Not only did agriculture respond rapidly--as it has in other countries such as Vietnam--but this generated the rural savings and surplus labor necessary to launch the next phase of reform, and created a constituency for reform.

89. The second element that seems to have been of particular significance in China was the emphasis on marketization instead of privatization, and on the role of growth of the nonstate sector in diversifying ownership patterns. The spectacular growth of nonstate enterprise has served two key functions.

(a) It created economic growth and generated employment opportunities, thus bringing out significant gains from reform.

(b) It generated competitive pressure on state-owned enterprises, forcing change in their behavior, even though this process remains far from complete.

This process is one that can be regarded as "privatization from below," in that, within just a few years, 45 percent of industrial output is now from nonstate industries. More generally, this emphasis on creation of new nonstate industries suggests the possibility of creating a competitive framework in which state enterprises can be made more efficient without recourse to direct privatization programs.

90. The gradual approach to reform runs the risk that the losers from reform can regroup either to oppose further change or even attempt reversal. Of course, this same factor can also work in the opposite direction, as reform skeptics can be won over when the pace of reform is gradual, and benefits start to emerge. The particular problem in a socialist system is how to change the interest of the bureaucracy and the Party. Bureaucrats, especially at the national level, are among the major losers from socialist reform, with loss of power, prestige and, in particular, nonwage income. Nevertheless, China seems to have had some success in reorienting the bureaucracy. The reforms created pressure on the planners because they reduced

central revenues and the profitability of state enterprises. Although to some extent, this caused part of the bureaucracy to seek to protect their profits and interests, it also redirected the interest of the bureaucracy towards ensuring that their enterprises were oriented towards profit-making. This has seen setbacks at times, but the periods of resurgence of planning theology, as in 1989/90, have proved short-lived as even planners have found it hard to preserve their interests through such methods in the face of past reforms. We can observe in 1992 a recognition of the failure of planning solutions to achieve significant restructuring of state-owned enterprises during the previous three years. Thus, the use of decentralization and promotion of nonstate industry generated a reorientation of the interest of the bureaucracy away from planning goals towards economic performance. This coincided with the interests of the Party, which saw its political interests geared increasingly to the achievement of economic success.

91. The fourth element of the Chinese approach that is distinctive has been its emphasis on export development and more generally its entry into world markets. The big contrast between this approach and that of other countries has been the postponement of import liberalization to late in the reform process, although it has had the result of a relatively high level of importation of advanced technology. This has been possible for two reasons: first, the size of the domestic economy has made it possible to generate competitive forces, especially among smaller enterprises vying for export business; second, while China had been closed to import competition, it has been very open to influence from outside in its export industry, and especially from Hong Kong entrepreneurs, who have been permitted to impose rigorous export design and quality control standards. The unique relationship between China and Hong Kong may reduce the replicability of this element of the strategy.

92. The fifth key factor in the Chinese approach has been the role of the state in maintaining social stability. By using the gradual approach, and by not subjecting the state sector to major shocks, China has succeeded in avoiding severe social costs during its transition. The Chinese effort has focused much less on changing old enterprises and more on generating new opportunities. Moreover, by postponing social reforms to the end of the reform process, this has given the opportunity to develop over time the institutional framework for a new social security system. What remains to be tested is whether China can now move beyond this approach to address the more fundamental issues of the state enterprise sector and the dismantling of this social system--and indeed the issue of whether the state wishes to carry out this aspect of reform. Nevertheless, it is clear that this approach has avoided some of the serious social consequences that could have undermined the case for further reform.

Sustainability

93. A key question in considering the Chinese approach to economic reform is whether this approach is sustainable over the medium to long term, or whether it is simply postponing problems that will later "come home to roost." Three potential issues for the future need to be addressed:

(a) The danger of future insolvency of some large banks, as they acquire an increasingly weak portfolio by funding the losses of the state-owned enterprises, with limited capital bases and small loan loss provisions. It is further argued by some that this problem will worsen as the influence of nonstate industry rises, which would result in the squeezing out of such enterprises from resources.

(b) The argument that so long as state-owned enterprises remain dominant, they will never be able to achieve efficiency at internationally competitive levels, so that so long as this position is maintained, China will always be a highly protected economy, and the benefits of present reforms will fade away to lead to stagnation until this issue is addressed.

(c) That social tensions will mount in two directions. First, that increasing provincial autonomy and self-sufficiency will increase further the growing regional disparities in China, leading to increasing conflicts. Second, that the fight against poverty in China is showing fragile gains, with many persons only just above the poverty line. With reforms and further difficulties for the central government, the present social safety net could collapse, pulling millions back into poverty.

94. In other words, these arguments suggest that the gradual approach has limitations, and that China will eventually approach these limits. This argument is based primarily on the recent experiences of the formerly socialist countries of Eastern and Central Europe. These are serious issues, and the possibility of such a collapse--forcing China into its own "big bang"--should not be dismissed out of hand. Moreover, it must be recognized explicitly that China's reform is indeed one which does not have successful historical precedent. But two important factors must be stressed as sources of reassurance:

(a) Over the existing reform period, China has generally responded to the problems arising out of the reform experience by introducing new reforms and by deepening existing reforms. Thus, we can see incremental reform movement over the entire period of the reform era, albeit at varying speeds. This gives reassurance that, as new problems emerge, so they too will be met by incremental movement, so that, as with the past ten years, deep crisis simply will not occur. For example, this could result in incremental reforms which restructure existing SOEs, such that these reforms in turn correct on an incremental basis the genuine portfolio problems of banks.

(b) The gains of the reform era have been "intensive" rather than "extensive," as measured by the strong productivity gains that have been registered, and China has succeeded in maintaining the momentum of GDP growth even during periods of adjustment. These productivity gains are not restricted to the new industries, but have been recorded also in the existing SOEs. This suggests that the economic results of the Chinese approach to reform may be qualitatively different from the

experiences of some others that tried such an approach, and we would suggest that this could lend credence to sustainability, and to the possibility that China will grow out of its problems. The secret to this success has been China's use of "marketization" and the vigorous development of the nonstate sector, which has been unique to the Chinese approach, and is in marked contrast to the Hungarian experience of the 1970s.

95. The key to sustainability thus rests, in our view, not on any theoretical or philosophical issues about the ultimate level of efficiency that publicly-owned enterprises can achieve, but rather on the solutions that China will develop towards the unfinished agenda. In particular, this relates to solutions to the problems of the financial sector and the state-owned enterprise sector and its environment. If appropriate incremental reforms are instituted, stressing growing "marketization" and a continued associated increase of competitive forces via growth of the nonstate sector and trade reform, then the remarkable experience of the past decade lends hope that the Chinese approach can indeed lead to a sustainable pattern of growth with reform.

No October Surprise in Beijing

The buzzword: Socialist market economy

The recent Congress of the Chinese Communist Party (Beijing, October 12-18) has been hailed as a major victory for the reform forces in China—and a major personal victory for senior leader Deng Xiaoping who has seen his reform proposals adopted as the guiding principles for the coming period and reform-minded candidates appointed to the leading positions in the Party. The Congress saw the elevation of what is called "Deng Xiaoping Thought" to the same standing as Marxism-Leninism and Mao Zedong Thought.

Deng's Thinking Prevails

Deng's approach to policymaking, which is essentially the art of pragmatism, has now been enshrined in the "theory of building socialism with Chinese characteristics." The Constitution of the Party was amended at the Congress to include this theory. The Work Report (the basic document presented to the Congress for approval) emphasizes economics development as a central task. The report also asserts: "We must not get bogged down in an abstract debate over what is socialist and what is capitalist." This is a more explicit version of Deng's often repeated, and more colorful aphorism "it doesn't matter if a cat is black or white, as long as it catches mice."

The emphasis on economic development also signals an abandonment of the very cautious targets of the 8th Five-Year Plan. Instead of the 6 percent per year growth target of the Plan, the work report calls for 8-9 percent economic growth. (In the Bank's recent economic report on China, it was also estimated that with faster reform, growth could rise to an average of 8.5 percent.) The report placed particular emphasis on the growth of the service sector and explicitly called for an early start to the famous Three Gorges project.

Ownership Targets

The Congress has made it clear that reform policies are to remain at the heart of policymaking and that the reform era is regarded as China's second revolution. The Chinese economy is now a socialist market economy, and where previous reports all used the word "planning," the current Work Report gives the strongest endorsement to the role of the market in China—and by implication criticizes planning. The Report notes that practice in China has proved that where market forces are given full play, the economy exhibits vigorous and sound development.

The Congress reaffirmed that the household responsibility system (in other words private farming) will be retained as the basic rural policy and that the Special Economic Zones policy will be extended to many parts of China, including border areas and the Yangtze valley (see box, page 5). The Congress reaffirmed multiple forms of ownership, "so long as the public sector remains dominant." However, public sector is defined as embracing not only collective enterprises, but also locally owned Township and Village Enterprises (TVE) and the Chinese share in joint ventures. This broad definition gives great scope for the continued decline in the share of state-owned enterprises in total output.

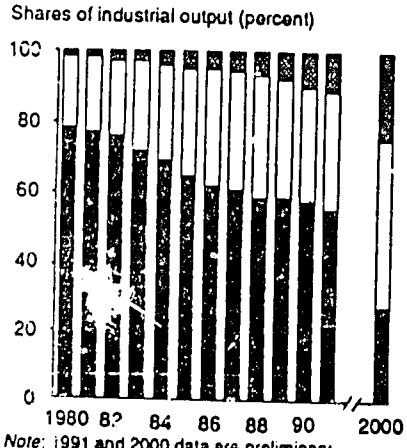
The Party now seems poised for a major rationalization of the state-owned enterprises. The Work Report underlines the need for price reforms and new incentives so that "efficient enterprises will prosper and the inefficient ones will disappear."

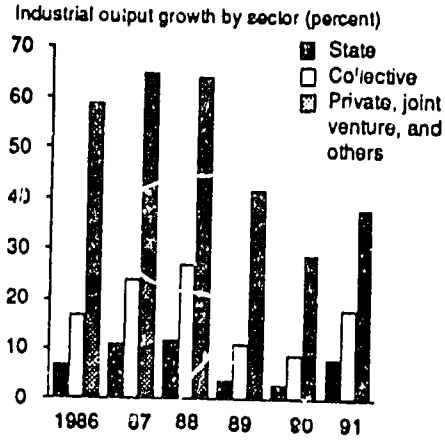
One of the main initiatives launched by the Congress is a program of government reform, to be completed over a three-year period. A major rationalization of the central government and the abolition of several ministries and agencies are expected, with the goal of creating a government organization that is more in line with the reform objectives and that exercises only indirect control of the economy.

The One-Party System Remains

The Congress reaffirmed Deng Xiaoping's long-held view on political

The changing property mix in China





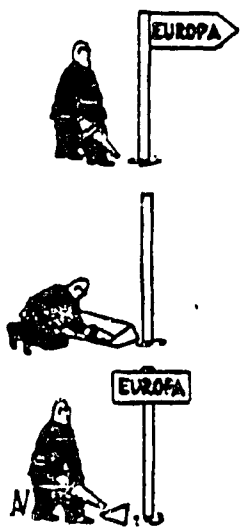
Note: 1991 and 2000 data are preliminary.
Source: Official Chinese statistics.

reform. Despite the debate about reforming the system of People's Congresses, a very clear statement emphasized: "the [political] goal of the reform is to build a socialist democracy suited to Chinese conditions and absolutely not a western, multiparty parliamentary system."

The new Central Committee has appointed a Political Bureau expanded to twenty persons, with much stronger representation of reform-minded leaders from such cities and provinces as Shanghai, Tianjin, and Guangdong. The Standing Committee of the Politburo—the most powerful group in China—now has seven members, and two of its older members have retired. Among the three new members are Vice-Premier Zhu Rongji, the former mayor of Shanghai, and an economist who has contributed to several World Bank studies on China.

The strong official backing for continued reforms in China is not an unexpected development; nonetheless it is of major importance. There is widespread expectation that the rest of this decade will witness an economic performance every bit as spectacular and enviable as was observed during the first decade of reform.

Peter Harrold, EA2CO,
The World Bank



From the Polish weekly NIE

Coastal winds blow inward

China's rapid growth is expected to continue over the next decade or more, based on two fundamental conditions: high savings and investment rates and a work force that is relatively skilled and healthy for a low-income country.

During the 1980s, economic liberalization proceeded at similar rates in the country. As a result, growth was fairly evenly spread nationwide. However, in the late 1980s coastal regions began to develop much faster than inland regions. Following 1989 the "coastal development strategy" was criticized and an "industrial policy" that would apply impartially to the whole nation was advocated. During the bitter ideological battle, however, foreign trade reforms were moving ahead, facilitated by the fact that elements of decentralization were already built into the system and driven by the need to export and the fact that local leaders could reap benefits from attracting foreign trade and investment.

The economies of the coastal provinces, which were better placed to take advantage of trading opportunities, grew more rapidly. In late 1991, and particularly with Deng Xiaoping's southern tour in early 1992, the emphasis was again on opening the economy to foreign participation—a far easier task than framing coherent reform policies for the domestic economy. As a result, there has been increasing differentiation between coastal and inland China. This is likely to continue to shape development in the 1990s for the following reasons:

- Because of poor communications and less skilled work forces, inland factories are not as efficient as coastal factories—producing between 15 percent and 40 percent less per unit of input.

- Transport costs for inland producers to access world markets are significantly higher than costs for coastal producers. And information about world market opportunities is less available.

- Inland regions are relatively concentrated in the energy and raw materials sectors, which are the least reformed part of the state economy. State price controls on these items act like an additional tax on inland regions.

- Foreign investors have been unwilling to invest in the interior's abundant natural resources because of depressed global commodity markets. With China's still underdeveloped capital markets, it falls to the central government to mobilize the large sums of capital necessary for resource development leaving the interior highly dependent on the state economy.

Coastal regions, by contrast, are poised to grow rapidly as they are further integrated into the East Asian and world economies. Thus far, only the provinces of Guangdong and Fujian have experienced integration into the global markets. Successful reform policies have been a precondition for this development. However, transfer of low technology, labor-intensive manufacturing from adjacent Hong Kong (China) and Taiwan (China) played a crucial part.

This integration process has not exhausted its potential. Transnational manufacturing is spreading rapidly throughout Southeast Asia, and southern China is becoming increasingly integrated into these networks. Although the region as a whole remains dependent on the U.S. market, demand for final goods within the region is also growing—slightly faster than U.S. demand.

The economic regions of northern and southern coastal China are expected to expand and meet in the Lower Yangtze region around Shanghai and then extend up the Yangtze valley. By 2000, the entire coastal area will be integrated into international trading relationships, with the "accelerated growth area" also incorporating selected inland provinces, such as Hubei and Hunen.

(Based on Oxford Analytica)

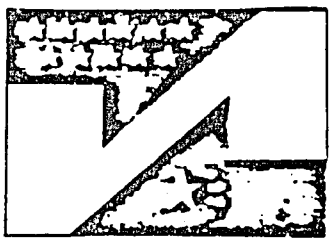
Issue: MFN status for China

Bottom line: President Bush's decision to renew most-favored-nation (MFN) trade status for China was strongly opposed in Congress, but lawmakers failed twice this year to override his veto of legislation to restrict normal trade ties.

Bills: HR 5318 — H Rept 102-658, no Senate report.
HR 2212 — Conference report: H Rept 102-392.

Synopsis: Since lawmakers began efforts to punish China for the 1989 massacre in Tiananmen Square, they have been unable to overcome a bloc of senators who, like Bush, oppose attaching conditions to renewal of China's MFN status.

The latest bill (HR 5318) would have tied next year's MFN extension to improvements in China's record on human rights, trade and weapons proliferation. In the absence of such improvements, goods from Chinese state-owned industries would not have been eligible for the low tariffs available under MFN. In targeting state industries, the sponsors — Senate Majority Leader George J. Mitchell, D-Maine, Rep. Nancy Pelosi, D-Calif., and Rep. Don J. Pease, D-Ohio — hoped to undercut the administration argument that the bill would harm private exporters who are helping to bring about political liberalization in China.



The bill would have imposed high tariffs on Chinese imports unless Beijing accounted for and released prisoners detained during the 1989 protests. China also would have had to make "overall significant progress" in achieving a list of human rights, trade and weapons proliferation objectives.

Most of the work on the earlier bill (HR 2212) was done last year. The measure would have placed similar restrictions on renewal of China's MFN status in 1992; it would have applied to all goods imported from China.

Final House action: The House cleared HR 5318 by voice vote on Sept. 22. The House voted 345-74 in favor of an override Sept. 30.

The House had voted 357-61 on March 11 to override Bush's veto of HR 2212.

Final Senate action: The Senate passed HR 5318 by voice vote Sept. 14. The override attempt failed Oct. 1 by a vote of 59-40.

The Senate had failed to override Bush's veto of HR 2212 on March 18 by a vote of 60-38.

President's action: Bush vetoed HR 5318 on Sept. 28; he vetoed HR 2212 on March 2.

DEPARTMENT OF STATE PUBLICATION 9997
The Commission on Broadcasting to the People's Republic of China
Released September 1992

Executive Summary

The implosion of the Soviet Empire demonstrated dramatically the power of ideas in world politics. It proved the truth of an old American notion that once had seemed romantic: that the fate of America is intertwined with the fate of American ideals.

This miraculous transformation was wrought by the democratic idea which in places like Gdansk, Prague and Leipzig emboldened workers and students, priests and intellectuals to challenge their rulers. It even infiltrated the minds of some of the rulers themselves, sapping their will, leaving them impotent to defend the old order.

The spread of democracy serves America's interests because it serves the interests of world peace. Experience shows that democracies start wars far less often than dictatorships. And it serves the interests of the nations to which it spreads because democracy is the only system that vindicates the rights with which God endowed all people.

One of the simplest yet most powerful means of influence is radio broadcasting. Now that the iron curtain has come down it is possible to assess the impact of four decades of broadcasting to Communist Europe. From the people who live there we learn that the Voice of America and Radio Free Europe/Radio Liberty were even more consequential than anyone had dared to believe. Together with the services run by other democracies, such as the BBC, they helped keep alive hope and dignity among people suffering under tyranny, and they discomfited the oppressors. They thwarted the grand totalitarian design of controlling the minds of the people by controlling the information available to them.

Though the Cold War is over, many millions around the world, particularly in Asia, remain under repressive rule.

One of the shackles with which these regimes try to bind their people is the denial of information—about what is happening in the world and what is happening in their own countries.

This Commission was created to "examine the feasibility, effect and implications" of instituting a radio broadcasting service to the People's Republic of China and other Communist countries in Asia in order "to promote the dissemination of ideas, with particular emphasis on developments within each of these nations."

The Commission believes that radio broadcasting can have significant impact upon trends in Asia, as it did upon democratic evolution in Eastern Europe and the former Soviet Union.

- Information is a powerful force for good.

- Radio is an instrument of peace, not a weapon of war. It is inexpensive and it maims no one.

- The United States has a unique opportunity at this moment in history to assist the wave of democracy that already has touched such Asian lands as the Philippines, South Korea and Taiwan.

- The United States should do this because it is right.

- The United States should do this because it is in its national interest.

The Commission agrees unanimously that increased broadcasting to the Communist countries of Asia—and others in that region where repression hobbles the operation of full and free domestic news media—by means of "Home Service" radio broadcasting is desirable, feasible and in the national interest.

By "Home Service," the Commission means a service broadcasting the kinds of information—particularly information about events and developments within the country itself—that would be available if there were no government censorship, and no repressive control of media. It is occasionally referred to as "Surrogate" radio.[1]

To be effective, such a service must be professional

[1] Mr. Anderson, Mrs. Cheng, Dr. Goldman, and Mr. Mater note that there are many different and often inaccurate interpretations of the term "Home Service" and often inaccurate interpretations of the term "Home service" and "Surrogate Service" but accept this limited definition.

and dispassionate, not polemical and not propagandistic. It must include strong research and monitoring functions to assure accuracy. It must have the commitment to journalistic independence without fear or favor similar to that displayed by Radio Free Europe and Radio Liberty in broadcasting to Eastern Europe and to the Soviet Union.

A majority of the Commission believe that for reasons spelled out in Part One—Conclusions and Recommendations, this service must be separate and insulated from the Voice of America and the United States Information Agency, and should be operated under the auspices of the Board for International Broadcasting.

A minority disagree, and for reasons spelled out in that same section, believe the Voice of America should be asked to create and operate this service by expanding on current broadcasting to China and Asia, emphasizing reporting of internal events.

1. The Commission recommends that the United States introduce a new "Home Service" broadcasting operation to totalitarian countries in Asia, with particular emphasis on China. The countries envisioned in addition to China are North Korea, Vietnam, Cambodia, Laos, and Burma.

2. A majority of the Commission (Cutchall, Hughes, Mosher, Muravchik, Tyson, and Wattenberg) recommends that the new service be insulated from the Voice of America and operate under the auspices of the Board for International Broadcasting and its citizen oversight board. A minority (Anderson, Cheng, Goldman, Mater) recommends that new service operate under the Voice of America. An eleventh member of the Commission (Marks) withdrew from the final deliberations and abstained from voting because of a possible conflict of interest.

To be effective, [radio broadcasting] must be professional and dispassionate, not polemical and not propagandistic. It must include strong research and monitoring functions to assure accuracy.

3. The Commission recommends unanimously that a new service, if created, not be called "Radio Free Asia," or "Radio Free China," but instead adopt a less confrontational name, such as "Asian Information Radio," or "Asia Democracy Radio."

4. The majority recommends that the headquarters of the new broadcasting service be located on American territory, in a region where it can draw on pools of Asian broadcasting and journalistic talent. Los Angeles or San Francisco are the preferred locations.

5. The majority recommends that the new service not embark on a program of transmitter construction, but lease time on a variety of transmitters presently available in various locations that can beam strong signals to the target countries. For the foreseeable future, the most effective means of delivery will be by shortwave radio, although the new service might also lease time on medium wave transmitters where these are available and effective.

6. The majority recommends that the new service be launched within 6 months of approval, with particular emphasis on China, phasing in additional hours and languages in the next 12 months, making the service fully operational within 18 months.

7. The majority estimates one time startup costs would be in the region of $30 million, and annual operating costs, with all programming under way, in the region of $35-39 million.

8. The Commission recommends that whoever operates the new service, its expense should in part be defrayed by suspending the ineffective operations of Television Marti—as distinct from the effective service of Radio Marti.

9. The Commission is unanimous in recommending that although Burma is not a Communist country the new radio service nevertheless should include that country whose ruling dictatorship is one of the most repressive in the world.

10. The Commission recommends unanimously that the Voice of America increase its existing broadcasting to China, particularly in Cantonese.

THE ENVIRONMENTAL EFFECTS OF STABILIZATION AND STRUCTURAL ADJUSTMENT PROGRAMS: THE PHILIPPINES CASE

Wilfrido Cruz
Robert Repetto

September 1992

Foreword

The Earth Summit in Rio demonstrated worldwide support for the principle of sustainable economic development. Under the banner of sustainable development, governments, environmental activists, and development bankers now scrutinize the environmental impacts of such individual investment projects as roads and dams. Although the results of these assessments are often controversial and sometimes unsatisfactory, at least all participants agree that scrutinizing the possible environmental consequences of investment decisions is necessary and important.

Compared to decisions on individual investment projects, decisions on tax, credit, international trade, and other macroeconomic policies can have much more far-reaching and pervasive environmental consequences. By affecting the incentives of millions of firms and households, macroeconomic policies can either unleash or discourage resource exploitation and degradation. However, until now, the environmental consequences of macroeconomic policies have never been rigorously scrutinized. In fact, the models used by analysts in government and research institutes to project the results of macroeconomic policy decisions assume away all possible environmental consequences. They are simply outside the analysts' field of vision. Consequently, debates about the environmental sustainability of macroeconomic policies have been ill-informed and perfunctory.

With so many developing and formerly communist nations undergoing sweeping economic change, understanding the complex interconnections among macroeconomic policy change, structural economic change, poverty, population growth and environmental degradation is not an academic exercise but a pressing real-world necessity. In *The Environmental Effects of Stabilization and Structural Adjustment Programs: The Philippines Case*, Wilfrido Cruz, a former WRI associate and Robert Repetto, WRI vice president and senior economist, begin closing this knowledge gap. The authors examine the environmental implications of macroeconomic policies in the Philippines during the 1960s and 1970s, before the onset of the debt crisis in the early 1980s, and also the consequences of the ensuing stabilization and structural adjustment programs financed by the IMF and the World Bank. They find that macroeconomic policies in both periods had momentous, and little understood, environmental consequences.

In this study, a natural resource accounting methodology developed largely by WRI is applied to the Philippines to demonstrate that its development strategy drew down natural resource assets while it built up external financial obligations, markedly undermining the country's national balance sheet. Macroeconomic policies prior to the debt crisis provided few incentives to manage forests, soils, or fisheries for sustained productivity.

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The analysis also shows how macroeconomic policies encouraged the rapid growth of relatively inefficient, pollution-prone processing industries, especially in the metropolitan Manila region, which consequently suffered severe environmental degradation. Although this process of overconcentration and degradation was observed as it occurred, little effort was made until too late to reverse the incentives that drove it.

Cruz and Repetto come to markedly different conclusions than previous observers about the environmental consequences of the stabilization policies designed to cope with the debt crisis. They find that the principal impact was not to force the Philippines to export its natural resources more rapidly to service the debt, as some have asserted. Because of the worldwide slump and domestic supply constraints, natural resource exports actually declined during the stabilization period. Rather, the principal impact was to send millions of unemployed and impoverished households as migrants into forested regions and onto marginal lands to seek a subsistence livelihood as shifting cultivators.

Based on their analysis, the authors conclude that structural adjustment policies, including trade liberalization and tariff reform, must be accompanied by other domestic policy changes to ensure sustainable use of natural resources. They point to options for the Philippines, such as reforms in resource taxation and land tenure, that could have forestalled much environmental damage, and they discuss alternative adjustment measures that could better have supported employment and eased the burden of poverty, thereby mitigating environmental pressures.

Policy-makers in development assistance agencies, international financial institutions, and developing countries can build on this report's analytical framework to design environmental considerations into structural adjustment and stabilization policies. It is to be hoped that the World Bank and the International Monetary Fund will develop and apply such new analytical approaches—and that environmental advocacy and watchdog organizations will elevate their scrutiny of national economic policies and structural reform programs.

The Environmental Effects of Stabilization and Structural Adjustment Programs: The Philippines Case extends and complements such recent WRI studies as *Accounts Overdue: Natural Resource Depreciation in Costa Rica, Paying the Farm Bill: U.S. Agricultural Policy and the Transition to Sustainable Agriculture, Wasting Assets: Natural Resources in the National Income Accounts,* and *The Forest for the Trees: Government Policies and the Misuse of Forest Resources.*

WRI would like to thank The Rockefeller Foundation and the Netherlands' Ministry for Development Cooperation, whose generous support made this study possible. We owe them a debt of gratitude for their support of WRI's work in natural resource accounting as well. To both, we express our deep appreciation.

James Gustave Speth
President
World Resources Institute

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Conclusions

Adjustment for Sustainable Development

The focus of macroeconomic policies in the Third World must extend beyond the immediate crises and encompass longer-term goals of sustainable development. At present, stabilization programs do not. Structural adjustment programs, even though they are intended to create an appropriate policy framework for long-term growth, also omit crucial environmental safeguards. Macroeconomic policies determine patterns of production, trade, investment, and income distribution. For good or ill, they therefore inevitably also influence how natural resources and the environment are used.

Policies that depress savings and lower the returns to investment shift resource use toward the present. Unmanageable domestic and external indebtedness are widely observable symptoms of this intertemporal reallocation. Less scrutinized but even more serious has been the depletion of natural resource assets. And yet, the analysis of the Philippines experience demonstrates that the rise in external debt and the depletion of natural wealth are both part of a general deterioration in the national balance sheet. They both arise from short-sighted policies. To promote sustainable development, macroeconomic policies must provide strong incentives to build capital--not just financial and industrial capital, but also natural resource and human capital. The deterioration of a nation's natural resource endowment is at least as serious an obstacle to sustainable development as the deterioration of its international credit standing.

The rise in external debt and the depletion of natural wealth are both part of a general deterioration in the national balance sheet. They both arise from short-sighted policies.

Reallocation of productive resources among sectors to achieve greater efficiency is the essence of structural adjustment programs. Changes in market incentives through reform of trade regimes, domestic price structures, taxes, and subsidies are the policy instruments of reallocation. However, if full environmental and resource costs are not reflected in the incentives resource users face, then efficiency will not be achieved either in the short or the long run. The Philippines study shows that macroeconomic policies without adequate environmental controls have increased emissions, concentrated pollution and congestion, increased pressure on open-access resources, and encouraged overexploitation of depletable resources. Structural adjustment policies have been designed without adequate consideration

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of such effects and implemented without the safeguards and corrective policies needed to control and reduce adverse environmental impacts. Without these intrinsic environmental components, there is no assurance that they effectively promote sustainable development.

Structural adjustment policies have been designed without adequate consideration of ecological effects and implemented without the safeguards and corrective policies needed to control and reduce adverse environmental impacts. Without these intrinsic environmental components, there is no assurance that they effectively promote sustainable development.

Such safeguards should not be regarded as impediments to structural adjustment policies or burdensome concessions to environmental interest groups. Indeed, policy and institutional reforms to correct environmental failures are complementary and essential components of a structural adjustment program. Policies can readily be identified that reduce environmental damage and simultaneously promote other economic objectives, such as fiscal balance, poverty alleviation, and economic efficiency. The Philippines study identifies several important examples, such as the taxation of resource rents, energy taxes, and the elimination of industrial incentives.

Recognizing the role of macroeconomic policies in environmental decline is the critical first step in formulating such an alternative approach. The World Bank and the IMF, as the main proponents and supporters of macroeconomic policy reform in the developing world, should actively promote new analytical approaches that simultaneously address structural reform and environmental needs. These institutions should have the capabilities and resources needed to carry out studies such as this one, with far greater sophistication and thoroughness, in cooperation with all of their clients.

Environmental organizations should also recognize that they need to extend their scrutiny and advocacy beyond their traditional concerns with individual investment projects and sectoral policies. They will have to take positions on national economic policy and structural reform programs. Those positions should be based on a deeper understanding of the direct and indirect workings of macroeconomic policies, not on oversimplifications and overgeneralizations regarding complex issues. This is a challenge to become involved, not an excuse to stand aside.

Wilfrido Cruz was an associate at WRI while completing this report. He was project manager of this Philippine macroeconomics and sustainable development study and of the Costa Rica natural resource accounting study. He is currently with the Environment Department of the World Bank. **Robert Repetto** is Vice President and Senior Economist at WRI and Director of the Institute's Program in Economics and Population.

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EDITORIAL/OPINION

Malaysia: Asia's Next Miracle

By JOSEPH P. QUINLAN

Malaysia's economy is like the Energizer bunny. it keeps going and going and going.

Indeed, for the fifth straight year, Malaysia expects to achieve real gross domestic product growth in excess of 8% in 1992. Not bad for a nation that less than a decade ago relied on a few primary commodities for growth.

Those days have long passed, however. Today, Malaysia is on the industrial fast track and a top candidate to become Asia's next newly industrialized country. Three key economic indicators underscore the industrial ascent of Malaysia.

One is the surge in manufactured goods as a percentage of total exports. Bolstered by foreign direct investment, manufactured exports like semiconductors, electronic consumer goods, electrical machinery and other items soared over the past five years and presently account for nearly two-thirds of Malaysia's total export earnings.

Conversely, the role and importance of traditional exports — tin, rubber and palm oil — have declined. Agricultural commodity exports made up 80% of total exports earnings in the 1970s, but now represent just 20% of total exports.

The rise of manufacturing output as a percentage of GDP is another indicator of Malaysia's push toward industrialization. Up through 1986, the manufacturing sector was secondary to agriculture and the minerals sector. But manufacturing output currently accounts for nearly 30% of GDP, having expanded by double digits every year since 1987.

Manufacturing now is the strategic driver of the economy, while the agricultural sector, though still a considerable source of employment, has seen its share of GDP drop below 20%.

Rapid per-capita income growth is the third sign of Malaysia's economic advancement. The nation's per-capita GDP stood at roughly $1,600 in 1986, but has jumped by more than 50% since then.

It now stands at roughly $2,600, which is twice that of Thailand and nearly six times that of Indonesia. In Southeast Asia, only Singapore has a higher per-capita GDP than Malaysia.

Why the sharp acceleration in manufacturing output and exports, along with the jump in per-capita income?

Malaysia's industrial takeoff is rooted in the market reform measures begun in 1986, and in the accompanying surge in foreign investment over the second half of the 1980s.

Following a brief but sudden recession in 1985 — the first downturn since independence — the government revamped its industrial policies and became more receptive to foreign investment. Growth in heavy industries was de-emphasized, while large state enterprises were sold off.

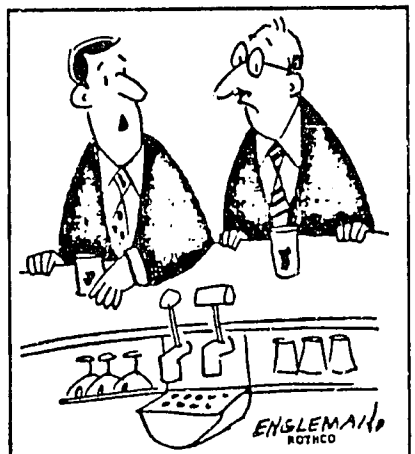
The New Economic Policy, a program designed to redistribute wealth to the economically underprivileged Malays, was revised as well.

The state's new priorities became private sector development and reduced dependence on commodity exports. Toward this end, a large privatization program was launched, the financial system was reformed and new wage guidelines and labor practices were implemented.

In addition, new tax incentives and regulations were introduced to attract foreign investment — a decision that paid off handsomely.

Over the 1986-91 period, foreign investment rose almost tenfold, from $675 million to $6.4 billion, with the bulk of the investment from Japan and Taiwan. For manufacturers like Fujitsu, Matsushita and Sony, Malaysia was an ideal offshore site given the nation's low wages, cheap currency, efficient infrastructure and abundant natural resources.

Many of these attributes, notably cheap wages and an adequate infrastructure, are under strain today, and have begun to worry foreign investors.



"Suppose Japan lifts its trade barriers and our products still don't sell?"

Indeed, the growing concern of investors are not unfounded: Five years of lady growth have spawned inflationary pressure, labor shortages and infrastructure bottlenecks. That's the bad news.

The goods news is that the government has embarked on an aggressive program, outlined in the Sixth Five-Year Plan covering 1991-95, that addresses Malaysia's most pressing problems.

To increase and ensure a steady supply of power, for instance, several new power stations are under construction. The plan is to double the country's electricity supply in the next 10 years.

New roads, airports and other infrastructural projects also are in the works, with $25 billion to $30 billion earmarked for infrastructural development alone in the Sixth Malaysian Plan.

Upgrading the technical skills of the nation's labor force is another priority of the five-year plan. The emphasis is on creating a pool of engineers, scientists and other technical personnel essential to promote Malaysia's long-term economic development.

In the short-term, the government has eased restrictions on imported labor to cover manpower shortages in the construction industry.

And in an attempt to deepen and broaden the indigenous manufacturing base, new foreign investment is being channeled into value-added products like automotive components and computer parts.

In addition, more investment incentives require foreign investors to forge links with local suppliers. This, in turn, will facilitate the transfer of technology, enhance local managerial skills, upgrade the product quality of indigenous firms and, in time, balance the need for capital imports.

Infrastructural bottlenecks, labor shortages, industrial development — these and other challenges will have to be hurdled in the coming years if Malaysia is to emerge as Asia's next newly industrialized nation.

Despite the economy's recent performance, some still doubt the nation's capacity to move ahead. Yet, given the government's record in managing the economy and the nation's copious natural endowments, the odds are that Malaysia's industrial rise will keep going and going.

Joseph P. Quinlan, an international economist, writes often about Asia.

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Executive Summary

Background

i. For most of its 70-year history as an independent state, Mongolia has been a centrally planned economy with extremely close ties to the Soviet Union, particularly since 1946. During this period, the country has been gradually transformed from a rural, essentially nomadic economy to one with a large industrial sector, mainly for the production of semiprocessed raw materials. Industrialization was made possible by large investments and loans from the Soviet Union, particularly in the early 1980s, which permitted Mongolia to run large fiscal and external deficits and to enjoy relatively high rates of growth.

ii. This situation began to change in the mid-1980s as Mongolians became increasingly dissatisfied with the rigidities of the centrally planned system. Some reforms were initiated as early as 1986 but did not improve the situation dramatically. After popular demonstrations in March 1990 and the country's first multiparty elections in July 1990, a new coalition government was formed that pledged to "construct a market-oriented economy." Since then, the government has embarked upon a comprehensive program of reforms covering the entire spectrum of economic policies, including privatization, price liberalization, and the establishment of new institutions for macroeconomic management.

iii. The new policy framework coincided with two major external shocks that have seriously affected the economy. First, owing to its own economic difficulties, the Soviet Union terminated its financial and technical assistance to Mongolia in 1991, except for the completion of ongoing turnkey projects; it has also found it difficult to maintain regular supplies to Mongolia of essential commodities such as cement, fertilizers, petroleum and spare parts. Second, the collapse of the Council for Mutual Economic Assistance (CMEA) system in 1991 has seriously disrupted Mongolia's external trade.

iv. Thus, Mongolia's economic reform process has begun under adverse circumstances. The external shocks have had two major effects. In the short term, they have necessitated strong stabilization measures to reduce large structural deficits in Mongolia's fiscal and external accounts. For the longer haul, they have emphasized the need for immediate policy changes to reorient and restructure the economy, so that efficient, self-sustaining growth can be resumed as soon as possible.

Recent Developments

v. The impact of the rapidly changing external environment was first felt in 1990, when GDP fell by 2.1 percent, the first decline in many years. A steeper drop occurred in 1991, estimated at over 16 percent. Among the major sectors, the most rapid decline occurred in the construction sector, as investment decreased dramatically following the abrupt termination of external assistance. This has already created a rapid increase in unemployment, despite the moderating effect of the development of the private sector, which has been creating new jobs in response to economic liberalization.

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vi. The reduction in foreign savings is leading to problems in financing the fiscal deficit, equivalent to about 17 percent of GDP in recent years. In 1991 the government resorted to heavy indirect borrowing from the central bank. Reforms under way, such as the conversion of enterprise profit remittances to taxes and changes in the price structure, have reduced old sources of fiscal revenue, while new ones are not yet fully effective. Credit to government and state enterprises together increased in 1991 by almost 50 percent. Credit to private enterprises also grew, fourfold. Estimating the impact of this credit expansion on inflation is not easy, because data are few and because the administrative doubling of most prices in January 1991 makes comparisons with earlier years unreliable. In addition, prices increased further, by an estimated 120 percent in 1991. The rapid growth of money supply in the face of declining production thus raises the specter of hyperinflation. This is why stabilization measures are being given top priority.

vii. Perhaps the most serious impact is visible in the foreign trade sector. In 1986-89, Mongolia's current account deficit was equal to about 30 percent of GDP. The deficit declined sharply in 1991, as imports and exports of goods and services fell by about 75 percent and 45 percent, respectively, from their 1989 levels in the face of the CMEA and USSR difficulties. Reserves became negative as Mongolia turned to hard currency imports to supplement declining CMEA supplies. All this has been compounded by recently poor prospects for some of Mongolia's main hard currency exports--cashmere, wool, and leather products.

viii. Thus, a wide range of measures is needed, both to arrest this serious economic decline and to stimulate efficiency gains and create new sources of growth.

Stabilization and Macroeconomic Reforms

ix. Mongolia has moved swiftly to remove its old central planning system, and new institutions and policy instruments are being put in place. In May 1991, a new central bank was created and the commercial functions of the old monobanking system are being privatized. Now that the central bank is operational, it has begun to tighten monetary policy, and strict money and credit targets have been adopted as part of Mongolia's stand-by program with the International Monetary Fund (IMF). Clearly, with recent runaway money growth and rapid inflation, reimposing monetary discipline is the central bank's most important and immediate task. Beyond this, its main priority will be to establish itself and train its staff to regulate and supervise a private banking system, and to complete the privatization of its commercial banking functions. Privatization has not proceeded as fast as had been expected, not least because of the many bad loans on the books of these banks as a result of past directed credit. While it is necessary to remove nonperforming loans from the banks' portfolios before privatization, it will also be necessary to avoid monetizing such debts.

x. Among the first measures that the government instituted were reforms of the taxation system, recognizing that old sources of finance would fast disappear. Indeed, continued adjustment of public finances remains at the heart of the stabilization effort and of the program to create a new economic system. Already, new corporate and personal income taxes have been insti-

tuted, and a new customs tax has replaced the old import price differential system. New indirect taxes have been imposed to fill the large revenue gap.

xi. The authorities have begun to reduce public expenditures, primarily by postponing or eliminating investment expenditures and by cutting the size of the civil service. In addition, cost recovery measures are planned to reduce net outlays in health and education. The major area still needing effort is reducing subsidies, which account for a quarter of public expenditure. Industrial and trade subsidies should be eliminated rapidly, as part of the transition to a market economy.

xii. On the external side, Mongolia has relied heavily on exchange rate measures and barter trade to adjust its external accounts. The rate moved from Tug 3 = $1 in June 1990 to Tug 40 = $1 today. However, a special rate of Tug 7 = $1 was maintained until November 1991 and then Tug 75 = $1 until March 1992 for barter trade with the Soviet Union. Foreign exchange retention is permitted (to differentiated ceilings) and can be exchanged in a third, parallel exchange market, at higher rates. However, nothing similar to the liberalization of foreign exchange has taken place in trade, which is still dominated by the old trade corporations and by compulsory state orders. Removal of this monopsony situation is urgently needed to improve incentives for non-state corporations to increase export efforts.

xiii. Finally, the authorities have yet to define clear policy coordination mechanisms with regard to macroeconomic issues. The old central planning system has been formally discarded but has not yet been fully replaced by new institutions and processes. Despite help from international agencies, these mechanisms are only slowly emerging.

Policies for Structural Change

xiv. Mongolia has also moved to institute a wide range of policies to improve efficiency in its industrial, agricultural, and service sectors. These will need to be supplemented by medium-term development strategies and accompanied by a reorientation of the role of government. Price reform has been given a central role. Already prices accounting for some 70 percent of all transactions have been liberalized, and some of the remaining 30 percent (excluding some public services) are scheduled to be freed by the end of 1992. While this is encouraging, price liberalization needs to be accompanied by the abolition of the state order system, especially the state marketing organizations in the agricultural sector. Instead, such organizations may offer in some cases minimum support prices to ensure some stability to farmers as new mechanisms are developed. For the remaining public services, appropriate pricing policies will be necessary, especially passing through the full cost of imported products, where the highly overvalued barter exchange rate has caused severe distortions.

xv. The government has placed privatization of state-owned enterprises at the center of its reform program. Over 2,000 enterprises, including 340 large ones, are to be privatized through a voucher system. Originally, the government hoped to achieve this over a twelve-month period, but has since adopted a more realistic three-year timetable. It will be important to link the pace and sequencing of the privatization program to reforms in other

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areas, in particular price and marketing reforms. Marketing reforms must precede privatization, not follow it. A particularly difficult issue is how to treat the enterprises' Tug 10 billion of domestic debt. Clearly, enterprises will have to be valued on a net basis, and debt may have to be converted into long-term bonds. Care will also be needed in addressing the possible macroeconomic impact of privatization, especially the distributional effects of the ownership transfer.

xvi. Considerable effort has gone into the price reform and privatization programs, but less attention has been given to promoting new private sector activities. Good progress has been made on the enabling environment, but this will need to be backed by supportive institutions. Sufficient credit, for example, must be available for new private enterprises so that they do not get squeezed out of the market by state-owned ones. Similarly, a significant number of enterprises (in terms of asset value) will remain in public hands indefinitely and others for some time prior to their privatization; early thought will need to be given to how such enterprises will be managed and regulated and how the state's ownership role will be exercised.

xvii. These reform issues--especially price reform and privatization--will be crucial for medium-term sectoral development. In agriculture, privatization of the herds and a full role for market forces are the main issues. Industry is hampered in particular by inefficiency and locational issues deriving from the central planning system. The energy sector has suffered from poor pricing policies, and from lack of access to modern technology, which has had an adverse impact on the urban environment.

xviii. As reforms take hold, government will have to assume new roles. Preparation for this shift needs to start soon. For example, the government will continue to have a role in providing agricultural services; industrial retraining, and especially management development, will be required; and public investment will need to be refocused away from production and toward financing essential economic infrastructure. The latter is especially important in transport and energy, where capacity constraints could pose serious obstacles to economic diversification, especially in terms of external trade. There are perhaps two key roles for government. First is to reorient the government itself and the civil service to managing an economy <u>indirectly</u> instead of by the old administrative means. It is evident, for example, in the program to promote small business, that the government still thinks in terms of direct actions rather than enabling policies.

xix. The second is to focus resources on the social safety net. The socialist system made notable achievements in terms of health, education, housing, and poverty alleviation. In the rush to discard the old structure, these functions of government should not be forgotten. During stabilization, special efforts need to be made to protect the most vulnerable groups from the effect of output declines and relative price shifts. At the same time, long-term gains in human resource development need to be maintained and improved.

<u>Development Prospects</u>

xx. Mongolia's medium-term development prospects include its well-educated labor force, abundant agricultural and natural resources, and the

traditional resilience of its rural economy. However, the country also faces a number of basic developmental constraints, in addition to its serious short-term problems. In 1991, the economy was hit by severe external shocks, and the authorities responded with a strong stabilization program and simultaneous structural reforms. The program was designed to limit the decline in GDP to 5 percent in 1992 and, after a year of zero growth in 1993, to resume average growth of 3 percent annually thereafter. [As in other socialist economies in transition, GDP growth rates can be seriously understated during reforms because of large relative price shifts and unmeasured activity.]

xxi. This scenario was based on two critical assumptions: that Mongolia's external environment would not deteriorate further; and that the government's reform program and policies would be effectively implemented on schedule. The greatest risk to the government's program is the prospect of a further collapse in trade with Russia and other former Soviet republics. Given Mongolia's high import dependence and harsh climate, this breakdown in trade could have potentially devastating consequences on its economy and people, although its rural sector may provide some resilience and security. Even in the absence of further external deterioration, the government's targets may not be achieved because of policy failures, either in design or implementation. The program's realization may therefore require bolder and firmer reform measures by government and a strong response from the private sector.

xxii. Throughout the period of stabilization, Mongolia will have to rely heavily on external financing if it is to have an acceptable minimum level of imports to maintain production and begin a modest recovery. Nevertheless, the balance of payments is subject to considerable risk, implying that Mongolia should obtain external financing primarily on concessional terms, with restricted access to commercial sources. If such terms can be achieved, related debt service should not be a problem, provided that the servicing of Mongolia's debt to the former Soviet republics remains manageable.

What U.S. Companies Need to Know About Intellectual Property Protection in Vietnam

Prepared by the Patent and Trademark Office and the Office of the Pacific Basin, U.S. Department of Commerce

U.S. companies may be vulnerable to the activities of trademark pirates who are registering the marks of U.S. companies in Vietnam.

The U.S. Department of Commerce has received information from at least one U.S. company indicating that trademark piracy is occurring in Vietnam to the extent that internationally well-known trademarks owned by U.S. companies are being registered by other than their rightful owners. Vietnam is the subject of a United States trade and financial embargo pursuant to the Trading with the Enemy Act, 50 U.S.C. App. 5(b) and implemented by the Vietnam Foreign Assets Control Regulations, 31 CFR Part 500. The embargo became applicable to North Vietnam on May 5, 1964 and was extended to cover the whole country when South Vietnam fell to the North on April 30, 1975. Trademark registrations obtained in South Vietnam before 1975 and not re-registered in the Socialist Republic of Vietnam by December 1982 were invalidated. Therefore, most U.S. companies do not own trademark registrations in Vietnam and these companies may be vulnerable to the activities of trademark pirates.

The U.S. embargo of Vietnam permits U.S. companies to obtain, defend, and maintain trademark registrations, as well as patents and copyrights.

While the U.S. embargo prohibits most trade and all investment with Vietnam, Section 500.528 of the regulations permits certain transactions in connection with obtaining, defending, and maintaining trademark rights by any U.S. entity or individual who is not, according to the regulations, a designated national. The regulations permit the following:

- The filing and prosecution of any application for a Vietnamese patent, trademark, or copyright, or for the renewal thereof;
- The receipt of a Vietnamese patent, trademark, or copyright;
- The filing and prosecution of opposition or infringement proceedings with respect to a Vietnamese patent, trademark, or copyright, and the prosecution of a defense to any such proceedings;
- The payment of fees to Vietnam, either directly or through an attorney or representative, in connection with the above or for maintenance of a patent, trademark, or copyright;
- The payment of reasonable and customary fees currently due to attorneys or representatives in Vietnam in connection with the above.

The regulations do contain limitations upon powers of attorney and transfers of property. Therefore, any company proceeding to obtain, defend, or maintain a patent or a trademark registration should ensure that it remains within the scope of permitted activities. Questions concerning the embargo should be referred to Jeff Braunger in the Office of Foreign Assets Control, Treasury Department, tel. (202) 622-2480.

Industrial Property Protection

The Socialist Republic of Vietnam is a member of the Paris convention for the Protection of Industrial Property of March 20, 1883 (Stockholm Text), the Madrid Agreement of 1881 concerning the International Registration of Marks, and the Stockholm Convention July 14, 1967, establishing the World Intellectual Property Organization (WIPO). Of the above, the United States is not a member of the Madrid Agreement, thus, U.S. companies may not avail themselves of the Madrid Agreement to obtain trademark registrations internationally.

Industrial Property Decree No. 13 LCT/HDNN8, as amended by subsequent decrees and regulations, defines rights in, and establishes procedures for protecting trademarks, inventions, utility solutions, and industrial designs in Vietnam. U.S. companies proceeding to obtain patents or register trademarks in Vietnam must work through an industrial property agent located in Vietnam and recognized by the Socialist Republic of Vietnam. Applications are submitted to, and examined by, the National Office of Inventions (NOI), with review in certain circumstances by the State Committee for Science and Technology.

Companies seeking trademark registration should note that Vietnam vests ownership rights in the first entity to file an application, regardless of prior use of a mark. Prior to seeking patent protection in Vietnam, U.S. companies may wish to review Vietnamese law pertaining to the use of an invention under certain circumstances by the government.

Copyright Protection

For foreign works to be protected [illegible] country, there must be a bilatera[illegible] multilateral commitment on behalf [illegible] both countries to protect works of [illegible] other's nationals. Currently, no [illegible] commitment exists between the Ur[illegible] States and Vietnam. A draft copyr[illegible] law for Vietnam appears to antici[illegible] that Vietnam will join one of the [illegible] international copyright conventions, [illegible] Berne Convention or the Unive[illegible] Copyright Convention, to which [illegible] United States already belongs. En[illegible] ment of such legislation, followed [illegible] accession by Vietnam to one or bot[illegible] these conventions, would provid[illegible] basis for the protection of U.S. work[illegible] Vietnam. Vietnam does not now ha[illegible] copyright registration system.

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President Bush Should End Vietnam Embargo

By Donald K. Emmerson

WHEN they assess the presidency of George Bush, historians will remember the winning of the cold and Gulf wars. The last months of his administration offer him a chance to burnish this reputation by moving to resolve the bitter aftermath of a war America lost. It is time for the president to end the embargo against Vietnam. In his first policy speech after the election, Bill Clinton promised to press Hanoi for a "final and full resolution" of what happened to Americans missing in action (MIAs) from the Vietnam War. He ruled out "normalization of relations with any nation that is at all suspected of withholding any information" on missing Americans.

But "normalization" can be understood to mean not a journey but a final step: exchanging ambassadors. Ending the embargo need imply neither beginning diplomatic relations nor ending the effort to determine the status of the MIAs. Allowing Americans to trade with Vietnam and invest there could, on the contrary, help intensify cooperation on MIAs as a condition of full relations.

Given on Veterans' Day to an audience ill-disposed toward Hanoi, Mr. Clinton's speech showed that he, rather than lame duck Bush, suffers from a misperception about Vietnam. Mr. Bush, the Republican World War II hero who rooted for the United States in Indochina, will find it easier to reconcile Americans with their former enemy than will Democrat Clinton, who in escaping the draft and opposing the war angered Americans who did neither. Elected in November by a minority of voters, the president-elect cannot afford to be distracted by controversy over Vietnam while he concentrates on reviving the US economy.

Lifting the embargo would not commit the US to opening an embassy in Hanoi or providing economic aid.

Yet lifting the embargo will help his domestic agenda by enabling US businesses to export to Vietnam and invest there, generating jobs and profits for Americans and meeting the new president's own requirement that foreign policy should help the domestic economy. For these reasons I can imagine Clinton's strategists quietly asking Bush to end the boycott so they will not have to.

In April 1991 the Bush administration gave Vietnam a "road map" of the turns Hanoi would have to take to earn normal relations with the US: (1) withdraw Vietnamese forces from Cambodia and support a peace agreement to resolve the conflict there; (2) permit the emigration of Vietnamese who worked for the US during the Vietnam War; and (3) help resolve the "discrepancy cases" of Americans missing in action but known to have been alive prior to hypothetical capture by Viet Cong or North Vietnamese troops.

Winners of long wars against France and the US in the 1950s and '70s, respectively, militant Vietnamese leaders once believed time was on their side. "For the last 4,000 years we have had no relations with your country," one official told me in Hanoi in 1987. "We can wait another 4,000." But that was before the cold war ended, the Soviet Union collapsed, and Russia stopped subsidizing the Vietnamese economy. These realities obliged Hanoi's hard-line Leninists to turn to the West.

The first two conditions on the "road map" have been met. One can disagree just how many Vietnamese troops and advisers were withdrawn from Cambodia at what times, and how many were later reintroduced and removed again. But clearly Vietnam has left Cambodia to its own devices. Hanoi signed the UN peace plan in October 1991 and has not obstructed its implementation. Vietnamese who were imprisoned or "reeducated" for helping the US fight communism have been allowed to emigrate.

Has Vietnam also met the third condition? Hanoi's willingness to cooperate with the US in clearing up discrepancy cases has waxed and waned. But the discrepancy list has been shortened, by some counts, to around 60 names.

Enough has been done to enable Bush to announce these near-certainties: There are no live US MIAs being held in Vietnam against their will; and even with Hanoi's cooperation we will never know the fate of all 2,000-plus Americans still unaccounted for, any more than the US knows what happened to its 8,000-plus MIAs from the Korean War or the nearly 70,000 still missing from World War II.

Recently, Hanoi opened its files and closets to American researchers. The resulting flood of evidence - thousands of documents, photographs, and objects - could be used, I admit, to postpone rapprochement. If Vietnam's leaders have for all these years denied access to their archives while hypocritically claiming to cooperate, why shouldn't Washington keep blocking trade until Hanoi coughs up still more information?

But this assumes the embargo can remain effective. Dozens of Asian and European countries are already in Vietnam - investing, trading, and lending. Taiwan's investments run to $75 million. South Korean trade will swell this year to $500 million, double last year's flow. Japan has announced a $370 million loan. Already Vietnamese consumers buy US products worth some $40 million annually, but the profits go to middlemen in third countries willing to ignore US displeasure.

Lifting the embargo would not commit the US to opening an embassy in Hanoi or providing economic aid. These would remain further destinations on the road map, Clinton and Congress someday willing. (It took eight years to move the US and China from economic to diplomatic relations.) Nor should Americans have any illusions that by trading with Vietnam and investing there they will assure the democratization of its government.

But that is not an argument for the status quo, because 17 years of isolation have not democratized Vietnam, nor will Clinton's proposed Radio Free Asia.

American trade with Vietnam's burgeoning private sector need not imply official US approval of the authoritarian socialists who are still repressing political pluralism there. But the Vietnamese have traveled far enough down the road mapped out for them for Bush to reciprocate with a few turns of his own: (1) acknowledging the likelihood of permanent uncertainty about many MIAs; (2) ending the embargo for the sake of American economic competitiveness; and (3) researching the fate of MIAs in an atmosphere of broadening contacts and interaction. Who knows? The Clinton administration might speed the "peaceful evolution" from dictatorship that Hanoi's hold-out Leninists fear so much.

Bush is a lame duck. But in that lameness lies the strength to be a statesman - to do what is in the silent interest of Americans.

■ *Donald K. Emmerson is a professor of Southeast Asian studies at the University of Wisconsin-Madison.*

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THE WASHINGTON POST, November 8, 1992

Elizabeth Becker

Showdown With the Khmer Rouge

As the United Nations peacemakers prepare for a showdown with the Khmer Rouge in Cambodia, their critics are declaring the peace plan for that country a shambles because the Khmer Rouge won't play by the rules. Implicit in this verdict is the notion that the Khmer Rouge are strong enough to hold Cambodia's peace hostage to their whims. The international community is about to demonstrate that, on the contrary, the loss of Khmer Rouge participation is not going to ruin either the plan or the country's prospects for peace. Instead, if the U.N. makes the right moves, the Khmer Rouge just might be on the way to digging their own grave.

Cambodia's peace mission is far more secure than those in El Salvador or Angola—not to mention the former Yugoslavia. Last week two foreign ministers who have been part of the Cambodian peace odyssey from the beginning—Roland Dumas of France and Ali Alatas of Indonesia—were visiting all the Cambodian leaders to make one last effort to persuade the Khmer Rouge to cooperate before the Nov. 15 deadline for a report on the Cambodia peace mission. Then the U.N. will decide how to proceed now that the Khmer Rouge have refused to honor the treaty they signed last year and will neither disarm nor participate in the elections set for May.

That report should stress how the U.N. mission in Cambodia has worked around the Khmer Rouge since it arrived six months ago, patiently giving the Cambodian people the security and tools they need to build a peaceful alternative the Khmer Rouge cannot destroy. This has been the result of one of those slow games within games that diplomats thrive on and revolutionary mass-murderers routinely fail at.

The first hurdle was to get the Khmer Rouge to sign the treaty last year, allowing their benefactors—especially China—a face-saving way to end all foreign support to that war. By the stripping away of their international credentials as well (they were the dominant partners holding the U.N. seat and theirs were the only ambassadors allowed at international functions), the Khmer Rouge were deprived of the political and material means to sustain their aura of omnipotence. Cambodia's civil war was shown to be as much a war of foreign intervention as one that truly divided the Cambodian population. Indeed, at the moment the Khmer Rouge control an estimated one percent of the population. The vast majority of Cambodians are not at war against each other.

Until July, the Khmer Rouge believed they could outmaneuver the United Nations and make the international community abort the plan. They have watched in disbelief as the U.N. plan has dismantled their power base step by step. The treaty ended the international sanctions against Cambodia, enforced since 1979 to pressure the Vietnamese occupation troops to withdraw. By ending this isolation and opening up the country, the treaty destroyed a precondition the Khmer Rouge have always sought to return to power and control the people. By returning to the community of nations after almost 20 years out in the cold, the Cambodian people know they have real alternatives besides the old cruel choices imposed by their isolation.

Refugees are being repatriated, families reunited, capitalism restored, human rights taught and voters and parties registered. All the benefits and the ills of our modern world have rushed into Cambodia, filling the void left by the wars, revolutions and despair.

As the United Nations started preparing for all of these changes, it demarcated who controlled what. We know with certainty now that the Khmer Rouge do not rule a single province, much less the entire countryside, as alarmists had said. Today, the U.N.'s military intelligence estimates Pol Pot's army to include no more than 5,000 to 10,000 troops, who spend far more time selling off Cambodia's resources than mounting military operations. The general offensive they have been threatening since 1989 has so far proved a bluff.

There are new reports the Khmer Rouge are trying to expand their territory, largely by inhabiting deserted tracts that are of strategic interest in war but of little use in peace, except for reasons of commerce. By Nov. 15, the United Nations should have a strategy to curtail this and other hostile activity.

The U.N. negotiators should continue to follow the strategy they have improvised since it became clear the Khmer Rouge would not keep their word. The U.N. diplomats patiently negotiated all points of contention until the Khmer Rouge were forced to admit they would not go along with the treaty. Then the U.N. deprived the Khmer Rouge of the benefits from the plan, largely aid money.

Now the U.N. must broaden the interpretation of this new precedent. Since the Khmer Rouge have shown they refuse to engage in the peace process, the international community and Cambodia should disengage from the Khmer Rouge. The Khmer Rouge should be deprived of all the benefits derived from Cambodia's return to the international community, especially commercial benefits. (Thailand's new foreign minister Prasong Sunsiri recently declared in an interview that his country, whose business community accounts for all the commerce with the Khmer Rouge, would respect such a resolution if it were passed by the U.N.) The Khmer Rouge could be reduced to a nonvoting observer status in the Cambodian body created to work with the U.N. mission.

So far the U.N. has wisely rejected calls to corner the Khmer Rouge with military action, hasty ultimatums or other emotionally satisfying denunciations that might have provoked Pol Pot to lash out against the Cambodian population. Critics often complained the U.N. was caving in to the Khmer Rouge. But to their credit, the diplomats and politicians involved—especially those from the five permanent member states of the U.N. Security Council plus Japan, Indonesia and Australia—have controlled their urge for quick results and have allowed the peace plan to succeed through improvisation rather than strict application.

The key to the success in Cambodia has been the deep international involvement, based in large part on the collective guilt felt for failing to help the Cambodian people during their two decades of tragedy. Instead of blaming the U.N. for Pol Pot's refusal to keep his commitments, the U.N. should be allowed to find the right formula to deepen Pol Pot's self-imposed isolation while protecting the Cambodian people from Khmer Rouge hostility.

The writer, a special correspondent for The Post, has written extensively about Cambodia.

The Threat to India's Economic Reforms

By Rajeev Malik

ON Dec. 6 a mindless mob of more than 250,000 Hindus attacked and destroyed a 16th-century mosque in Ayodhya, northern India. Ignoring a supreme court directive against any action that might cause harm to the disputed mosque, the crowd of Hindus leveled the Babri *masjid* (mosque). The action focused the world's attention on one of the thorniest issues in India's effort to remain secular: communal strife between Muslims and Hindus.

The massacre of more than 1,200 Muslims and Hindus in the aftermath of the heinous crime was enough to raise the specter of India's partition in 1947. An estimated half a million people were slaughtered during the partition that led to the creation of Muslim Pakistan. For the first time since independence, sectarian conflict between Hindus and Muslims (constituting 83 percent and 11 percent respectively, of the population) now threatens to undermine the secular nature of the world's largest democracy.

The timing of the present crisis could not have been worse. Only a year and a half ago India had launched its most ambitious liberalization program. With a middle class of about 250 million people, India is a significant market, and the opening of the country to foreigners was greeted with widespread euphoria around the world. Just as the country was beginning to respond to the new economic initiatives, the liberalization package faces possible extinction because of the recent crisis.

For more than 40 years since independence, India has failed repeatedly to capitalize on a multitude of global opportunities. Nearly all governments since 1947 have managed to downplay their inefficiencies, bad policies, and corruption, while keeping the country in virtual isolation from the world by invoking the anticolonial sentiments associated with the British. The goal of self-sufficiency only led to a web of intricate, inward-looking policies, a heavy reliance on socialism, and the rise of a counterproductive bureaucratic structure.

The economic malaise reached crisis proportions last year when India nearly defaulted on its foreign debt obligations. Foreign exchange reserves had plummeted to $1 billion – barely enough to finance two weeks of imports – and total foreign debt had amassed to $71 billion. Given the pathetic state of the economy, foreign investment fell earlier in the year, and non-resident Indian (NRI) money flowed out at an alarming rate of $310 million a month between April and June 1991. The downgrading of India's credit rating only compounded the problem.

It was a combination of external reactions to the domestic crisis and the outright rejection by the World Bank and the International Monetary Fund of any help prior to economic restructuring that forced India to identify pockets of inefficiencies. Last year, the world witnessed fresh thinking from the otherwise parochial Indian planners. The year carried with it the hope that at last India was making a concerted effort to break free from its economic past. Prime Minister Narashimha Rao, along with Finance Minister Manmohan Singh, unleashed a spate of deregulation measures and initiatives to enhance India's economic growth. Mr. Rao was elected prime minister following the assassination of Rajiv Gandhi.

In July 1991 the rupee was devalued by 20 percent to stop the outflow of NRI money, give a boost to exports, and convince exporters to repatriate their foreign earnings. The government boldly decided to eliminate $879 million in export subsidies and to practice fiscal austerity. In a surprise move earlier this year, the government made the rupee partially convertible in order to strengthen the market mechanism. Foreign equity participation was increased to 51 percent and foreign investors were allowed access to primary and secondary financial markets.

THE significance of these changes lies not only in the unprecedented emphasis on structural reform, but also in their reflection of a pivotal change in the Indian psyche. Although India is ideologically more open than China, it is, in an economic sense, more closed than China. Centuries of foreign rule have made generations of Indians averse to foreign capital. After all, according to the gospel preached by ethnocentric Indians, the British came in as traders and decided to camp for a long time.

Although Indians have flirted with liberalization measures in the past, this is really the first time that any government has come this far toward restructuring the economy. Many impediments still remain; the infamous bureaucracy exists, and corruption still pervades the system. Yet economic liberalization is slowly but surely taking shape.

And now this religious fervor threatens a monumental collapse of economic initiatives. There have been repeated calls for Rao's resignation because he is not able to safeguard the interests of Muslims in India. A change in government at this time could deliver a hard blow to the reform program and irreparably damage foreign confidence regarding India's commitment to reforms.

The pace of future economic reform is likely to slow. Rao's government so far has avoided many politically sensitive decisions, such as the fate of employees laid off by the closure of unprofitable public sector enterprises and the liberalization of the financial sector.

Having experienced unpleasant results at the hands of Indian governments in the past, many foreign companies have adopted a posture of cautious optimism toward India. They are pleased with the reforms but are wary of potential policy reversals lurking in the background. The incident at Ayodhya provides an opportunity for the government of India to rise to the occasion by avoiding any serious repercussions on the liberalization policy. If it can achieve that, it will have eliminated yet another threat to the unshackling of the economy. If it fails, however, the world will once again shy away from India, and India will reenter its cocoon.

■ *Rajeev Malik is the Analyst for India in the World Markets Group at DRI/McGraw-Hill, an economic consulting firm based in Lexington, Mass.*

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WASHINGTON
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A Digest of Development Policy Information

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FALL/WINTER 1992
EASTERN EUROPE

January 22, 1993

Dear Readers:

Welcome to the first edition of the 1993 series of Washington Economic Watch. We are pleased to announce that funding has been reinstated and quarterly production will resume in 1993. As in previous issues, WEW covers the important economic policy debates in Washington. This inaugural edition provides insight on issues of concern to developing countries, as monitored during the pre-election and transition period in autumn of 1992.

Herein you will find statements made by senior U.S. government officials, summaries of U.S. congressional hearings, press commentary, and excerpts from policy research and analysis published by Washington 'think tanks' and multilateral financial institutions. The material is organized according to six functional categories; within each are subject groupings, with policy statements generally appearing first and commentary and analysis following. Also included is a bibliographic listing of participating institutions. Please direct requests for publications to the respective organizations.

ODC has experienced a few administrative changes as well. Dawn Murphy recently joined ODC as the new WEW Coordinator to whom all future correspondence should be directed.

We look forward to an exciting year with the new administration in place and hope that this issue proves to be an informative resource for your institution.

Sincerely,

Christine Contee

Christine E. Contee
Director of Public Affairs
& Fellow

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High Stakes in Bosnia for Clinton and Bush

TOM HUGHES

By George Kenney

IT'S time for a change in United States policy toward the Yugoslav war. Before Jan. 20 there is time to stabilize the situation. But President-elect Clinton and President Bush must work together quickly to push the West to take responsibility for Bosnia's survival. If they do nothing, President Clinton will inherit a festering crisis that may carry into other areas. Bosnia could be doomed – a terrible precedent for further aggression in the Balkans.

The first priority is to abandon efforts at neutrality Balkan history or no, Serbia is the clear aggressor, a rogue country in central Europe. Although the US and United Nations single out Serbia as bearing an overwhelming share of the responsibility for this war, Western statements tend to lapse into a phony "moral equivalence" where blame is all equally spread.

Worse, the fact of Serbian culpability is lost when Mr. Bush or Acting Secretary of State Lawrence Eagleburger speak. In the first presidential debate Bush talked about "ancient ethnic rivalries that cropped up as Yugoslavia has dissolved." He went on to say he would "stand by and use moral persuasion." Mr. Eagleburger echoes such remarks. He talks about centuries of ethnic conflict. He reminds the press that he has said "38,000 times" that intervention in this "civil war" won't work.

It is those often-repeated remarks, not official statements, that inform the American public. No American wants a part of another foreign civil war. So while the public remains misinformed, assistance to the victims, especially to Bosnia, is not a US policy option – for either Bush or Clinton.

Here are the facts: In July 1991, Serbia invaded Croatia, arguing that the 12 percent Serbian minority there needed protection. They did. Croat ethnic nationalism threatened non-Croat minorities. But most Serbian Croats were fairly well assimilated in places like Zagreb; Serbian minority problems could have been handled. Instead, Serbia invaded and occupied 30 percent of Croatia – killing 10,000 people and committing thousands of atrocities.

Then, in April 1992, Serbia invaded Bosnia – saying Bosnia's 31 percent Serb minority was threatened. But in Bosnia, Serbs were well assimilated – better than in Croatia. The Bosnian government pursued moderate policies to guarantee civil rights for all ethnic groups. There was no problem. In fact, Bosnia had been the model of ethnic tolerance the US government wanted other areas of Yugoslavia to emulate! Now Serb forces occupy 70 percent of Bosnia, have killed 70,000 people, driven 1.5 million from their homes, and committed uncounted acts of barbarism.

These events were not and are not a "civil war." There has been no fighting on Serbian soil. Neither Croatia nor Bosnia has ever harbored intentions to take part of Serbia. Rather, this is a war of aggression waged by an evil regime in Belgrade that has brainwashed its people much in the fashion of Nazi Germany in the 1930s.

For the West to oppose Serb aggression it must be seen for what it is. Diplomatic hedging or indulgence in denial only prolong the suffering of innocent people. To save Bosnia, Bush and Clinton must agree the US should take sides.

Yugoslavia is the benchmark for the kind of foreign policy crises the Clinton administration will face repeatedly. It calls for US leadership in a new but dangerous world. The lesson is that international institutions, as currently organized and operated, can't deal with local, high-intensity aggression. No one knows how to deal with fragmenting forme communist states – how to sort legitimate from illegitimate demands for self-determination.

The lack of such a set of rules need not result in a lack of will to confront aggression. Rather, it shows a need to adapt current institutions such as the UN and NATO to the post-cold war world.

Turmoil may rock Europe for a decade. With no institutions ready to confront aggression, the West can't cope with mini-wars in the old USSR, or elsewhere. Local leaders bent on aggression will learn from Yugoslavia that aggression pays.

The key to a larger solution is in Bosnia. The next two months are critical. The Bush administration must not give in to the inertia of failure; the men around Bush should pause to consider their role and responsibilities. They will be blamed if the rot spreads. They may well appear culpable for the deaths of many innocent people when history is finally told. Before leaving power, they should leave a cleaner slate:

First, close the US embassy in Belgrade. Its very existence sends Serbia the same mixed message Bush and Eagleburger send the American people. It tells Belgrade we can almost do business as usual. It tells Serbs that the US won't act militarily, lest we put our diplomats in a hostage situation. In a sense, having an embassy in Belgrade is much like siding with Serbia. If the embassy were closed, the US could move to deal with the problems at hand.

THE second, perhaps last, step the Bush administration should take is to work to lift the UN arms embargo against Bosnia.

Giving Bosnians access to weapons, and giving aid to people affected by the fighting, are linked. Unless Bosnians control some land, the ability of Western governments and the UN to deliver aid depends on Serb willingness to distribute it. Incredibly, the US government considers it possible to deliver aid through Belgrade. More likely, despite assurances, Serb forces will not forward humanitarian relief – but continue to kill civilians and ethnically cleanse Bosnia of non-Serbs.

The 1.5 million refugee Bosnians, mainly Muslims, plus 500,000 others in beseiged towns, are caught, to quote Bosnian Serb leader Radovan Karadjic, "like rats in a cage." They are desperate to escape. But Croatia, ignoring international obligations to accept refugees, turns displaced Bosnians back. Europe and the US only take a token number. Recently, Croat forces in Bosnia – assuming the collapse of the Bosnian government and the carving up of Bosnia between Serbia and Croatia – have begun "cleansing" Muslims, who have literally nowhere to go but the hills. Earlier UN estimates that 400,000 people may die this winter may be too low. A million deaths is not inconceivable.

As things stand, Bosnia cannot long survive. Bosnia's government still controls 10 percent of its territory – a few towns and the capital, Sarajevo. But with no weapons, Bosnians cannot resist Serb heavy guns. If the US were to give the Bosnians arms, or allow them access to arms, they could defend the areas they control; expand them into "havens" for people trapped in small villages; protect convoys through enemy territory. Arming the Bosnians is far more sensible than sending UN or NATO troops to fight their way through on escort duty. That *would* be the sort of quagmire we want to avoid. Arms won't assure that Bosnia or Bosnians survive, but they offer a chance. In my judgment, the Bosnians could, if armed now, succeed in recovering and reconstituting their country.

The logic against arming Bosnians is that it would only contribute to more violence. Western mediators tell Bosnians to give up land in exchange for their lives. But from the Bosnian point of view, negotiation or surrender is not an answer. They know what to expect from Serb forces. The choice the Bosnians see is to give up and die quickly, or resist and die slowly but with hope. They choose the latter. That is their choice to make, not ours.

Not only morally, but legally, the arms embargo doesn't make sense. The UN imposed an arms embargo on Yugoslavia when that state was intact. But Bosnia, Croatia, and Slovenia are now UN members. The former Yugoslavia no longer exists. As an independent state, Bosnia has a right to collective self-defense under Article 51 of the UN Charter. Bosnians want that help. If the US won't give it to them, other states will – but only after the embargo is lifted. For that, US leadership is needed. If Bosnia loses control of its land, the task of reconstituting Bosnia becomes far more complicated, perhaps impossible. A victory will only whet Serbia's appetite for further conquest. Kosovo is next. Then the entire Balkans will go up in flames.

Until resigning in August, George Kenney headed the US State Department's Yugoslavia desk.

THE WALL STREET JOURNAL, November 13, 1992

Macedonian Lesson for Clinton

By Robert S. Greenberger

What's in a name? The name Macedonia, birthplace of Philip II and his son, Alexander the Great, carries the ancient hatreds and modern passions that, once again, enflame the Balkans. But Macedonia also spotlights the sluggishness and shortsightedness of U.S. and European reaction to Yugoslavia's disintegration.

Soon, it will be President-elect Bill Clinton's turn to deal with this volatile mix. When he addressed the issue of Macedonia, candidate Clinton showed the same tendency as Mr. Bush to take the short view, succumbing to domestic political pressure. But, overall, he seemed more willing than President Bush to back up United Nations actions in the Balkans with force, saying that the U.S. "should be prepared to lend appropriate support, including military, to such an operation."

Poor, landlocked and burdened by the past, Macedonia, the southernmost republic of the former Yugoslavia, declared its independence in November 1991. Once, the historic region of Macedonia included portions of what is now Greece and Bulgaria. To calm its neighbors' fears, Macedonia's government amended its constitution, formally accepting the existing borders and guaranteeing minority rights. Early this year, the Bush administration was moving toward diplomatic recognition. So was the European Community, after a special European commission determined that Macedonia met the criteria for recognition.

Then the Greek-American lobby went into high gear, urging the administration to delay a decision until Macedonia picked another name. The name Macedonia, the lobbyists said, robbed Greece of part of its past and revived fears of encroachment on Greek territory. President Bush and his senior cabinet members were pressed by wealthy Greek-American supporters to withhold recognition. Greek Prime Minister Constantine Mitsotakis telephoned the White House to warn that his government would collapse if the U.S. recognized Macedonia.

The lobby engaged Mr. Clinton's attention, too. In an Oct. 2 letter to the Greek-American community, Mr. Clinton endorsed recognition of the Yugoslav republic "provided its name does not include 'Macedonia.'"

In March, then Secretary of State James Baker had urged European foreign ministers to support recognition of Macedonia. A month later, with the lobbying effort in full force, the pragmatic Mr. Baker reversed course, and the administration put the issue on hold. Privately, it asked Macedonia not to press its application for admission to the United Nations until after the presidential election, according to a U.S. official. Meanwhile, the EC sided squarely with the Greeks.

But Mr. Clinton may be forced to confront the issue soon. Earlier this week, during a U.S. trip, Macedonia's president, Kiro Gligorov, asked the U.N. to begin considering his nation's application for membership – under its current name. Unless the matter is resolved sooner than most observers think likely, Mr. Clinton must decide whether to accept Macedonia's right to choose its own name, or veto the application. "Let us see if the permanent members of the Security Council, the five of them, could in such a clear case raise a veto for this, and how this is going to be explained to the public," Mr. Gligorov said.

What is at stake in this name game? By caving in, Washington missed an opportunity. It might have influenced its allies and

headed off yet another crisis that will fuel more violence in the Balkans. A combination of collective pressure on Greece, which is billions of dollars in debt to its European Community partners, and on Macedonia, which desperately needs aid, along with collective guarantees and assurances to both nations might have yielded a compromise early on. Now, both sides are entrenched.

Diplomatic recognition by itself isn't a panacea. Recognition of Bosnia hasn't stopped the slaughter there. But the absence of recognition of Macedonia increases the risk of the darkest of Balkan nightmares – the internationalization of the crisis.

One ominous scenario: Serbia completes the "ethnic cleansing" of Bosnia and its emboldened forces move south to Kosovo, which the Serbs have considered the cradle of their nationhood. Kosovo's two million Muslims are driven toward Albania, and Macedonia's ethnic Albanians – about one-third of its two million people – join the fray. This combustible combination brings in neighboring Albania, Bulgaria and Greece, all of which may have designs on pieces of Macedonia. Turkey, hoping to prevent further atrocities against Muslims, joins in.

"The real danger is that the longer you leave the Macedonia problem unresolved, the more likely it is that the pressures that will make Mace[illegible] fragment will build," says George Kenney, a former State Department desk officer for Yugoslavia who resigned in August to protest U.S. policy. "In a sense, we're giving Serbia license to move in."

If that happens, Congress must share the blame. Last spring, a House Foreign Affairs subcommittee was working on a resolution calling for U.S. recognition of three republics of the former Yugoslavia, including Macedonia. Then The Coordinated Effort, an organization of Greek-American groups and lobbyists, applied the pressure. Among the measures, according to a July 7 memo written by the group, legislators "were approached face-to-face by the most influential Greek-Americans in the country." Within weeks, Macedonia was dropped from the resolution.

In February, GOP Sen. Al D'Amato, then in a tough re-election race in New York, rose in the Senate to praise the "unique opportunity the Republic of Macedonia has to set an example for the multi-ethnic states in Eastern Europe." A few months later, Sen. D'Amato headed the list of 36 senators who, along with 139 representatives, urged President Bush to withhold recognition until Macedonia changes its name. Most of the lawmakers had little understanding of the issues involved.

To be sure, Greece has concerns that need to be addressed. A sample Macedonian currency note featuring the White Tower, a seafront landmark in Thessaloniki, a Greek city that was part of historic Macedonia, raised the specter of irredentism. (The design was later abandoned.) And in the current highly charged environment, recognition of Macedonia by that name likely would bring down Greece's pro-Western government.

Much of this problem might have been resolved with quick, creative diplomacy by the one remaining superpower. Instead, the U.S. dawdled, decided it wasn't worth the fight, and yielded to political expediency.

Describing this process with unintended irony, Andrew Manatos, an adviser to the Greek government, calls the U.S. decision to withhold recognition "a laboratory case study of how policy is formed." Unfortunately, he is right.

Mr. Greenberger is a diplomatic reporter for the Journal's Washington bureau.

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THE WASHINGTON POST, November 13, 1992

Bosnia: 'A Sense of Fury'

From an interview with George P. Shultz, secretary of state from 1982 to 1989, on the MacNeil/Lehrer Newshour Dec. 8.

Robert MacNeil: You believe the United States should be taking leadership in the Bosnia situation?

George P. Shultz: Many of the conceptual bridges have been crossed in the Bosnia's situation. For example, the United Nations has said in the Security Council resolutions that the Serbs should not be able to use the skies. We have started a process of identifying human rights violations. . . . We must go further and follow through on the undertakings we've made.

I view your program and other programs and read what's going on, and it brings in me a sense of fury about what's taking place. The problem, of course, is a humanitarian one. People are being killed senselessly, hospitals are targeted, not just hit. A . . . nun told me about the thousands of young girls who have been raped and are pregnant. . . .

But I think it goes further than the humanitarian aspects. The next time you do a program on Bosnia, start by showing some films of Bergen-Belsen or Auschwitz, because the message is the same. What does "ethnic cleansing" mean? It goes right back to what Hitler did. And when we say, never forget, never again, what are we talking about? Of course the Jews in Germany, and, of course, what can happen if antisemitism gets out of hand. But more broadly, we're saying, when forces of intolerance go wild, you get a result that is basically intolerable. . . .

I think beyond that . . . the most difficult problem in the world today, including in the United States, is the problem of governing over diversity. One of the tragedies we see unfolding is that Sarajevo was a city where people of diverse religions and backgrounds were living in reasonable harmony. And that's been smashed.

Q: The Bush administration has been saying all the things you say, but that to get militarily involved would result in the United States getting bogged down.

A: Becoming involved militarily does not necessarily mean putting troops on the ground. Again, last night [a Bosnian] was asked why was he [defending his city]. He said a man who won't defend his own home doesn't deserve one, and I'm here to defend my home, and why won't you let me have any weapons? So in the Reagan years, we called people like that freedom fighters.

Q: United Nations' sanctions against the former Yugoslavia at the moment prohibit Bosnia from importing arms that it could use to defend itself against the Serbs. You would want to go to the U.N. and make an exception?

A: Yes. . . . That doesn't involve enmeshing United States troops. It involves saying to people who want to defend themselves and defend their freedom, yes, we'll help you. A U.N. resolution has said we should take control of the skies. . . . It is not being observed. . . . Furthermore, there have been all kinds of violations of every cease-fire that gets negotiated.

So what can we do about that? We can handle that. Those are identifiable missions. They're doable missions by our Air Force and our smart weapons. We can cause them not to be able to fly. And if they insist, we can take out targets on the ground, and we can identify where there are arms caches and where there are military command headquarters. Those can be hit so that we get their attention and say that if you insist on trying to demolish Bosnia by force, you meet resistance.

Q: So since these things have been discussed for many months now—they've been proposed a long time ago, and nothing has happened—would you propose that the United States, as it has in Somalia, take the lead and say to NATO, either you guys do it or we're going to do it with U.S. planes?

A: I think that in this world, and desirably so, you have to do things in partnership. It's also, I think, been pretty well demonstrated that there is a leading partner. It's the United States. That's where we are. So we have to be ready to step up to this.

If the U.N. Security Council were to decide to take further action and NATO were willing, it's a mission NATO could carry out. NATO is there. It has a command structure, and it has military assets that can do the job. It has bases and so forth. Whether the countries involved would be persuaded, I don't know, but at any rate, it seems to me, that's the kind of leadership we should be taking.

Q: Can this wait until President-elect Clinton takes office?

A: The situation is deteriorating. You show that on your screen. It doesn't go to our electoral, governmental change calender, but I don't think that's all that should be done. The United States and other countries, responding to the Security Council, have given evidence of violations of human rights. We should be establishing perhaps through a kind of case law a personal accountability for leaders who encourage such things. . . .

There was a U.N. resolution passed during the Iraq-Kuwait war that called for countries to bring in evidence, and that was done, and when the war was over, so far as I can see, the whole thing has been dropped. . . . Saddam Hussein is a war criminal, and he should be held to account. . . . At least you can indict him, and you can bring this evidence, and you can do the same with leaders in the Yugoslav situation. . . .

I think we also should be prepared to put forward the possibility of something constructive and establish a U.N. commission or some other form of trusteeship or something that says, here is a way out, here is a way of trying to resolve differences. . . . And combine that with an effort to help people with reconstruction so that you don't just try to stop negative things, you try and get people thinking in more positive terms.

Q: Are you disappointed that the United States has not exercised this kind of leadership up till now in Bosnia?

A: Well, the United States has done things, and I am not involved at all. I don't know all of the considerations. But as I look at it, I have, as I've said, a sense of fury about what's going on, and I try to connect what I feel in my gut to what goes through my head.

THE WASHINGTON POST, December 22, 1992

Jim Hoagland

Beam Up That Czar

Bill Clinton promised to focus "like a laser beam on the economy." When he arrives in Washington, he will find two old Senate hands, Sam Nunn and Richard Lugar, taking just that approach on the former Soviet Union.

After four years of Bushspeak, America seems to have anew a phrase-making president who has a feel for the link between language and action. The Little Rock economic summit added content to the president-elect's colorful promise to focus unrelentingly on the economy.

Nunn, the Georgia Democrat, and Lugar, the Indiana Republican, have chosen to laser (verb, intransitive, showing soon in Webster's) on an equally important problem—the building down of the Doomsday nuclear arsenal assembled and trained on the United States for four decades by the paranoid rulers in the Kremlin.

About 30,000 warheads remain in Russia, Ukraine, Kazakhstan and Belarus. Nunn and Lugar visited all of these ex-Soviet republics last month as part of their effort to persuade the ex-Soviets "to get about the task of actually dismantling the weapons and handling this material in a safe way," in Nunn's words.

Working over the last two sessions of Congress, Lugar and Nunn got $800 million appropriated to dangle before the republics that are willing to cooperate in the most important nuclear disarmament effort the world has ever known. But getting the sustained, coordinated attention of the political leaders involved—including those in Washington—in recent months has been more difficult than getting the money.

Lasers on the blink could describe what the two senators have encountered.

They met with President Bush on Dec. 9 to encourage a final all-out push by Bush—using his ties to Yeltsin and simultaneously deeply involving Clinton's team—to get strategic arms reductions nailed down in Bush's last six weeks. But they discovered that some of the most creative parts of their disarmament approach were being held up by bureaucratic wrangling here.

Nunn and Lugar have pushed almost to completion negotiations to have the United States finance the dismantling of ex-Soviet warheads by buying the highly enriched uranium they contain. The revenue would be shared by the four ex-republics.

But the two senators were stunned when they were told at the Dec. 9 meeting that approval was being held up by objections from the Commerce Department that the deal would give the Russians unfair trading advantages. "It was the most ridiculous thing I ever heard in my life," Lugar told a friend later. "The administration just seems unfocused on this problem."

The same kind of unfocused response came from presidential advisers when Lugar and Nunn pointed out an opportunity to cut years off the removal of ICBMs from Belarus by helping provide 5,000 housing units in Russia for the Russian guard units that will have to be moved when the rockets come down.

Clinton operatives have indicated to Democrats in Congress that they hope Bush can, without them, wrap up the proposed framework agreement that would eventually cut the number of Russian warheads on ICBMs to 3,000. The incoming administration fears inheriting negotiations in which they would be pressed to make concessions that Bush would not make as the price of the deal.

Yeltsin surprised Washington by indicating in China last Friday that he and Bush could sign a START II accord in January. Hopes for a breakthrough had fallen earlier in the week when Ukraine decided to postpone until next year ratification of the START I treaty, which begins the process of deep reductions in U.S. and ex-Soviet strategic arms.

Lugar called the Ukrainian move "extremely disappointing," since START II and many of the Nunn-Lugar proposals cannot go forward until Ukraine ratifies START I.

While trying to manage their own futures as well as those of Somalia, Bosnia and other flash points, the Bush team will now have to woo, coerce or otherwise move Ukraine back onto a disarmament track. These developments underscore one of the central points Nunn and Lugar made to Bush, and indirectly to Clinton, in the reports on their trip.

They strongly recommend that a "single high-level coordinator" be appointed by the president to handle the complex security, economic and political problems arising from the collapse of the Soviet Union. That, the two senators feel, is an essential step to "developing a U.S. strategy for dealing with the former Soviet Union instead of doing everything ad hoc."

Adding another bureaucratic layer in crisis-management is normally both the easiest and worst possible proposal. But Nunn and Lugar have earned enormous credibility by focusing on this problem relentlessly, effectively and creatively. If an American czar for Russia et al. is key to keeping the Nunn-Lugar laser-like approach on track, the next administration should consider beaming the czar up.

THE WASHINGTON POST, December 3, 1992

Foreign Affairs

LESLIE H. GELB

Get Cracking on Bosnia

Or stop leading the Muslims on.

The people of Bosnia and the tinderboxes nearby might meditate on two realities: First, President Bush will not order U.S. forces to the rescue. Forget it. Second, President-elect Clinton won't either — at least not for months. He shows little disposition to walk economics and chew foreign policy gum at the same time. He has barely begun to select his national security team.

Mr. Bush's decision to dispatch troops to Somalia has in no way altered his opposition to American intervention in Bosnia. His senior aides are absolutely clear about that. He just sees too many land mines in Bosnia and no way to get out.

Mr. Clinton is unlikely to set his course in Bosnia until weeks after inauguration at the earliest. Which means thousands more dead Bosnians and hundreds of thousands more Bosnian refugees pouring into an already floundering Germany. Which means little prospect of heading off wider Balkan wars in Kosovo and Macedonia. All this portends moral and strategic disaster.

Mr. Clinton should move now to put his senior foreign policy and defense team in place and get them cracking on Bosnia and other world crises. Focusing on the economy is right. But treading water on foreign affairs is dead wrong.

His transition staff for national security cannot do the job of creating policy. It contains few experienced, high-level pros. And these pros have to spend most of their time answering ridiculous press queries about Clinton policies that don't exist, playing footsie with anxious foreign diplomats, taking phone calls from panicky job-seekers and meeting with political allies to keep them from feeling excluded when the moment comes to exclude them.

Sandy Berger, the leader of the transition staff, has commissioned various policy papers from able, senior people. But these papers cannot substitute for the advisers who will form the Clinton National Security Council.

The first task of these senior advisers should be to flesh out Mr. Clinton's promising campaign rhetoric on Bosnia. He talked sensibly about providing arms to Muslims, now virtually defenseless against Serbian attacks. He hinted creatively at bombing attacks against military targets in Serbia to deter Serbs from further aggression. But good thoughts do not a policy make.

Before the Clinton team goes too far down the road on a Balkan policy, it should talk with key Bush aides. The President and his team have been far too cautious, unimaginative and shortsighted on Bosnia. But they have some telling arguments. Clinton advisers should listen and fashion convincing responses.

Mr. Clinton wisely rejects fighting a ground war in Bosnia. Instead, some of his advisers speak of establishing a safety zone there where Bosnians could go for food, shelter and security. Bush aides and Bosnian Muslims — along with the international mediators Cyrus Vance and Lord David Owen — reject this idea. They feel it would legitimize Serbian conquests of Bosnian Muslim territory. But surely a formula can be found to provide for immediate humanitarian needs without compromising long-term negotiating positions.

Bush advisers also fault the Clinton inclination to arm Muslims. They believe, again backed by Mr. Vance and Lord Owen, that this will only lead to greater violence and even more Muslim deaths. But there is a trade-off here: a heavy short-term price may be worthwhile to stabilize the battlefield and save lives thereafter.

Bush aides insist that if the U.S. bombs Serbia, as Mr. Clinton may propose, London and Paris will withdraw their humanitarian-relief forces from Bosnia. And so they will, unless Mr. Clinton successfully mounts a risky and ambitious campaign in private and public diplomacy.

Most compellingly, Bush advisers warn that getting into Bosnia will be far easier than getting out. Before taking any action, Mr. Clinton will have to fashion a persuasive plan of limited involvement, explaining what lines he will and will not cross — then sell it to Americans and to Congress.

After looking at all this, Mr. Clinton may decide it's too late to help Bosnia. If so, he had better stop leading the Bosnian Muslims on, come up with a second line of defense against Serbia in Kosovo and Macedonia and sell that to Congress and the American people. □

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Sam Nunn and Richard Lugar

Still a Soviet Threat

Our understandable national focus on the human tragedy in Somalia and Bosnia must not divert our attention from events in the former Soviet Union that will affect our vital national security interests for generations to come.

Russian Foreign Minister Kozyrev's dramatic speech in Stockholm, when he spoke as if Russian foreign policy had been taken over by right-wing nationalists, electrified the senior American and European officials in attendance. The tension was relieved when Kozyrev shortly thereafter explained that he had just done it to illustrate the importance to the West of President Yeltsin's cooperative foreign policy and therefore of Yeltsin's political survival. Yet the perilous condition of the Russian economy and the continuing struggle for political power should remind us daily that Kozyrev's audacious illustration cannot be dismissed as unrealistic.

That is why we must not be distracted from the threat posed to the United States and its close allies by the thousands of nuclear warheads still mounted on intercontinental missiles in Russia, Belarus, Kazakhstan and Ukraine, still aimed at the United States, still capable of being launched without warning in massive numbers at our cities and our citizens.

Unlike the situations in Bosnia and Somalia, the potential humanitarian disaster posed by the former Soviet Union's nuclear weapons—even if only one or two were launched accidentally or exploded due to faulty maintenance—cannot be seen right now on television. We dimly recall the images of the Chernobyl disaster—even though hundreds of square miles are still uninhabitable in its aftermath, and the number of Chernobyl-related cancer cases continues to grow. We are dimly aware, for that matter, of the fact that numerous Chernobyl-type nuclear reactors remain in operation today in the former U.S.S.R. and in Eastern Europe.

The threat of a massive nuclear attack against the United States is at an all-time low. But the threat of an unauthorized launch or nuclear accident may have increased, in part because one nuclear superpower has been replaced by four successor countries with strategic nuclear weapons on their respective territories. And each of these countries currently faces severe internal economic, political and ethnic strains that hardly contribute to reliable centralized control over nuclear weapons or to the safety of nuclear reactors.

This is far more than a theoretical danger. Senior Russian military officials told us in Moscow last month that they were deeply concerned over the safety of, and central control over, strategic nuclear weapons deployed in Ukraine. Senior Ukrainian officials told us in Kiev of their determination to establish "administrative control" over these weapons to ensure they were not launched by Russian command from Ukrainian soil and to protect for Ukraine the potential negotiating and deterrent value these weapons embodied. The other two new "nuclear" countries of Belarus and Kazakhstan are following these developments intently. Neither they nor Ukraine has yet adhered to the Nuclear Nonproliferation Treaty as "non-nuclear states," which they formally pledged to do in Lisbon last May.

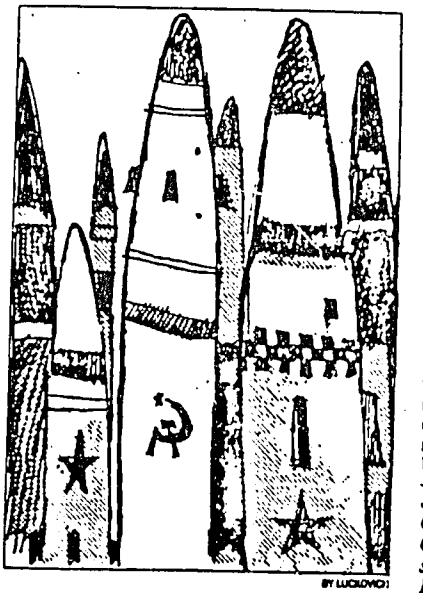
No less ominous is the related danger of proliferation of weapons of mass destruction, nuclear technology and materials, and nuclear know-how. History has never before witnessed scientists, technicians and military personnel, highly skilled in building and operating nuclear weapons, who must worry daily about finding food and housing for themselves and their families.

To our credit, we have made the provision of humanitarian aid to Somalia and Bosnia a national commitment. At our peril, we have not given the unstable and potentially threatening situation in the former Soviet Union the high national priority it demands. The United States mobilized the world and conducted the largest fund-raiser in history to save Kuwait; we have been unacceptably passive in addressing the most important national security issue of our time.

The Bush administration has been commendably active in utilizing some of the authorities and funding given it by Congress, in providing humanitarian and technical assistance, and in establishing diplomatic missions in the new countries of this important region. Nevertheless, what is now required, and in our judgment required urgently, is (1) an overall strategy that integrates *all* aspects of our policy toward the former Soviet Union and (2) careful, Washington-based management of this strategy so that the United States can respond with maximum effect to the historic opportunities afforded us by the collapse of the U.S.S.R., while minimizing the nuclear and associated risks that accompany this collapse.

Our specific recommendations include the following:

- **There must be no recess, no time-out in formulating and implementing a national strategy regarding Russia and the other new countries that have emerged from the Soviet Union.** This is an awkward time for the United States, with the outgoing president concerned not to infringe on the prerogatives of the incoming president, and the president-elect anxious not to take policy initiatives before he is sworn in. At the same time, this is a uniquely dangerous moment for the peoples of the former Soviet Union and the rest of the world.
- **All aspects of our policy for this part of the world should be organized under one high-level coordinator, reporting to the secretary of state and the president, who is responsible for the overall effort and can cut across departmental lines, who works closely with the U.S. business community and who has no other substantive responsibilities.** This should be an early priority for the Clinton administration.
- **Our prime goal must be the prompt, safe dismantling and destruction of strategic nuclear weapons.** Ukraine and Belarus have yet to ratify START I; neither they nor Kazakhstan has adhered to the NPT as nonnuclear states. We should urge them to take these actions without further delay, as they pledged to do in Lisbon last May.
- **Once START is ratified by all parties and enters into force, we should endeavor to accelerate the pace at which nuclear warheads on missiles covered under START I are removed from the missiles.** There is no reason why we should continue to aim thousands of warheads at each other while the seven-year period provided in START I for reducing weapons runs its course.
- **We should continue to press for finalization and signature of a START II Treaty between Russia and the United States before the Bush administration leaves office.** Although Secretary of State Eagleburger and Foreign Minister Kozyrev failed to complete this negotiation in Stockholm, and more recent contacts between Presidents Bush and Yeltsin have not resolved the matter, four more weeks are available before the Bush administration leaves office.
- **Our next priority should be to assist economic stabilization and reform, above all by government-to-government cooperation to improve the investment climate for U.S. private investment in the economies of these countries.** After Jan. 20 President Clinton should deliver a simple but crucial message to our private sector: Investment in the former Soviet Union—particularly in energy, defense conversion and housing—is important now for our national security and will be important in coming years for our country's economy.
- **We should also assist the building of democratic institutions and practices, such as civilian control over the military.** We should help institute systems for export control and accountability of nuclear and other sensitive materials and technologies.
- **Using our moral authority and our good offices as well as traditional forms of assistance, we should do all we appropriately can to assist in easing the ethnic tensions that plague this region and in resolving the ethnic conflicts that have already erupted there.** We need in particular to address housing needs in Russia as a pivotal means of facilitating the withdrawal of Russian troops from newly independent countries.
- **And we should better utilize our embassies and consulates throughout the region.** Our posts need to be better staffed, better equipped, more closely listened to by Washington and better informed about Washington's policies.



BY LUCIOVICI

The United States has spent trillions of dollars defending against the military threat posed by the former Soviet Union. This threat has also preoccupied our friends in Europe and in Asia. We and they now have a unique opportunity: For a comparatively modest investment over several years, we can help ensure that our children and grandchildren will not be confronted by a similar threat from the territory of the former Soviet Union.

Sam Nunn is a Democratic senator from Georgia and chairman of the Armed Services Committee. Richard Lugar is a Republican senator from Indiana and a member of the Foreign Relations Committee.

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On the Road to Paradise Again?

Keeping Hopes for Russia Realistic

JERRY HOUGH

In the year since the tumultuous breakup of the Soviet Union, events in Russia and the other successor states have gradually slipped from the view of the American public. There is a sense, though, that Russian economic reform—let alone that in Ukraine or Central Asia—is not going very well and that the reformers are being threatened by a conservative coalition led by Arkady Volsky.

The former Soviet Union is not likely to remain out of the headlines for long. The Russian "democrats" have been canceling elections and appealing for the dismissal of the freely elected legislature. The Russian "reformist" economic team has combined tight-money rhetoric with a loose-money policy. The disintegration of the Soviet Union left the successor states without governmental institutions that could implement a coherent policy, but these institutions are now being built, and they will be used. The lack of a coherent policy in the face of economic decline cannot continue for long.

This year we have nourished the hope that Russia can pull off a marketization and privatization process even more painful than that imposed on Chile by General Pinochet in the 1970s, while becoming a full-fledged democracy up to the standards of constitutional democracies of the West. In comparison with such unrealistic dreams, events in the successor states are bound to be disappointing. But even more difficult for us, a coherent economic policy is going to be accompanied by and to require tighter integration within the former Soviet Union as a whole.

As Russian policy becomes more coherent, the West will have to make hard choices. The danger is that American policy will have to be decided by a new administration that is strongly within the Wilsonian-Carter human rights tradition, but with an idealized view of events in 1992 and a simplified view of the choices in the Russian policy debates. A realistic policy must begin with a realistic understanding of just what has been going on.

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The Gaidar "Tight-Money" Policy

Americans who have been following Russia casually this year have a vague sense of confusion and unease. The pieces of the puzzle don't seem to fit. Americans who follow Russia more closely and who think through the conventional wisdom differ only in that their sense of confusion and unease is well defined.

The central problem is that during 1992 the economic czar Yegor Gaidar supposedly followed an extremely tight-money, low-subsidy macroeconomic policy of the type endorsed by the International Monetary Fund, but the result was a surge of inflation that threatened to accelerate instead of subside.

How is this anomaly to be explained? Clearly the money supply was expanding rapidly, and someone was responsible. "Villains" have come and gone. Initially it was the State Bank, under the control of the parliament instead of the president, that was issuing money irresponsibly. Then when the State Bank struck back by not issuing money, creating a cash shortage that kept workers from being paid, it was said that the state enterprises were making loans to each other without control. At other times provincial officials—representatives of the old nomenklatura—were the culprits: their failure to transmit tax revenues to

ILLUSTRATION BY BOB SOLE

Moscow was causing a revenue shortage and thereby creating a central deficit. Then Jeffrey Sachs discovered that the real source of the difficulty had been the non-Russian republics. They had had the de facto power to create rubles, and they had helped inflate the Russian currency.

All these explanations contained a grain of truth, but none really made sense. Inter-enterprise loans did not create money. The money supply increased when the enterprises received bank loans to pay for wages, taxes, and supplies not provided on inter-enterprise loans. The non-Russian republics could not really create rubles. They were issuing letters of credit and making transfer payments that were translated into rubles inside Russia. But it was Russian banks that honored this paper and created the rubles, not the non-Russians. The State Bank did not make loans, but simply issued money to cover loans and wages already committed—as it was obligated to do by law.

The major loan-making banks were a peculiar kind of commercial bank. "Founded" by major industrial enterprises of an industrial branch in 1991, they were obligated to give loan preference to the enterprises that founded them. One, for example, the "Stankinbank" (the Machine Tool and Instruments Bank) served the industry once run by the USSR Ministry of Machine Tools and Instruments.

If these branch banks really were commercial banks, obtaining their loan money in ways well established in the West and making loans to their enterprises at commercial rates on the basis of potential profitability, their behavior could be discussed in terms of such categories as the interest rates set by the Central Bank and the quantity of money issued by it. But Russian branch banks don't work like that. Stankinbank, for example, is housed in the same building as the Department of the Machine Tool and Instruments Industry of the Ministry of Industry of Russia. The branch "commercial" banks worked under the direct supervision of the Ministry of Industry. Top IMF officials working with the Russian system could not distinguish between bank and government—because there was no real distinction.

In other respects too, large elements of the old system remain. The Department of Agricultural Machinery and Tractors of the Ministry of Industry, with 100 employees, is a government body that provides policy guidance and conducts "investment policy." "Autoselkhozholding" (Auto-Agricultural Machinery Holding) is a "private organization" staffed by 500 people who engage in "wholesale trade" and buy supplies and sell them at a 5–6 percent commission. But with the holding company headed by the former minister of the auto industry and located four doors down the corridor from the Department, one can guess the meaning behind the cliché that old supply ties are being maintained through independent managerial inertia.

Now the Ministry of Industry is being split into five state committees—one for industrial policy and four branch committees for the defense industry, machinery, metallurgy, and energy. The committees will be given larger investment funds and larger staff to administer it.

Heavy Industry as the Unemployment Office

For 60 years communist leaders have used the big industrial enterprise as a central instrument of social welfare, and with few functioning alternatives, they still do today. Loans are being made not only to finance production, but also to provide de facto unemployment insurance to workers and to pay taxes to finance local government. Loans continue to be given when the enterprises are bankrupt by any meaningful standard and when they have no hope of solving their problems by normal commercial activity.

The application of profitability criteria to Russian industries, already greatly overstaffed by Western standards, should have dramatically shrunk the work force. Instead, while the labor force has shrunk because of attrition and frustration over low wages, a 20–25 percent drop in industrial production has caused no significant unemployment, particularly in large-scale industry. June graduates from high schools, technical schools, and colleges seem to have found work. The explanation? Loans were being used to pay the wages of those who were not working.

Sometimes factory managers are described as a law unto themselves, protecting their workers and paying them what they want. Banks, it is said, have no choice but to honor managerial commitments. But the banks belie that view on occasion simply by not issuing the requisite cash. On some questions, managers have, in fact, been able to act with arrogance and impunity, but wage increases have not been random. They have tended to vary directly with the recipients' importance to society—and ability to strike. Hard-currency earners such as coal miners and oil workers receive high wages, while social scientists in the Academy of Sciences receive below-subsistence wages. Insiders assert that local managers are told what wage rates they can establish and these instructions are enforced by the size of loans or allocations provided.

Perhaps the most revealing evidence comes in the way city government is financed. In 1992 rapid inflation forced monthly changes in the budgets of city governments. Yaroslavl, a city of 650,000 people, kept its budget in balance for at least the first four months of the year, matching a precipitous rise in spending with a precipitous rise in tax receipts. Remarkably, the large portion (65 percent) of revenue intended to come from the tax on profits of state enterprises kept pace with inflation during the spring. The enterprises themselves were going bankrupt by any normal accounting procedure, but their "profits" kept rising—so the taxes on them could support the schools, hospitals, and city services of Yaroslavl.

This was a nationwide phenomenon. From March to May the value-added tax remained level at 52–54 billion rubles. Excise taxes declined from 10 billion to 9 billion. Individual taxes rose from 16 billion to 19 billion. But the profit tax more than doubled, from 41 billion to 101 billion. But since the enterprises had huge cash-flow problems, these "profit tax revenues" were being financed in significant part through loans from the branch "commercial" banks.

Such loans were made in different forms throughout the economy. For example, the cost of medicines

produced in Russia rose tenfold during the first quarter of 1992. To cushion the blow on customers and hospitals, the regime increased the price of the medicines sold to them only four times. The regime should have provided a subsidy to the wholesale pharmaceutical distributor—a wholly state institution—to cover the difference, but, to maintain the appearance of budgetary stringency, it did not. Instead, when producers refused to ship medicines, the government told the distributors to go to the banks for "loans" to get the money to pay for the medicine. In Yaroslavl, the debt of the regional distributor rose from 3 million rubles on January 1 to 20 million on April 15. The total budget for medicines for Yaroslavl hospitals for the first quarter was 7 million rubles.

In short, the Gaidar government followed a loose-money policy from the beginning, but put most of the deficit off-budget to create the impression of a balanced budget. Its February 1992 memorandum to the IMF claimed that inflation would soon level off, but even Stanislav Shatalin, Gaidar's mentor, felt it necessary to write in *Nezavisimaia gazeta* on March 21 that the calculations had no basis in reality and that there would be either a catastrophic drop in production or hyperinflation. So it turned out.

The reasons for the duplicity in Gaidar's declared economic policy are not clear. Perhaps, as a young macroeconomist, Gaidar had no option but to endorse standard IMF policies and claim he was following them. Otherwise, a person with other expertise would have been chosen for his post. Perhaps the international organizations made admission conditional on the enunciation of certain policies even if they were not being followed; perhaps they virtually compelled Gaidar to say what he said. (In practice, U.S. congressional appropriation of the pledged $12 billion U.S. contribution to the IMF became politically tied to Russian admission and "aid.") Perhaps both Gaidar and the international monetary organizations thought the declared policy was a good cover for inflationary price liberalization and that real policy could be made to move toward declared policy once price relationships become more rational. Perhaps Gaidar was so inexperienced that he could not see the outcome of the processes and mechanisms over which he was presiding. We simply do not know.

> For 60 years communist leaders have used the big industrial enterprise as a central instrument of social welfare, and with few functioning alternatives, they still do today.

The Reform Model—Polish or Chinese?

In recent months the Russian and Western press has talked about a loosening of monetary controls. The reporting, however, has been misleading. The big development of the past few months has been a change in the level of honesty, not in the rate of increase of the deficit. Spending is now being put on budget, and the reality of the deficit is being recognized. There actually seems to be a tightening of money to industry and a rise in unemployment.

The political battle of recent months has centered not on whether to loosen monetary policy, but on whether to continue that policy or to tighten it to correspond with declared policy. The long-term political battle, however, has been over whether to adopt the Polish or the Chinese model of economic reform. The Polish model envisions a complete overhaul of the economy, the sooner the better. The Chinese model implies fairly rapid economic reform in the agricultural, service, and small industry sectors, but much more gradual reform in heavy industry. The debate, obviously, hinges on what to do with heavy industry.

The Polish model was pushed by the young team Boris Yeltsin chose to cooperate with him in breaking up the Soviet Union in 1991. Gennady Burbulis and Sergei Shakhrai handled the political portfolios, Yegor Gaidar and Aleksandr Shokhin, the economic ones. Burbulis and Shakhrai had virtually no political or administrative experience before the 1989 elections, while Gaidar and Shokhin were very knowledgeable about Western economics but had no experience in the economic and administrative system.

Gaidar and Shokhin both worked as young economists as heads of "laboratories" in the Institute of Systems Research under the leadership of Stanislav Shatalin. Gaidar's laboratory specialized on macroeconomic questions; Shokhin's on social problems. When Shatalin moved to the Institute of Economic Forecasting, they followed him. Both were part of the team that put together the Shatalin plan in 1990 and then developed the economic plan in 1991 that Yeltsin used to attack the Union.

For Russia, a tight-money, low-subsidy, low-tariff policy, intentionally or not (and in Gaidar's case intentionally), was a policy of deindustrialization. The bloated heavy-industry sector would be subjected to intense pressure—the minister of industry talked about a 50 percent decline in production.

While all the deputy premiers, including Gaidar and Shokhin, were confirmed by the Russian legislature, Gaidar's declared policy never really had the support of a majority of that body. The Russian parliament elected in the spring of 1990 had two major blocs—Democratic Russia and Communist Russia—each with about a third of the deputies. Enough deputies in the middle joined the Democratic Russia forces to elect Yeltsin chairman of the Supreme Soviet in 1990 by four votes and then to authorize the presidential election of 1991. Nevertheless, they decisively united with conservatives on a number of key symbolic issues and were clearly moderates on reform.

The "Businessman's Lobby"

The response of the industrialists to Gaidar's policy was predictable. They resisted the destruction of industry as economically, ethically, and politically inexcusable, and they poured scorn on the inexperience of the Yeltsin team. Their leader became Arkady Volsky and his Union of Industrialists and Businessmen. Volsky, who began his career as an engineer at the Moscow Auto Works, worked from 1966 to 1982 in the defense and machinery industry departments of the Central Committee. In 1982 Yury Andropov made Volsky his leading personal assistant, but after Andropov's death, Konstantin Chernenko and Mikhail Gorbachev gave him relatively minor posts.

In 1989 Volsky became a deputy of the USSR Congress of People's Deputies. He formed a Scientific-Industrial Union and headed the industrialist forces in the Congress. After the attempted coup in August 1991, he was one of four men named to head the coordinating USSR Committee for the Operational Management of the Economy. In practice, he became its dominant figure.

After the breakup of the Soviet Union, Volsky returned full-time to what was now called the Russian Union of Industrialists and Businessmen. As the leading figures of the Russian government took over the offices of the secretaries of the Central Committee in the Old Square, the Union of Industrialists and Businessmen moved in right next door. In appearance a businessman's lobby, actually the Industrialists' Union was becoming the country's political opposition.

Volsky's political strategy was twofold. First, he worked to unite the industrialists and the trade unions in opposition to deindustrialization. Implicitly and sometimes explicitly, he and his supporters threatened cooperative strike action by the unions and industrialists if economic policy became too harsh.

Second, Volsky organized the centrist forces of the Russian parliament. Two major issues arose—one, the strength of Yeltsin's power vis-à-vis the legislature and, two, the character of economic policy. Volsky put together somewhat different coalitions on these issues and defeated Democratic Russia on both. Indeed, key elements of Democratic Russia broke away and moved toward the center.

In the late spring and summer, Volsky organized the centrist forces formally. In May he created a political party called Renewal. Then he formed a coalition called Civic Union with a number of the factions and parties formerly associated with Democratic Russia or Yeltsin. One, the People's Party of Free Russia, was headed by the vice president, Aleksandr Rutskoi, who had broken the previous year with Communist Russia to support Yeltsin; another was the first major non-Communist party of Russia, the Democratic Party of Russia, headed by Nikolai Travkin.

The Russian system is like the French in having both a president and a prime minister. Volsky is not trying to replace Yeltsin, but the government beneath him. And, of course, he wants to turn Yeltsin more into Queen Elizabeth than François Mitterrand.

Like all political groups, Civic Union has not been as explicit about its economic program as one might want. Volsky does, however, talk explicitly about the Chinese or the Asian model of reform in preference to the Polish one. (He has visited Japan and Korea half a dozen times each, but refuses invitations to the United States.) What is striking is the extent to which Volsky, who is often described as a conservative on economic policy, has moved the debate about the economy in a reform direction. Almost no one talks openly about returning to the old Soviet economic system. Even *Pravda* writes favorably about China's agricultural reform.

> Democracy is incompatible with pure marketization, for the vast majority of democratic politics center on efforts of people to protect themselves from the market and to receive more income or security than it would provide.

The real problem from our point of view is that Volsky rightly emphasizes that economic integration of the old Soviet Union is vital for the economy. One hopes that the re-integration of the Soviet Union will be done quietly and more or less voluntarily, leaving a confederation in place. The new Ukrainian premier, Leonid Kuchma, once the director of the large Ukrainian rocket plant, is a friend of Volsky's and speaks of the Chinese model and close cooperation with Russia. He is scornful about the introduction of a separate Ukrainian currency. The Lithuanians, in their November parliamentary elections, supported the former communists and rejected Sajudis. Nevertheless, Yeltsin's decision to leave troops in the Baltics until they treat local Russians well is a reminder that the Soviet army remains intact and stands behind the new policy.

The exact nature of Volsky's policy toward heavy industry is also unclear. In 1992 the former Soviet Union had neither the orderliness of the old system nor real market mechanisms. Capital goods producers continue to ship goods, but pressure for technological improvement (or even the possibility for it) seems absent without investment. Moreover, with production falling, the economy seems to be running down more than being transformed. Volsky clearly plans to try to promote state-directed industrial investment. Certainly the enterprises will issue shares in exchange for investment, and the government will retain control of them. Volsky's dilemma is how to do it without locking industry into the old administrative system.

How Should the United States Respond?

Since many near-term and middle-term scenarios are possible, it is difficult to talk precisely about the proper

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U.S. response. If the financial chaos continues, talk about a financial stabilization program will remain academic. But the introduction of order will require America to face real decisions. Obviously, if order is introduced by Soviet troops acting in the Baltic states, the U.S. response will be different than if domestic political change in Ukraine brings it into a common economic market.

It is possible, however, to make several general points. First, the old U.S. propagandistic position on the Soviet Union alternated between two inconsistent views. Often we compared the Soviet Union with the United States—to emphasize Soviet political and economic shortcomings. At other times we sneered at it as a third world country. Neither position was right, but the latter was closer to the truth.

In the past few years we have combined an excessive denigration of the achievements of the Soviet Union with the hope that we can force the successor states to embrace democracy (including full national self-determination for ethnic groups), human rights, and free markets over five to ten years. We seldom even recognize the inherent contradictions in these goals, let alone the difficulty of introducing either democracy or free markets, as history has shown in Europe and the third world.

Indeed, we have seen the choice in the Soviet Union as a dualistic one between reform and reaction and have often personalized the choice. For years Gorbachev, Aleksandr Yakovlev, and Eduard Shevardnadze represented in our minds all that was good, and Yegor Ligachev was unfairly demonized. Now Boris Yeltsin and Yegor Gaidar are cast in the "good" role, and Arkady Volsky is the villain.

We must become much more sophisticated. Democracy is incompatible with pure marketization. Indeed, the vast majority of democratic politics center on efforts of people to protect themselves from the market and to receive more income or security than it would provide.

Volsky's ally, Aleksandr Rutskoi, speaks of the need for a "strong, liberal state." In fact, market economies require orderly, predictable political conditions and reliable institutions that can enforce contracts and adjudicate legal disputes. This aspect of economic reform has been neglected in Russia, and the legal anarchy of the past three years must be ended. It is not clear how much stronger a state Rutskoi has in mind and even less clear whether Volsky shares his vision.

Last October Gaidar explicitly condemned Volsky's embracing of the Chinese model, arguing that the Chinese political system goes with its economic system--the implication being that a freer, democratic state requires a freer market economy. But, in general, Volsky's economic policy is closer to Western social democracy and is less likely to require repression than an extreme market position.

Volsky's Civic Union controls about 40 percent of the deputies of the Congress of People's Deputies and a third of the smaller Supreme Soviet. (The latter will be changed in December to reflect the new balance of forces.) Many elements of its basic program—support for the industrial state sector and for a strong confederation within the old Soviet Union—are attractive to the moderate right, and the Volsky forces almost surely will be able to maintain a working majority in the parliament by maintaining an alliance with them.

Political philosophers have long pointed out the inherent conflict within constitutional democracy between majority rule and minority rights. The American tradition emphasizes the dangers of the tyranny of the majority. In the normal course of democratization in Europe, the gradual and uneven introduction of constitutional limits on the king came before democracy. In her famous defense of authoritarian regimes in 1979, Jeane Kirkpatrick would have been less severely criticized if she had described them as constitutional or semi-constitutional dictatorships on the 18th- and 19th-century European model (and if she had limited herself more clearly to defending such "limited" modern dictators).

There is a strong logic to this sequence. If democracy is introduced when the elite still conceives of government in absolute terms, then elected democrats naturally think they should have absolute power. That is why democracy often leads to extremism and plebiscitary dictatorship in its early stages, and is replaced by some kind of dictatorship. These succeeding dictatorships tend to be less absolutist, and, as a result, the democrats too have a more liberal conception of government in the next phase of democratization.

In Western Europe and Latin America, democratization was a 150-year process. At best, as in England, the reduction of the power of the king and the rise in the influence, first, of the middle class and then of workers was a slow and gradual process. The power of parliament varied greatly over time and by issue. The French process from 1787 to 1958 was more typical in being interrupted by periods of various types of dictatorship.

If the successor states to the Soviet Union have the kinds of mixed political systems and economic systems we saw in Europe in the 19th century and in the third world in this century, we should see this as normal, not inadmissible. If full democratization takes 150 years, then Russia began in 1905 and is well along in the process, but it still has a long way to go.

In the 1930s many Westerners read into Stalin all their hopes for socialism and planning. They saw the loss of half the nation's cattle through farm collectivization as a minor cost on the road to paradise. Today many Westerners read into Russian reformers all their hopes for a pure market system—and see the loss of half of industry as a minor cost on the road to paradise.

The American tradition has emphasized gradualism, pragmatism, and constitutional rights. We have lived with regimes in the Pacific, in Asia, and in Latin America that do not correspond to Western political and economic models. We nudge them in the direction of those models, but we understand that the process is a long one. If Russia is willing—as it seems—to join the Western geopolitical community, we need not treat it differently than we do other countries making the same journey. Given our long-term geostrategic and economic interests, it would be foolish to do so.■

Save the Peace Dividend

Bill's List

By Richard Nixon

PRESIDENT-ELECT Bill Clinton deserves high marks for aggressively addressing a number of important issues during the transition period. But as was the case during the campaign, the most important issue since the end of World War II has received minimal attention.

It may be politically shrewd to give domestic policy, as it affects an economy just beginning to recover from recession, a higher priority than foreign policy. But the collapse of Boris Yeltsin's pro-Western, democratic Russian Government would have a far greater impact on the American economy than anything the new Administration could do at home.

The Yeltsin Government is in mortal danger. The National Salvation Front, an unholy alliance of ex-Communists and ultra-nationalists, have boldly demanded Boris Yeltsin's resignation, a return to authoritarian rule and the restoration of the Soviet Union within its 1991 borders. That would be a prescription for the beginning of cold war II.

The peace dividend, which the Clinton Administration is counting on to help finance its new domestic policies, will be down the tube. Instead of cutting the defense budget, it will be necessary to increase defense spending by billions of dollars.

It has been projected that the United States over the next 10 years can save between $250 billion and $300 billion in defense expenditures if present trends continue. A new Russian nationalist authoritarianism government, heavily controlled by the military and shorn of the failed faith of Communism, would be a greater threat to the forces of peace and freedom in the world than the old Soviet totalitarianism.

What are the chances that the Yeltsin Government will survive? On the minus side, Russia is plagued by massive corruption and runaway inflation. Bloody ethnic conflicts are on the rise. The gridlock in Moscow between President Yeltsin's Cabinet and the heavily Communist Parliament he inherited from the Soviet era is much worse than anything ever witnessed in Washington.

On the plus side, Mr. Yeltsin has proved to be a skillful politician and formidable statesman. His popularity, at a time when his country is suffering not just from a recession but from a deep depression, is still above 50 percent.

Russia is a rich country; we are not dealing here with a nuclear-armed Bangladesh. Ninety-five percent of the Russian people are literate, and 90 percent of the Russian work force has graduated from high school. The press is free, and Mr. Yeltsin has acted as its greatest defender against undue interference from both conservatives in the Parliament and his own Government. There is considerable progress in overall judiciary reform. Most important, in foreign policy, both vis-a-vis the West and the newly independent post-Soviet states, Mr. Yeltsin has consistently acted with enlightened moderation. He needs our help and he deserves it.

It is essential that we be understanding and tolerant as he tries to find a new way of ruling the country through a compromise with the centrist forces organized under the umbrella of the Civic Union. I personally know some of the top leaders in this diverse coalition. While questioning many of the current Government tactics, they have a fundamental commitment to democracy and a free-market economy and are loyal to Mr. Yeltsin as the Russian President. If he makes a compromise with the Civic Union, there is no need to panic and to perceive it as a mortal blow to the Russian democratic experiment.

One of the most effective ways we can help Mr. Yeltsin survive is to champion the rights of the 25 million Russian-speaking people in the Baltic and the other post-Soviet states — both bilaterally and in international forums. The Russian people should be able to feel that their human rights are a priority for American diplomacy. This will be a constructive way to respond to xenophobic Russian nationalists who are paranoid and suspicious of the West and violently opposed to President Yeltsin.

The Yeltsin Government will not survive unless it receives a major new economic assistance package. The Freedom Support Act was a positive first step, but it has been overtaken by events. Urgent action on three fronts is required.

1. The $80 billion debt that Mr. Yeltsin inherited from Mikhail Gorbachev must be rescheduled for 15 years as Mr. Yeltsin has requested.

2. There must be a substantial bridge loan from Western governments to help the Russian people through a cruel, cold winter and to assist the transition from a command to a free-market economy that is unprecedented in a major country.

3. Russia needs massive investment from the private sector in the West. Government aid is limited by budgets. Investment from the private sector is limited only by opportunity. If Russia adopts the same legal guarantees for private property as we have in the West, it has been estimated that $300 billion would be invested over the next five years, dwarfing the $25 billion in Western government aid currently allotted.

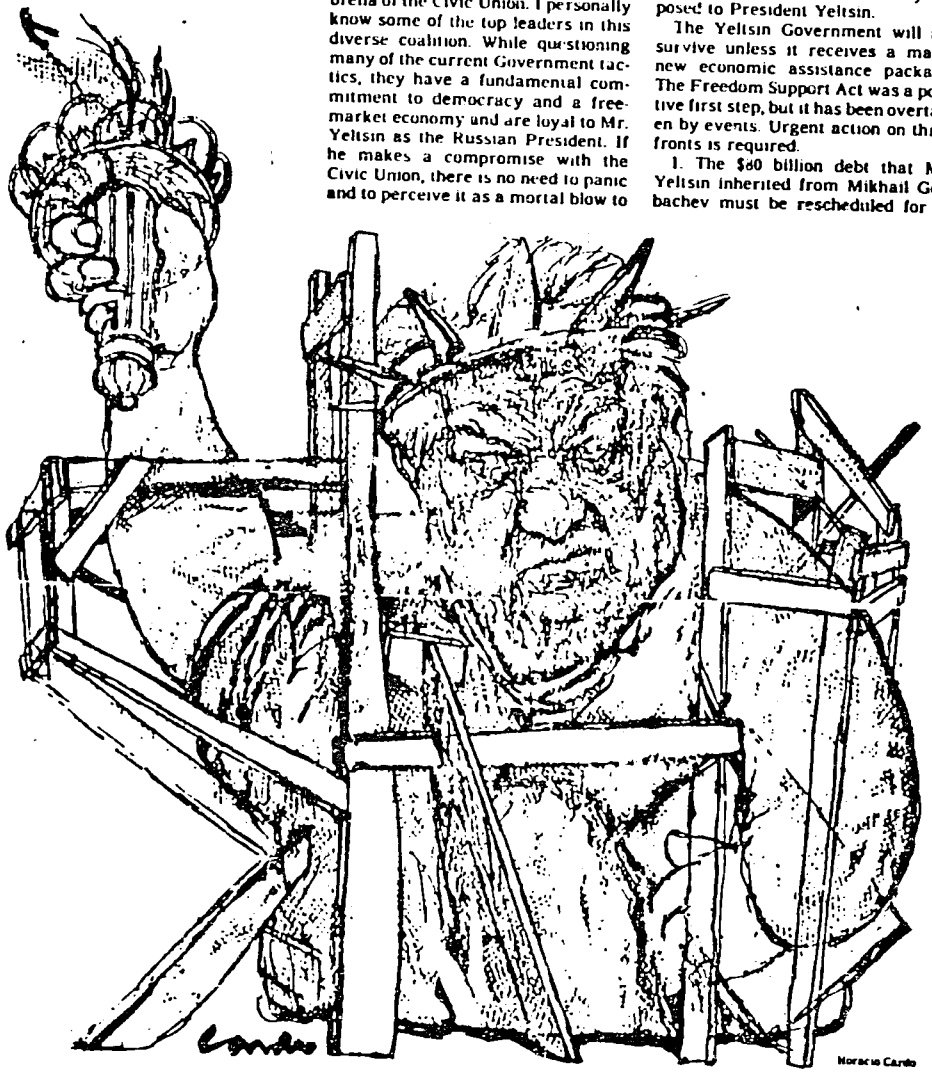
4. As Senator Sam Nunn has recommended, responsibility for the aid program should be given to one high-level individual reporting directly to the President who would act as the principal coordinator of all U.S. Government efforts. This individual should be of sufficient stature so that he can talk to Mr. Yeltsin and to Western leaders as an equal.

None of these things will happen unless the President plays a direct role. Only he can persuade the Europeans to accept debt relief, force the American bureaucracy to shape up and get Congress to approve foreign aid appropriations.

If we don't help Yeltsin, it will cost us plenty.

What's in it for us? If Mr. Yeltsin fails, we will again live in a dangerous world with the threat of nuclear war hanging over our heads. The wave of freedom sweeping the world will ebb and we could get caught in the undertow. If Mr. Yeltsin survives, and freedom and democracy succeed in Russia, we will live in a safer world.

We will also live in a richer world. A vigorous free-enterprise economy in Russia will mean billions of dollars in trade and hundreds of thousands of jobs for American workers. We will live in a freer world because the success of democracy and free markets in Russia will be an example for China and other dictatorships around the world to follow. □



Horacio Cardo

Richard Nixon, the former President, is honorary chairman of the Fund for Democracy and Development.

Jim Hoagland

Fiddling While Moscow Freezes

Crime or blunder? That is the question Russian democrats ask as they gaze on the failure of the West and Japan to support Boris Yeltsin's faltering experiment in capitalism and democracy. Is this lack of support a plot to break Russia apart, or stupidity of historic dimension?

Even if you opt for the blunder factor—I do—it is important to understand why senior Russian officials increasingly see the world's inattention to Russia's turmoil as mischief, not simple miscalculation.

As Yeltsin approaches the make-or-break point for economic and political reform in Moscow, Western leaders skirmish in petty trade quarrels over soybeans and Chablis. America's ambassador resigns after little more than a year actually spent in Moscow, leaving his post vacant at this critical moment. The foreign leaders who could help Yeltsin are totally absorbed with elections and transitions, domestic political problems and economic reversals.

They fiddle while Moscow freezes.

But inattention is not all. Worse, Western actions and words have contributed to a growing backlash against Yeltsin's program of reform. Three strains of doubt about Western intentions have become clear in recent weeks, Russian officials in Washington and visitors from Moscow report:

■ Exaggerated, unfulfilled promises of foreign aid have damaged Yeltsin's credibility. The $24 billion promised by then-Secretary of State Jim Baker on April 1 turns out to be more like $8 billion, according to the figures of the Yeltsin government, or $14 billion, according to the International Monetary Fund. Whatever the correct figure, "The people figure the money they heard was coming but have never seen went into the pocket of somebody at the top," says one Russian. "They don't know that Baker had his own political purpose in giving a fictitious figure."

■ The portrayal in the West of Russia as an inherently aggressive and expansionist state stirs deep suspicion of American motives. Yeltsin's ambassador to Washington, Vladimir Lukin, warns American "realpolitik fundamentalists who see the strong-arm rivalry of great powers as the eternal law of world politics" that they are playing into the hands of "jingoists" in Moscow who oppose Yeltsin.

Lukin did not name any "fundamentalists" in remarks he made at a Moscow conference in October. But conference-goers assumed that his main target was former secretary of state Henry Kissinger, who also addressed the meeting and repeated his long-standing concerns about Russia's imperialist, authoritarian history reasserting itself.

■ America's inconsistent policy on arms sales is fueling demands in Russia that its military-industrial complex be kept intact rather than converted to civilian industry. While pressing Russia not to sell arms to Iran and others in the Middle East and Asia, the Bush administration announced major U.S. sales to Saudi Arabia and Taiwan.

"We have lost 50 percent or more of our markets for our only productive industry," says one official noting Russian observance of United Nations arms embargoes on Iraq and Libya. "If Washington really wants us not to sell to Iran, why not help us get some of the market in, say, Saudi Arabia?"

Russia, of course, bears the primary responsibility for its democratic experiment. The second Russian revolution is Yeltsin's to win or lose. The West's failure to keep promises on aid have been matched by Russian failure to keep promises on economic reform, blocking further aid. Historians will settle which failure is chicken, which is egg.

But the inability of Western leaders to distinguish the important from the urgent—to keep a big-picture outcome for Russia constantly in mind as they deal with their own daily problems—already invites comparison to an earlier generation of rulers who watched Weimar Germany founder on hyperinflation and eventually swing to fascism.

One small incident tells the tale: As early as August, Yeltsin advisers saw that his retreat from reform and attempts to compromise with his Brezhnevite opponents would lead to the economic crisis that now grips Russia. Inflation runs at 25 percent a month and the ruble's value in foreign currency trading has plummeted from 30 to the dollar in June to 430 today.

These advisers sought help from the "sherpas," the senior-level officials who coordinate the Group of Seven summits and policy declarations, in getting other leaders to warn Yeltsin of the consequences of slowing reform to keep unemployment low. But elections in the United States, an impending change of sherpas in Germany, vacation schedules in France and other national considerations prevented any coordinated attention to the appeals from Moscow.

That is how it has been all year as Yeltsin has stalled maneuvered and muddled through with little real help from abroad. Premeditated sabotage? No. No Western plot to weaken Yeltsin would have been carried out this effectively. But we may never be able to convince the Russians of that, if Yeltsin, and democracy, come a cropper in Russia.

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Go Faster on Russian Reform

By Anders Aslund

STOCKHOLM

As has been the case so often, Russia faces a vital decision. A battle is raging between the liberal Government and the "centrist" Civic Union alliance. But is compromise what Russia needs? Instinctively, many people react positively to terms like "compromise" and "moderate reform," but we must not be fooled. The essence of politics is to provide viable solutions to the problems facing society.

The specter haunting Russia is hyperinflation. In the face of such a danger, moderation provides no solution. If a house is burning, you do not pour a little oil on it. You flood it with water. Similarly, you do not treat extreme inflation by issuing more credit, but by blocking new credit. This is the key difference between the approaches of the Civic Union and the reformist Government.

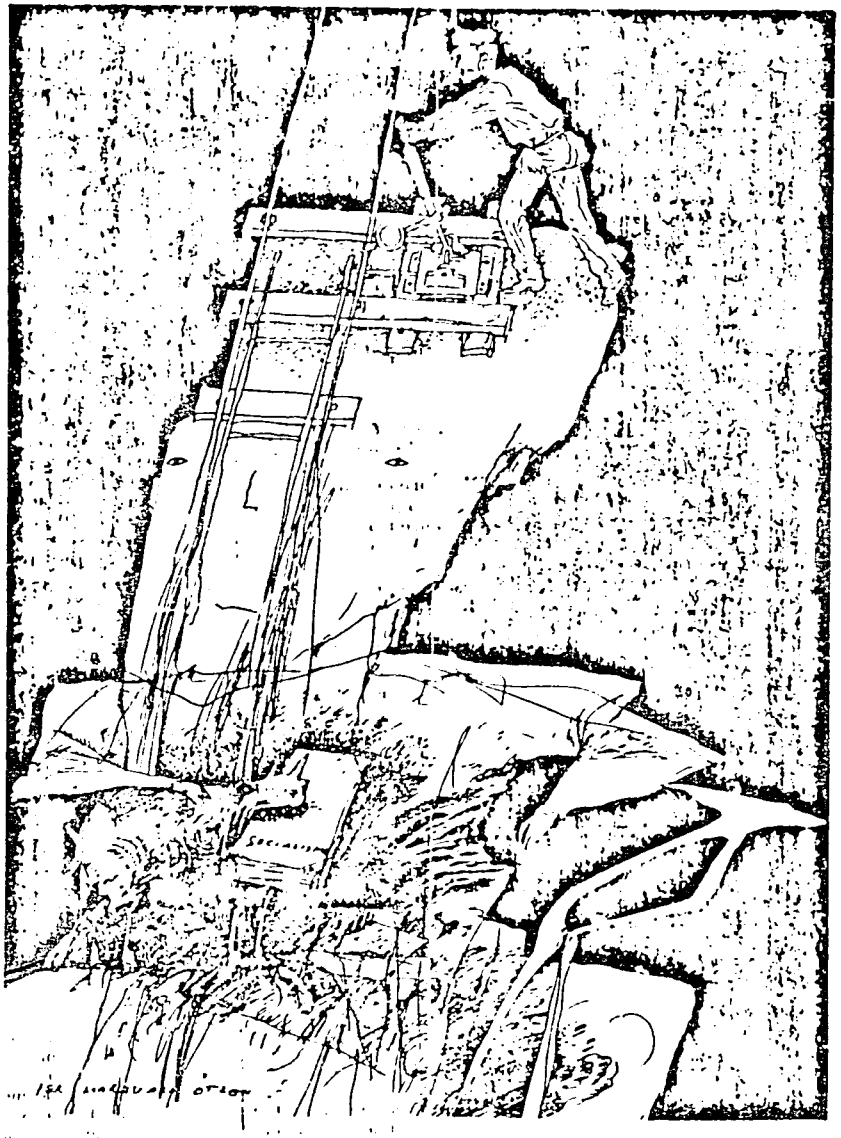
The Civic Union is a broad alliance of two populist parties headed by Vice President Aleksandr Rutskoi and Nikolai Travkin, and the Russian Union of Industrialists and Entrepreneurs, led by Arkady Volsky. Mr. Volsky is a prime example of the old apparatchik. He was the personal economic adviser to Yuri Andropov and Konstantin Chernenko. The old official trade unions are also part of the Civic Union. In essence, it is the clever Mr. Volsky who dictates Civic Union policies.

Viktor Gerashchenko, chairman of the Central Bank of Russia, bears the prime responsibility for today's inflation. Appointed in July, he, too, is an old Soviet official, the last head of the Soviet State Bank. Weirdly, Mr. Gerashchenko has abandoned all monetary restraints. The money supply has increased by about 30 percent a month, causing inflation to rise from 8 percent in July to some 25 percent today. Hyperinflation, defined as 50 percent a month, remains a threat.

On a gloomy day in October, I sat in our offices in the Russian Government headquarters in Moscow talking to one of the Government's strategic thinkers. Was there any hope for revitalized reform? Yes, my friend said. By the end of the month, the Civic Union would present its program and it would be an unmitigated disaster.

My friend later faxed me the 55-page program. It was extraordinary. The goal of "stopping the chaotic fall in production" was hailed as primary, while combating inflation ranked second. The suggested measures belonging to the old Communist economy, compulsory state orders, price regulations, state monopolies and even food rationing. It was similar to the Soviet economic system just before its collapse.

The Civic Union's program opposed any attempt to balance the budget. Instead, it wanted to guarantee the real value of enterprise assets and to restore the real bank savings that had been inflated away. Thus, a maximum amount of benefits was to be given to the vested interests of the old Communist society. The public, on the contrary, would be hit with strict controls on wages and social benefits. And this is not all. The Civic Union is also against rapid privatization, especially the free distribution of enterprise shares to the public at large, which the Government pursues at present.



No compromise with the old-line apparatchiks of the Civic Union.

This Civic Union program was written by two old-reform economists, Nikolai Petrakov and Yuri Yaremenko. Mr. Volsky's respected chief economist, Yevgeny Yasin, was not allowed to work on the program. Mr. Yasin, siding with the Russian Government, has warned that it would lead to hyperinflation.

This Civic Union program was not only a recipe for destabilization. It was the most antisocial program imaginable. The lost savings of the nomenklatura were to be restored and enterprise assets safeguarded, while the workers and pensioners would have seen their real incomes fall drastically.

Fortunately, the Civic Union had to withdraw this program. The official trade unions protested against its grave social implications. One week later, the Civic Union circulated an abbreviated program of 35 pages. Almost all the concrete demands had been deleted. What remained was little but platitudes. The well-kept secret is that the Civic Union has failed to adopt an economic program.

Politically, the Civic Union is dead set against referendums and elections, which are vital for the construction of new legitimate policy-making bodies. But the Civic Union as an alliance of vested interests of the old system would fare poorly in free elections. Mr. Volsky instead favors round-table negotiations, where he can prevail with his skills as an old apparatchik.

President Boris Yeltsin accepted the breakup of the Soviet Union, while Nikolai Travkin and Mr. Volsky opposed dissolution. The Civic Union advocates an aggressive policy toward the other former Soviet republics and an anti-Western foreign policy.

And yet, Mr. Volsky's group has its supporters in the West. Some uninformed U.S. Sovietologists, who still mourn the departure of the good old Soviet Union and its last leader, Mikhail Gorbachev, have thrown in their lot with the Civic Union.

While changing the economic system in Russia is a far more precarious operation than it has been in Eastern Europe, much has already been accomplished. One little-noticed fact is that there is no longer a threat of famine. The problem is that the reforms are going too slowly, not too fast. To promote a rational transformation of the economy, inflation must be brought under control. Only the Russian Government has a viable program to accomplish this.

If it wins at the Congress of People's Deputies, we can expect to see the Government blow new life into its stabilization and liberalization efforts, while privatization is already going excellently. That is why President Yeltsin and acting Prime Minister Gaidar should insist on their policies, as they do, and why the West should support their reform efforts. [.]

Anders Aslund, economic adviser to the Russian Government and director of the Stockholm Institute of East European Economics, is author, most recent-

Stephen S. Rosenfeld

For Russia, Democracy First

Yes, the Cold War is over, but from a security standpoint the largest, most important and most difficult single piece of the global jigsaw puzzle that remains to be put in place is Russia. Ready or not, Bill Clinton is going to have to turn to this formidable task.

Until now the West has had it easy. The major initiatives have been Moscow's, and they have mostly involved unilateral bursts of strategic retreat, military reduction and political restraint. The West took the gains and claimed much of the credit and paid relatively little in return.

This imbalance has generated a backlash at the Russian end: a feeling that the relationship is one-way and unfair. This feeling exists apart from, but it feeds, a parallel tendency of nationalism that runs not only among extremists of the left ("red") and right ("brown") but among committed democrats as well.

The Russian ambassador in Washington, Vladimir Lukin, is among the proven democrats who think Russia should not fall into what he calls "infantile pro-Americanism." An example: Russia inherited a lopsidedly militarized economy and is driven by desperation to sell arms abroad, but it is then scolded by Washington, which is far richer and less militarily dependent and peddles its own arms energetically. As a parliamentary deputy, says Lukin, he has learned not to let policy get out ahead of public opinion.

NATO should reinvent itself as the Atlantic club of democratic nations.

Lukin is mentioned as a possible replacement for Foreign Minister Andrei Kozyrev, should he be dumped by the embattled President Boris Yeltsin. Kozyrev's subordination of foreign policy to domestic revival has made him a champion of accommodation with the West. He has been outspoken in warning of a comeback by those with a "fascist ideology" and "a grand vision of restoring Russia in its grandeur to the borders of the former U.S.S.R."

Russia's passage puts Russians in psychological duress. The United States must respond with due tact.

The difficulty comes in the specifics. Should the United States stop expecting Yeltsin to eliminate the big SS-18 intercontinental missiles? What about use of the Russian army in the current Baltic mode—in bargaining out the rights of the 25 million ethnic Russians whom the breakup of the Soviet Union left as citizens of countries other than Russia? Is the American government supposed to sit and smile if Russia decides to resume a classical pan-Slav pro-Serbia course in the Balkans? Suppose the no-return crowd continues to keep Moscow from negotiating on the Kurile Islands with Japan?

The United States has got to assert its interest in these and other related matters. There's no place in our policy for "infantile pro-Russianism." But American chances to be listened to can only be improved if some basic considerations are kept in mind.

- The first priority is democratization. Nothing else will ensure that Russia, weak or strong, will be a good friend and partner. Anything else mocks the sacrifices of the Cold War. Winston Churchill in his famous Iron-Curtain-is-descending speech of 1946 invited Stalin's Russia to take its "rightful place among the leading nations of the world"—but democracy was the condition. Recalling this offer recently, the Bush Pentagon's Paul Wolfowitz renewed it. Democracy remains the condition—in particular, he said, political control of the military's policy and budget.
- The West should see to it that NATO stops dithering and reinvents itself promptly as the Atlantic club of democratic nations. Military NATO will stew for years over what sort of threats to prepare for. Political NATO should offer membership to the countries, reborn or new, that earn it. Poland would be first. It is not simply a matter of prestige. It is a matter of giving the politically invaluable reward of full acceptance in the company of the West.
- Overpromising—inflating the stakes and then failing to deliver—is a Western habit, and an especially bad one when it comes to offers of economic assistance. Says Anders Aslund, esteemed Swedish adviser to the Russian government: "The West is purportedly supporting President Yeltsin, democracy and a market economy in Russia, but it stopped supporting this country after it had ceased to be a communist, totalitarian, aggressive, centrally planned economy." We are entitled to ask the Russians and the others if they are serious. They are entitled to ask us.

A Cold-Cash Winter Proposal For Russia

By George Soros

I gave up hope for Russia in April of this year. It was then that I began to foresee a process of disintegration without end. The process could take many forms: the continued erosion of government authority, a breakdown of essential services and the rioting of troops; or a *Putsch* that would remove Boris Yeltsin and seek to unite the nation by finding enemies both without and within; or a combination of the two.

My cataclysmic view was based on a recognition that the economic reform introduced by Prime Minister Yegor Gaidar was not working. Mr. Gaidar was trying to stabilize the economy by means of monetary policy at a time when the economy was not obeying monetary signals. Enterprises continued operating according to a nonexistent plan, which meant that they kept filing claims on each other for which there were no funds. Inter-enterprise debt was accumulating at a rate that was roughly half the total national output. What was worse, it was reaching across national borders, causing tensions among successor states of the Soviet Union, particularly between Russia and Ukraine.

In April, Mr. Gaidar won a parliamentary victory that gave him another six months' lease on life, and Western governments went through the motions of offering economic assistance. But the proceedings had the quality of a charade. There was no reason to believe that the situation could be corrected within six months.

Now Mr. Gaidar's lease on life is expiring and everyone is full of foreboding about the coming session of the Congress of People's Deputies, which is scheduled to start Dec. 1. Even if a reformist government is endorsed by the congress, it is likely to be swept away in the subsequent hyper-inflation, and the inevitable attempt to reintroduce price controls and state orders would be resisted by the regions, leading to civil war. The window of opportunity is closing.

Is there nothing to be done? The truth is that the situation could still be turned around if only Western governments would put their heads together and use a little imagination. They could offer a social safety net that would provide minimum subsistence to the unemployed, the pensioners and the needy.

This could be done at a ridiculously low cost due to the undervaluation of the ruble. At present, the minimum wage is less than $6 a month. Admittedly, the exchange rate would be affected by the introduction of a large amount of foreign currency. Even so, $6 a month would enable those in need to buy bread and a few essentials at unsubsidized prices. As long as they had somewhere to live – and most people in Russia do – they could survive. Demobilized officers would need extra benefits; and the frozen North, which was not resupplied during the summer, would require special treatment.

I propose distributing social benefits in cash: in dollars or German marks. This would have a miraculous effect. It would introduce a stable currency into a hyper-inflationary situation. A hard currency in people's hands would be a powerful inducement to reorient production to meet people's needs. How this reorientation would be accomplished could be left to people's ingenuity – no need to rely on government policy. Food would find its way from producer to consumer. The production of all goods that can be sold for dollars or marks would soar.

Moreover, such a plan would remove the main obstacle to the closing of inefficient factories. Why keep people employed in nonexistent jobs when making them unemployed would bring a positive benefit from abroad? When enterprises whose output is worth less than the cost of inputs are closed, and food and energy subsidies are abolished, the budget can be balanced and inflation brought under control. The most intractable problems of the economy would suddenly become soluble.

Of course, once the currency is stabilized, $6 a month would not be sufficient as an unemployment benefit, but by then the process of disintegration would have been arrested and the problem could be left to the Russian government.

The whole scheme could be put into effect with $10 billion even if all the successor states of the former Soviet Union that are not actually engaged in warfare are included. This is a pittance, especially when compared to the cost of German reunification. The money could be advanced in the form of a loan from the International Monetary Fund. The offer itself would be unconditional, but its continuation would depend on Russia meeting certain conditions, such as the observance of human rights and the eventual creation of a common market among the former Soviet states.

Since such aid would take a purely humanitarian form and would involve little interference in government policy, it is difficult to foresee any objections from the Russian side. Yet the political effect would be immense. It would not only preserve the reform orientation of the Yeltsin government but give it a tremendous boost.

I have discussed my idea with key policy makers in Russia and they agree that it would have the effect I envision. But they tell me it is an idle dream, since the Western powers would never endorse such a plan. I am afraid they are right. Western governments are apparently too busy with their own problems. One thing is certain: They could save the world a great deal of aggravation if they helped Russia now – with hard currency. It would be a bargain compared with the amounts that will be spent on humanitarian aid as the former Soviet Union slips into the black hole of bottomless disintegration.

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Aslund Urges Stronger Western Involvement

Interview with a leading economic adviser to Russia

Anders Aslund, professor and director of the Stockholm Institute of East European Economics and the Stockholm School of Economics and foreign economic adviser to the Russian government, is a vigorous opponent of slowing down market reform. In both his recent paper, "Prospects for a Successful Change of Economic System in Russia," and his new book, "Post-Communist Economic Revolutions: How Big a Bang" [Center for Strategic and International Studies Series, CSIS, Washington, D.C. 1992, 92 p.], Aslund advocates an even swifter economic transformation in Russia. He explained his uncompromising stand to Transition *editor, Richard Hirschler, just a few days before the crucial December meeting of the Russian Parliament.*

Q. Let me quote from your latest paper: "If Russia becomes really successful, it might come to resemble the United States near the end of the 19th century, that is, a Wild West economy with few regulations, but therefore limited corruption." You suggest that private businesses should lead Russia out of the present mess. Can you really trust rent-seeking businessmen to sort out distribution problems and get the country moving again? Will market forces be sufficient to reach socially optimal levels of output in the present Russian situation?

A. I'm convinced that in Russia more government regulations lead to more monopolization, more excessive profits, and more conspicuous consumption. The market is a far better equalizing force than any kind of regulation, given a very corrupt state administration in Russia. According to opinion polls, 1 percent of Russians are extremely rich, and I have no doubt that extreme income differences could be socially dangerous. But the way to mitigate social tension and prevent rent-seeking is to go ahead with liberalization and privatization and create a large middle class. My worry is that liberalization is not going far enough, while the policymaking apparatus is disintegrating. Therefore, I support the introduction of constitutional changes, the call for new parliamentary elections, and as a result, a gathering of a new democratic assembly. In the meantime, the government should tighten up the macroeconomic policy as far as possible.

Q. According to their just released 1993 program, the Russian government will reduce the annual inflation rate to 70 percent next year, a dramatic improvement from the present hyperinflation of about 25 percent a month. Do you think this cut is feasible?

A. I admit such a drastic cut of inflation seems a little ambitious, but correct monetary policy is the key to stopping inflation. The main obstacle to macroeconomic stabilization has not been so much the budget deficit as the monetary policies. Inflation in 1992 will exceed 2,000 percent, turning bank credits into subsidies because of the negative real interest rate. [The refinance rate of the Central Bank climbed last May to a mere 80 percent.] The Central Bank and the 1,500 commercial banks—the latter owned predominantly by large state-owned industrial enterprises—are channeling quasi-state subsidies to the big, and in most cases inefficient, state enterprises so that they do not have to adjust to the market. Most of this money will feed the ruble supply at the currency auctions, thereby undermining the Russian currency. That is why it was so important that President Yeltsin decided to subordinate the Central Bank to the government and that the chairman of the Bank, Victor Gerashenko, became a member of the cabinet. In my view, some kind of control was necessary because the Central Bank was not properly performing the duty of safeguarding monetary discipline.

Q. Without doubt, Gerashenko represents a solid block of economic opinion in Russia, which claims that even flagship industries could be crushed if they have to

restructure production and management and redirect sales while being exposed to indiscriminate taxes, spiraling costs due to hyperinflation, and a centrally orchestrated credit crunch. Why not give them at least a little breathing space through carefully managed policies? The future of state-owned enterprises is also a burning issue in countries of post-communist Central Europe, such as Hungary, which up to now have quite successfully weathered the pains of transition, but which now face difficult social problems.

A. There is a legitimate case for cutting taxes in Russia where people complain about excessive tax burden. Public expenditures amount to only one-third of GNP, which indicates the country has already moved far in the right direction. But in Hungary, public expenditures amount to an extremely high portion (about 60 percent) of the official GNP. The demand to cut taxes without slashing public expenditures presents a serious problem there. Hungary also suffered mass bankruptcies this past summer, which has not happened in most of Eastern Europe. Similarly, unemployment has been surprisingly low in the region with the exception of eastern Germany. At a time of such major restructuring, that level of unemployment is not high, even by international standards. In the Czech Republic, where unemployment has fallen to 2.6 percent, the government is concerned that unemployment is artificially low and there are practically no bankruptcies. In Rus-

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sia, the problem is that massive restructuring of the economy has not even started yet.

Q. You argue that in Russia half measures in price and trade liberalization only help the rent-seekers. What are your specific suggestions?

A. Liberalization needs to go farther although it is much easier in the East European countries than in Russia, where state authorities intervene on a massive scale on different levels. Liberalization of foreign trade has been insufficient. Besides unnecessary export regulations, all kinds of import regulations have been introduced recently. Major progress is required in this area. As to privatization, I think this is one area where the Russian government is doing what really needs to be done. A new definition of the ruble zone is also required, to make clear what the Russian Central Bank can and cannot do. Clear monetary authority must be asserted within each currency zone. Of far less importance is how many currency zones will be established in the ex-Soviet Union.

Q. You expressed many times your dissatisfaction with the West's low-key involvement in support of Russia's transition efforts.

A. It is surprising how slow the West has been in responding to Russia's needs. Russia will soon be ready to implement a new macroeconomic stabilization program, a sort of anticrisis program. Assuming that the country fulfills ordinary IMF conditionality, the West must be ready to provide funds to support that program. There is little awareness of that in the West, and that should be made a top priority. On the other hand, the World Bank, IFC, and EBRD are all actively involved in providing technical assistance on privatization. Cooperation between the Russian government and the Western agencies has been excellent in this area. Joint efforts for human capital development also hold enormous possibilities, considering the large number of research institutes, management institutes, and business schools mushrooming in Russia. Lots of activities are being undertaken already, for example, translation and dissemination of Western economic textbooks.

Q. Do you expect the Clinton administration to undertake a more active role in supporting Russia and the other postcommunist economies?

A. I don't know, I hope so. It is important that someone high up in the administration has a major responsibility for assistance to the former Soviet Union and Eastern Europe. Someone who focuses on these issues and can act reasonably fast. What we have seen in the past year is that sherpas have been in charge of a policy for the ex-Soviet Union and Eastern Europe, Group of Seven sherpas, mostly deputies of finance ministers. During the exchange crisis this fall they were unable to focus their attention on such matters as Russia. And the West seemed to have no policymaking capabilities whatsoever.

That is not to deny the importance of World Bank or IMF involvement. But more is needed; strong Western involvement is needed. I do not think there is a danger that Western advisers will overrun the ex-Soviet Union, as was the case in Eastern Europe. On the contrary, it seems that there are too few advisers in Russia, and even fewer in other new states of the ex-Soviet Union.

Q. In your paper you came out with a catastrophy scenario: that unless hyperinflation is halted and international support is granted, the menace of dictatorship looms, and a new Hitler could emerge. How can this scenario be prevented? Is your appeal for more Western advisers the answer? Or can Yeltsin's appeal for faster reform prevent this eventual collapse?

A. I want to alert the world that very little international policymaking is being generated in today's world. The fate of the former Yugoslavia is a graphic illustration of the West's inability to handle the situation. Senior politicians were not informed about the real dimensions of the crisis, and when they finally realized what was going on, they didn't know what to do. Moreover, from the beginning of the crisis, they never even tried to do anything. If that happens in Russia, or in Ukraine, the consequences could be even more disastrous, replicating on a massive scale what has happened in Yugoslavia. It is difficult to understand, but we are again in a postwar situation and many of the ground rules have to be rewritten, no matter that it was a cold war and not a hot one. We must understand that intellectually and act accordingly.

Q. As to a foreign adviser, you take a surprisingly fierce attitude in defending the economic reforms of the government. A few weeks ago at the Financial Times *conference in Moscow, you were rebuking Arkadi Volski, head of the Union of Industrialists and Entrepreneurs, who felt compelled to defend himself publicly against your charges.*

A. What Volski really suggests is that we learn from the Japanese and the Chinese models. But this is unrealistic. Those countries pursued prudent monetary and fiscal policies. Most had far better civil services and state administration than Russia has today.

Q. As an adviser to the Russian government, you have been spending one week a month in Moscow since November 1991. How do you fulfill your role as an adviser and who is funding your activity?

A. I try to keep up with major current policy issues and provide advice on a general level, while others give more technical advice on specific issues. I work with a team of ten senior people, among them Jeffrey Sachs, Davis Lipton, and Andrei Schleifer. I'm funded primarily by the Ford Foundation and the Swedish government, and we have some other sources of funding. Basically this is a form of technical assistance for the Russian government.

Q. Did you lose some illusions in the past month? Would you do anything differently now?

A. Not really. I have been in favor all along of a very liberal solution for Russia. And the failures suggest that one has to go in a more liberal direction, as quickly as possible.

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Russia's Optimism: A Prime Minister Can't Stop Reform

By GARRY KASPAROV

MOSCOW – The news that a technocrat, Viktor Chernomyrdin, will replace Yegor Gaidar as Russia's prime minister is being interpreted widely as a step backward for Russia. The change is indeed not an inspiring one. But it is not a change that can stop Russia's move toward free-market democracy. In fact, Russia's transition is too big to be stopped from the Kremlin.

To understand how this is so, it is important to see that the Yeltsin-Gaidar government has been doomed since the fall of 1991. After the coup attempt in August of that year, Mr. Yeltsin had almost unlimited power to undo the old Soviet state. But he is a former (albeit nonvoting) Politburo member himself. It was easier for him to work with the old guard – old colleagues – and compromise with them.

And so he did. The story of the Gaidar government is the story of unnecessary compromise. Mr. Gaidar started as a true reformer, on both the political and social fronts. But soon fights for power came to replace the fight for reform. Mr. Gaidar gave in to Russia's *nomenklatura*, to the all-powerful People's Congress, and to other hard line forces. He committed himself to helping Russia's bankrupt state industries through further subsidy – rather than privatizing immediately.

Viktor Chernomyrdin

The Gaidar team slapped a 28% value-added tax on all transactions, which hurt the small entrepreneur. It imposed other taxes that further hurt the businessman. The Russian central bank – without strong opposition from Mr. Gaidar – extended loans and credits of up to a trillion rubles to the old industries. Tax revenues were used to support overly ambitious social promises from Mr. Yeltsin that included raising salaries and pensions connected to that old system. Import taxes raised the prices on alcohol, clothing and many foodstuffs for the average Russian.

As a result of the central bank credits, and other policies, the ruble's value has fallen to 418 to the dollar today from 130 earlier in the year. At the G-7 summit in Munich, Mr. Gaidar committed a further error (and copied Mikhail Gorbachev) by focusing on getting new money from the West – instead of on a deal to reschedule or write off old debt.

An outstanding example of President Yeltsin's hesitation and failure is the referendum on the future of the Congress of People's Deputies. It can be argued that this entire structure of some 1,000 members is a relic of communism. Mr. Yeltsin announced that he wanted such a referendum. The people were behind him. But pressure from the Congress on this was strong, and the president yielded.

Mr. Chernomyrdin, a man with lifetime experience in the workings of state-controlled economies, is not an obvious candidate to lead free-market reforms. Nonetheless, there are reasons the new situation may not halt progress in Russia:

• *The change will free democratic forces.* The forces that toppled the August 1991 coup muzzled themselves when they chose to back Mr. Yeltsin unequivocally. Now that the progress they hoped for has so clearly failed to emerge, they can once again provide criticism – and opposition – to the government. True democrats in Russia have, over the past year, quarreled among themselves. The frightening news of the new prime minister will galvanize them, putting them in the position they held in 1989 and 1990 – that of pure opposition. In coming weeks they will join together and dissociate themselves from Mr. Yeltsin.

• *The change will not be strong enough to halt private enterprise.* Regardless of the government's damaging behavior, private enterprise here has taken root in the past year. Members of the nomenklatura now have a stake in the privatization of industry. They want the companies they control to be worth something when they are privatized, and will fight for that.

• *The change will make even hard-liners realize the Congress more realistic.* Russia's leaders realize that they risk a repeat of August 1991. If they clamp down, the people will rise up, and this time the uprising will not be peaceful. So Mr. Chernomyrdin and the government will likely work to follow a moderate path. (The new prime minister's statement that he is pro-free market is evidence of that.)

A hopeful sign from the new government would be strong support for the privatization of agriculture and the private ownership of land. (Mr. Yeltsin promised this, but it never happened.) But the most important test for the new government is the referendum on a new Russian constitution, set for April. Russians need the chance to vote on the new document in a free way. Further tests are the future of the People's Congress and the presidency. Elections for these bodies are scheduled for 1995 and 1996, but neither one is likely to last until then in its current form.

The most dangerous consequence of this week's changeover is in foreign policy. Foreign Minister Andrei Kozyrev's statement this week in Stockholm that Russia might no longer cooperate with the rest of the world on foreign policy is a bad sign, even if Mr. Kozyrev later backtracked. Many Russian nationalists, for example, support the Serbian army and the Serbian national cause. They would like to end Russia's participation in the international embargo on Serbia. Russian citizens are divided on such issues – and ill-informed. If Mr. Yeltsin makes concessions to the hard-liners on this, he may even end up weakening Russia's alliance with the civilized world.

Mr. Kasparov, the world chess champion, is a Journal contributing editor.

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THE WASHINGTON POST, December 18, 1992

Jeffrey D. Sachs

Russia Needs Real Aid—Now

"Supporting Russian Democracy" [editorial, Dec. 4] claims that Russia has received $23.5 billion of the $24 billion in aid that was promised in April. This is unfortunately incorrect and is based on faulty accounting by Bush administration officials intent on hiding a record of reckless neglect. In fact, an accurate count shows that Russia has received only about $10 billion in 1992 and that even this aid was overwhelmingly in the form of short-term commercial credits that will soon come due. There has been no real strategy or program of Western assistance to support Russia's reforms, and the reformers have consequently been left in extreme peril from the political attacks of the hard-liners.

The editorial's reckoning starts with $1 billion lent by the IMF but does not mention that the IMF funds were lent under the incredible condition that they not be used in 1992. The World Bank has recently agreed to a $600 million loan, but it is likely that only $250 million or so will be used by the end of the year.

The editorial then reported that $14 billion will come in other grants and loans from Western governments. As a matter of fact, only about $8.5 billion of credits had come as of October, with another $500 million in grants. Nearly $1 billion of the credits actually constitutes a rescheduling of previous debts rather than a real inflow of new resources. Moreover, the credits has almost all been short term (less than three years) and at market interest rates. Around $2.5 billion will come due already next year (and will be unpayable at that time).

The administration is also apparently trying to count $2.5 billion of expenditures on Russian troop withdrawals even though the money is actually spent in Germany, was committed before 1992 and was never part of the $24 billion aid package, a point made clear to the Russian government and to me personally by the highest officials of the German government earlier this year.

The editorial also credits the West with rescheduling Russia's debt. Unfortunately, this has not occurred. The Paris club of official creditors has so far failed to agree on a debt rescheduling this year. It is true that Russia did not pay its debt, since it lacked the money, but it is untrue that it received the relief of a formal debt rescheduling. Russia has suffered as the result of the Paris club's inaction; many funds offered to Russia at the start of the year have since been blocked by the donor governments, because of the absence of a debt rescheduling. The best that the West has come up with are several three-month rollovers of debts, which have given no relief to Russia or to potential new donors and investors.

Incidentally, the editorial questions whether debt principal as well as interest should be counted in the "assistance." The Western governments made clear to Russia back in

Taking Exception

March that principal rescheduling would not be counted in an assistance package for 1992, because it was already assumed in November 1991 that the principal would be rescheduled and that a 1992 package should be counted as additional to the previous agreement (since the needs were measured as additional to the previous debt agreement).

The editorial also states that the stabilization fund is "ready and waiting." Alas, if it were only true. The Russian government argued for months with the international community about access to such a fund. Absurdly, it was told that the fund would not be available until Russia actually succeeded in stabilizing. By contrast, in Poland a similar fund was made available at the start of the stabilization program.

But the situation is even worse than this. There never was a sense of urgency or a strategy to the Western assistance. There was never an overall design of the policy. There was nobody in charge of the U.S. government effort. There was no strategy for using assistance to bolster the reforms. The $7.5 billion or so of trade credits were not coordinated or made conditional on actual reforms. And remarkably, even the Soviet debt has not been rescheduled. Of course, The Post could not know these things; they have been well hidden by the administration.

If Russian reforms now fail, the Bush administration's neglect will certainly rank among the greatest failures of American foreign policy. On the other hand, if the reformers are able to survive the political test in Moscow now underway, the new Clinton administration will face an urgent need and opportunity to get a real assistance program underway.

The writer is a professor of economics at Harvard University and an economic adviser to the Russian government.

THE JOURNAL OF COMMERCE, December 18, 1992

Setback for East Europe

EUROPE VIEW

Bruce Barnard

BRUSSELS, Belgium — The crisis in the European Community has delivered a killer blow to Eastern Europe's bid to integrate into the capitalist mainstream.

The EC's struggle to salvage the Maastricht Treaty on political and monetary union and quell the turbulence in its currency markets leaves it little time to help the fledgling market economies of the former communist nations.

Britain put Eastern Europe high on its agenda when it took over the EC presidency in July, pledging an increased community effort to help its vulnerable eastern neighbors.

But sterling's ragged retreat from the fixed exchange rate grid of the European Monetary System, the growing opposition to the Maastricht Treaty in the ruling Conservative Party and a deepening economic recession have stranded London on the periphery of the community.

Britain's presidency is now focusing on insular community affairs, as it strives to save the Maastricht Treaty amid growing political turmoil at home.

British Prime Minister John Major and EC Commission President Jacques Delors are going ahead with a mini-summit with the leaders of Poland, Hungary and Czechoslovakia next month. But Eastern Europe is getting only a sideways glance from the beleaguered community.

Even before the currency crisis erupted, EC interest in Eastern Europe was waning, its conscience soothed by trade accords with Poland, Hungary and Czechoslovakia, negotiations with other East European states and the occasional aid package.

The trade accords threw a lifeline to the three most advanced East European countries and dangled the prospect of eventual membership in the community.

But the deals betray the EC's protectionist instincts by imposing severe restrictions on steel, chemicals, coal, textiles and farm produce, the very sectors where Eastern Europe is most competitive.

The EC is ready to turn the screws when its domestic industries, outpriced by East European producers, cry foul. Thus the community recently allowed Germany, France and Italy to clamp quotas on certain steel products from Czechoslovakia — though the volume of shipments was relatively small.

The EC is denying Eastern Europe its only realistic chance of medium-term salvation — free trade. And Eastern Europe is really hurting: The Polish and Czechoslovak economies have shrunk by about 20% since 1989.

Eastern Europe's misery is compounded by the fact that Germany, its biggest market and potential investor, is preoccupied with the restructuring of the ravaged east German economy.

None of the East European economies is likely to return to pre-reform levels of output before the end of the century, according to Wilfred Thalwitz, a senior World Bank official.

The plans of Poland, Hungary and Czechoslovakia to join the community within the next 10 years were always considered wildly optimistic. In the wake of the currency crisis and the Maastricht debacle, this timetable is even more unreal.

Jacques Attali, president of the European Bank for Reconstruction and Development, is a voice in the wilderness. Without real hope of economic improvement, Eastern Europe, he warned, could "slide into tribalism" that will affect both East and West. His prediction, on the eve of the EC's currency upheaval, didn't get much play in a community obsessed with its own acute short-term problems.

Mr. Attali has urged the EC to rapidly renegotiate its trade accords with Poland, Hungary and Czechoslovakia — and to follow that with multilateral free-trade negotiations involving some 40 European nations, including distant former Soviet republics.

There is no sign the EC is ready to give the front-line Eastern European states a better trade deal, much less open its doors to countries with weaker historical and cultural links to the community.

Instead, the EC likely will come under increasing pressure to clamp down on Eastern Europe's most competitive exports as higher-cost community producers plead for protection to stave off plant closures and layoffs.

The EC faces a daunting challenge in rescuing the Maastricht Treaty and restoring the credibility of the European Monetary System. It has to accept four new members — Austria, Finland, Sweden and Switzerland — as well as cut a deal in the GATT's Uruguay Round and ensure the smooth functioning of its border-free single market in 1993.

Nevertheless, the EC should not duck the challenge of Eastern Europe. As Mr. Attali has warned, economic breakdown in the East will trigger ethnic and territorial disputes that will make Yugoslavia look like a dress rehearsal.

Bruce Barnard is Brussels correspondent for The Journal of Commerce.

OPINION

CHALLENGES IN RUSSIA AND ESTONIA

Where the Action Is in Russia

By Eugene B. Rumer and John Tedstrom

■ *Regional and local leaders have taken legal steps to wrest ownership of assets on their territories from Moscow. In some cases they are pushing ahead with privatization faster than the center had planned.*

THE replacement of Yegor Gaidar with Victor Chernomyrdin as prime minister of Russia ends the political gridlock in Moscow. It also hands radical reformers a defeat. But this event will not lead to the restoration of central control, as the state-industrial lobby hopes. It is likely, however, to result in more inflationary policies and inconsequential attempts to restart the economy through central planning, thus adding to the disintegrative forces within Russia and, ironically, weakening the central government even further.

Western media and policymakers have missed the real story of political and economic change in Russia: Preoccupied with political jockeying inside Moscow's Beltway, they have paid little attention to the rise of Russia's periphery as the locus of political and economic power.

This trend may not seem as significant as the disposition of nuclear arms, economic aid, or the reactionary opposition's onslaught against the Yeltsin government. But the transfer of power from Moscow to Russia's periphery is of more lasting importance. It ought to be factored into our policies toward Russia.

Given Russia's size, its regional and ethnic diversity, and its needs, no centrally devised reform program, no matter how clever, could encompass the entire challenge of transforming the country from an authoritarian state and planned economy to a democratic state and capitalist economy. Devolution of power to the regions, by design or default, offers the only hope for economic reform in Russia.

To some, the erosion of Moscow's authority is a harbinger of dangerous instability in a country where the foundations of pluralistic society have yet to be laid. But the erosion of central authority has been offset by a rise in the standing of regional and local leaders.

The strengthening of regional political and economic forces poses a formidable obstacle to the reactionary elements in Moscow who would like to restore an authoritarian central government and reassert Moscow's control over the territories of the former Soviet Union. Any such attempt would encounter strong opposition from ethnic and regional political movements in all former Soviet republics, including Russia.

The rise of local centers of power promises to be a key factor determining Russia's transformation. Economic reform in several regions has outpaced policies emanating from Moscow. Regional and local leaders have taken legal steps to wrest ownership of assets on their territories from Moscow. In some cases they are pushing ahead with privatization faster than the center had planned. The most successful initiatives on foreign investment and opening to the outside have come from these local leaders.

While the danger of political and societal breakdown in the young Russian state cannot be taken lightly, the chances of such an outcome would be even greater if a discredited central government attempted to hold on to the levers of power. The analogy with Mikhail Gorbachev's failed attempts to preserve the center's preponderance in economic and political life is obvious.

This mandates a new direction for Western policy toward Russia. From now on it must become sensitive to the rise of regionalism and the potential conflict between center and periphery. The West must realize that, as in the former USSR, no amount of reasoning on the "logic" of maintaining the union will persuade regional politicians to accept a dominant role for Moscow. Likewise, by politically embracing emerging regions, the West could damage relations with the center.

In light of these considerations, the US and other Western nations should take a fresh look at how they give economic assistance to Russia. Aid packages tied to macroeconomic indicators and federal government programs should yield to endeavors focused on regional economic growth and employment. The primary vehicle for a new aid policy toward Russia should be the World Bank, which has the appropriate charter and expertise. Fortunately, Yeltsin has appeared sensitive to regional political and economic trends. He has delegated important powers to regional authorities and has promised more of the same in the new Russian constitution. He seems to have learned from Mr. Gorbachev's mistakes.

■ *Eugene B. Rumer is a political scientist and John Tedstrom an economist in RAND's International Policy department, Santa Monica, Calif.*

Regarding Estonia's Russians, the Basic Issue Is Justice

By Jaak Treiman

MUCH has recently been said and written about the status of Russians living in Estonia. While many of these discussions have focused on legal and economic considerations, the essential, unstated question has been "How will justice prevail?"

Philosophers from Plato to Doonesbury have argued about the meaning of justice. Some believe that justice cannot be defined; we can only know what injustice is. How, then, does an entire nation try to implement a just society, after living with injustice for 50 years?

Last year, Estonia, a land of 1.6 million people, regained the independence it lost in the 1939 Molotov-Ribbentrop Pact. The secret protocols to the pact gave Estonia and the other Baltic states to the Soviet Union.

Estonia, a sovereign nation with its own Nordic culture and traditions, was a member of the League of Nations. Its population was predominantly Lutheran and spoke Estonian. The literacy rate in Estonia was more than 95 percent. It had historical ties with Denmark, Sweden, and Germany.

During the 50 years of Soviet occupation following the Molotov-Ribbentrop Pact, about 100,000 Estonians were killed or deported. Its economy stagnated as Estonia's pre-war soul mate and economic equal, Finland, became one of Europe's economic stars. Historians worked as janitors. Artists were sent to psychiatric prisons. Estonia's population developed a protective mindset that sought to avoid rather than comply with every law and regulation.

Before World War II approximately 9 percent of Estonia's population was Russian. After the Soviet annexation, thousands of Russians were sent (not always willingly) to Estonia. They were sent to supply additional workers for factories and culturally dilute, if not obliterate, the Estonian nation. Because of this, Russians now make up about 30 percent of the population.

The Russians who arrived in Estonia lived in their own enclaves, refused for the most part to associate with the native Estonian population or to learn the Estonian language, and enjoyed a preferred political position.

These Russians and their descendants continue to live in Estonia and, until the past few years, their sheltered, unintegrated world remained secure. That shelter collapsed in August 1991, when Estonia regained its independence. Now they must choose where their allegiance lies.

Estonia's new Parliament must decide what policies to implement toward its Russian population. Should they be considered automatic Estonian citizens? Should they be treated as second-class citizens? Should their presence even be considered?

Estonia's Basic Law, its new Constitution, guarantees fundamental human rights to all residents without distinguishing between citizens and noncitizens. In that sense, the Estonians have rejected legalized retribution as an element of the justice they seek to define and achieve.

UNDER Estonia's new citizenship law, however, those people (and their descendants) who came to Estonia after the Soviet occupation are not granted automatic citizenship. In Estonia, the post-annexation immigrants may vote in local elections but not in national elections. They cannot serve as policemen or receive certain government-sponsored benefits. To become citizens they must have lived in Estonia for at least two years and demonstrate a knowledge of 1,500 basic Estonian words. Compared with the citizenship laws of most of the world's countries, Estonia's is extremely liberal.

Estonians would be among the first to acknowledge that liberal words do not necessarily translate into liberal reality. The newly freed colonial subjects of the British, French, and Spanish empires initially found it difficult to forgive past injustices, even as the British, French, and Spanish colonists found it difficult to accept their loss of control.

Some Estonians are also finding the idea of immediate forgiveness of the Russian colonists difficult, just as many Russians are finding it hard to accept that they are no longer as powerful and privileged. To the credit of them both, their ongoing process of readjustment has not resulted in a Yugoslav-style conflagration.

The Estonian government must decide how to implement and execute the principles embodied in Estonia's Basic Law, which has received almost unanimous praise from human rights groups, so that all residents of Estonia have a stake in the country's success. But within this legal framework, the real issues are whether the Russians want to become part of Estonia's society and how willing the Estonians are to encourage them to do so. These are the issues which will determine whether Estonia's search for justice will succeed.

■ *Jaak Treiman is Estonia's honorary consul in Canoga Park, Calif. The views expressed are his own.*

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THE NEW YORK TIMES, December 19, 1992

Trapped In the Baltics

By Francis Fukuyama

WASHINGTON

The plight of the 25 million Russians outside of Russia has become a foreign policy concern of President Boris Yeltsin's Government. In this issue are the seeds of another crisis more dangerous than the breakup of Yugoslavia.

Estonia has passed and Latvia has proposed discriminatory citizenship laws requiring Russians, as well as other ethnic minorities, to go through a difficult naturalization process during which they cannot vote, own property or hold certain jobs.

These policies may be understandable for historical reasons, given Baltic fears of being overwhelmed by the Russians. Nevertheless, discrimination is discrimination; many Russians have become victims, and the Russian Government is understandably upset.

At the United Nations in September, Andrei Kozyrev, Russia's pro-Western Foreign Minister, criticized Estonia for violating the human rights of Russians. And in October, the Yeltsin Government halted troop withdrawals from the Baltics to put pressure on local governments to respect Russians' rights. In Moldova, Georgia and Tajikistan, Russians have killed and been killed in ethnic violence. Increasingly, they are arming themselves in self-defense.

The instincts that served us well during the cold war may be inappropriate now. It is natural for Americans and Europeans to side with the Baltics and other captive nations that suffered under the yoke of Russian and Soviet imperialism. But the human rights principles underlying U.S. foreign policy do not extend to support for efforts to create ethnically or racially homogeneous nations.

More important, as a purely practical matter, Latvia and Estonia are tiny communities on the border of the world's largest country. It's unrealistic for them to expect protection from the U.S. or the European Community; they will have to find a way to live with Russia in the long run. It is hard to see how Latvia and Estonia can expect to disfranchise half their populations and remain viable, stable and democratic countries.

To be sure, Moscow's motives in championing the rights of Russians abroad are in many cases highly suspect. Some officials, such as Vice President Aleksandr Rutskoi, are not entirely reconciled to the loss of empire and would like to use local Russian populations as a means of winning back the country's hegemony.

But many other Russians are sincere democrats who supported Baltic independence two years ago and feel betrayed by the Baltics' reneging on promises to treat their minorities fairly. It is senseless to hand would-be fascists in Russia an easy issue with which they can attack Mr. Yeltsin and discredit his close relationship with the West.

Under these circumstances, the U.S. must take an unprejudiced and evenhanded position, supporting the rights of all ethnic minorities in the region, including Russians. This might mean applying pressure on Baltic and other post-Soviet governments to liberalize their citizenship and permanent residency laws, even as we continue to press Russia to withdraw its forces from the former Soviet republics.

New states are mistreating ethnic Russians.

Aid and trade to these states should be conditioned not just on economic reform but also on human rights. George Kennan's suggestion that aid be used to build housing for Russian servicemen being brought home from the Baltics and elsewhere is a good one for the incoming Clinton Administration.

With the appointment of Viktor Chernomyrdin, a lifelong Soviet bureaucrat, as Prime Minister, the Russian Government is more likely to provoke a crisis with the Baltics over the rights of ethnic Russians. But the big explosion is in the future, if Ukraine moves away from its liberal policies on rights and citizenship toward nationalist conformity.

Unlike the crisis in the former Yugoslavia, the one in the ex-Soviet states will present the Clinton Administration with not just a moral but a major geopolitical problem. Russia could intervene against the Baltics or, worse, confront Ukraine over the rights of Russians in Crimea. Let us hope that our tragic reluctance to become involved in Yugoslavia will not be repeated in the case of the former Soviet Union.

Francis Fukuyama, a consultant at the Rand Corporation, is author of "The End of History and the Last Man."

STUDIES OF ECONOMIES IN TRANSFORMATION
PAPER NUMBER 2

Trade and Payments Arrangements for States of the Former USSR

Constantine Michalopoulos and David Tarr

Foreword

In early 1992, trade among the 15 states of the former USSR had declined dramatically, and trade relations were in disarray. There is evidence that the pattern of trade that had developed in the former USSR was far from optimal and insufficiently linked to the international trading community. However, it was widely feared that, given production linkages, too rapid a decline in interstate trade could aggravate unemployment and prove extremely costly for all of the states. Urgently needed was a transitional trade and payments arrangement that would encourage market-determined realignment of the trade patterns and absorption of these economies into the international trading community in the long run, while reducing the more immediate costs of the transition. This study, a joint product of the Europe and Central Asia Department III and the Country Economics Department, presents the contours of a transitional mechanism for the states of the former USSR.

The study discusses the incentives in the interstate trading environment of 1992 that have led to interstate export controls and the decline in interstate trade and proposes solutions that address the incentive problem. It explains how interstate trade can evolve from intergovernmentally determined and controlled trade to enterprise-to-enterprise trade. The impact of the free-rider problem present in the 1992 monetary system on the incentive to import on an interstate basis is analyzed. The study proposes methods for allowing enterprise-to-enterprise trade after the introduction of new, possibly inconvertible, currencies by independent states. The advantages and disadvantages of a clearing union, a payments union, and an auction market for rubles in countries with new currencies are discussed. The study explains why enterprises face little competition from imports from outside the former USSR now, but why external import competition may become a serious concern after the introduction of new currencies or convertibility. It evaluates the case for preferential trading arrangements among the 15 states as a transitional device for easing unemployment and elaborates why any differential protection provided should be moderate and transitory.

The study is intended for trade policy analysts and decisionmakers in the 15 states of the former USSR and their advisers. All those who are interested in the role that trade and payments arrangements can play in facilitating a successful transition to the market economy should find the study useful.

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Estonia Stabilizes Economy Through a Currency Reform

On September 14, 1992, Estonia entered into a 12-month stand-by arrangement with the IMF for SDR 27.9 million. The arrangement supports a stabilization and reform program designed to overcome the remaining legacies of the command economy and speed up the transition to a market economy. The program has two cornerstones: stabilization, which includes a major currency reform; and a series of structural reforms.

In the following article, Tapio Saavalainen of the IMF's European II Department discusses the economic problems Estonia was facing when it adopted the IMF-supported program; the policies it is pursuing under the program; its early experience in implementing them; and the tasks ahead.

Economic Transition

Estonia had begun to move toward a market system even before achieving independence in August 1991. It had nationalized several enterprises that had previously been under Soviet control, established a central bank, and set up a tax system similar to that in some industrial countries. Moreover, a private banking system was emerging, and price liberalization—which had started in late 1989—was well under way.

However, as a small, newly independent, open economy, Estonia was vulnerable to the economic turmoil that followed the collapse of the Soviet Union, with which it had strong trade links. Also, until its currency reform in June 1992, Estonia was part of the ruble area, leaving the economy open to monetary shocks from Moscow. Estonia's inability to insulate itself from these shocks was compounded by the legacy of central planning, which had created severe rigidities, suppressed economic incentives, and weakened its ability to respond flexibly to increasing external disturbances.

In this environment, Estonia suffered far more serious adjustment costs during the early phases of economic transformation than the other reforming economies in Eastern Europe. After declining by 4 percent in 1990 and 12 percent in 1991, real GDP is expected to fall by another 25–30 percent in 1992. The cumulative contraction since 1989 is some 10–20 percentage points more than in Bulgaria, Czechoslovakia, Poland, or Romania.

Despite declining real output, prices soared. Consumer price inflation reached 210 percent in 1991 and accelerated to more than 1,000 percent in 1992. Two processes explain the price explosion. First, Estonia liberalized most prices in 1991 to improve the allocative efficiency of its economy. Second, the price of imported oil from Russia jumped to close to world market levels in early 1992. At the same time, Russia's price liberalization raised prices of other goods and raw materials imported by Estonia. Hence, to a large extent, Estonia's inflation in 1991–92 can be characterized as an adjustment to an increasingly deregulated domestic environment and to external price shocks, the effects of which were intensified by the lack of insulation from ruble inflation in the former Soviet Union.

Despite the abrupt fall in output, officially recorded unemployment remained low (under 1 percent of the labor force) in the first half of 1992, implying that a large "employment overhang" still exists in the Estonian economy. The cost of adjustment resulted in declining real incomes.

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Nominal wages lagged behind inflation in both 1991 and 1992, generating a strong downward shift in real wages. By September 1992, the average real wage was 45 percent lower than it was at the end of 1991.

On the external side, Estonia's foreign trade was badly hurt by the economic disruptions in the former U.S.S.R.. Its traditional trade deficit turned into a surplus in 1991, owing mainly to declining imports. In the first few months of 1992, foreign trade virtually collapsed, as Russia suspended deliveries of fuels. Moreover, the increasing malfunctioning of the foreign trade payments system curtailed raw material deliveries. The lack of external financing and increasing cross-border payments arrears added to foreign trade problems. In the first half of 1992, Estonia's trade account was broadly balanced, although at a very low level.

Until the currency reform of June 1992, the scope for autonomous macroeconomic policies to reverse these trends was limited. Monetary policy remained dependent on the Gosbank in Moscow. The supply of ruble notes from Russia decreased, leading to a serious ruble cash shortage, which resulted in the extensive use of hard currency and sporadic delays in the payment of salaries and pensions. In the fiscal area, Estonia achieved some autonomy with the tax reform in 1990, which formally eliminated its dependence on budget allocations from Moscow. Thanks to the better responsiveness of the new tax system to inflation and buoyant corporate receipts, the general government fiscal position was in substantial surplus in 1991. Nevertheless, political instability and institutional weaknesses, mainly in tax administration and social security systems, prevented prudent fiscal planning: in practice, Estonia relied on cash rationing to run public finances.

Adoption of a Currency Board

After reforming its currency on June 20, 1992, the Government was in a better position to implement independent economic policies. It replaced the ruble with the new Estonian currency, the kroon, in the context of a "currency board" and fixed the exchange rate to the deutsche mark at the rate of EEK 8 = DM 1. The kroon was backed by gold and foreign exchange, and kroon bank notes and reserve deposits of banks were made freely convertible into deutsche mark at the fixed exchange rate.

Estonia: Key Economic Variables

	1990	1991	1992[1]
		(percent change)	
Real GDP	-3.6	-12.6	-26.3
Consumer price index	...	210.0	1,055.3
Average wage	26.1	98.3	528.7
		(percent of GDP)	
General government			
Revenue	35.8	39.0	46.8
Expenditure	32.9	33.9	45.2
Surplus	2.9	5.1	1.6

[1]Preliminary estimates.

Data: Estonian authorities; and IMF staff estimates

The currency board introduced market discipline into the Estonian financial market. The Bank of Estonia cannot interfere with the setting of interest rates in the banking system. Thus, market-determined interest rates have become the chief mechanism through which the demand and supply of foreign exchange and cash are equilibrated. Nor can the central bank lend to the Government, enterprises, or banks, except in the event of a general banking crisis or in the context of restructuring an individual bank. Even in such cases, only the excess external reserves of the Bank of Estonia (that is, reserves other than those of the currency board) would be used. This ensures that the currency board's support for the kroon will never be compromised and that the monetary base is always fully, or more than fully, backed by foreign exchange.

A comprehensive fiscal package that became effective on the same day as the monetary reform increased confidence in Estonia's new currency. The package comprised an increase in the single value-added tax rate to 18 percent from 10 percent; a consolidation of the previous three-tier corporate tax rate structure, with an average effective rate of 27 percent, to a single rate of 35 percent; and the introduction of a top rate of 50 percent on all monthly incomes in excess of ten times the minimum monthly wage of EEK 200. Overall, this package was expected to generate revenue equivalent to about 5–6 percent of GDP and to ensure a surplus of about 1 percent of GDP in the consolidated general government operations for the second half of 1992. To support the monetary and fiscal policies, the Government also announced, as part of the stabilization package, a tax-based incomes policy.

Economic Stabilization and Reform Program for 1992–93

With the currency reform and the supporting fiscal package, the authorities have laid a strong foundation for stabilizing the Estonian economy. However, because the economy was experiencing a severe contraction and inflation was still high, further measures were necessary to obtain the external financing needed to ensure a successful transition to a market economy and to set the stage for sustainable growth. To that end, the Government adopted a comprehensive economic program for the 12 months

from July 1, 1992 through June 30, 1993, whose two main objectives are macroeconomic stabilization and structural reform. The main elements of the program as regards stabilization are

- completion of the price reform to realign domestic prices with world prices and with domestic production costs;
- restrictive fiscal policies to support the credibility of the new currency and prevent crowding out of the emerging private sector;
- monetary discipline under the currency board arrangement to reduce inflation and to provide the economy with a strong nominal anchor;
- strict incomes policies to contain wage inflation; and
- further liberalization of the exchange and trade system to open the economy to global competition, raise efficiency, and encourage foreign capital inflows.

The program's principal structural reforms include

- an acceleration of privatization so as to raise productivity and stimulate savings and investment;
- financial sector reforms to enhance efficiency in financial intermediation;
- strengthening of the social safety net to protect the most vulnerable groups from excessive costs of transition;
- restructuring or closure of nonviable enterprises and banks; and
- establishment of a legal framework consistent with a market economy.

With the concerted implementation of these policies, it was expected that the fall in real output could be limited to 15 percent in the program period, with some resumption of growth during 1993.

With tight fiscal and monetary policies, supported by an incomes policy, the rate of inflation was targeted to decelerate to a single-digit annual rate by the end of the program period. Although the inflation rate during the program period is likely to exceed rates in Western Europe, the initial undervaluation of the kroon should ensure the maintenance of cost competitiveness in the tradable goods sector. To support this aim and to prevent excessive declines in purchasing power, the authorities set wage guidelines so that real wages would remain unchanged in the absence of unforeseen external shocks. On the external side, as a result of necessary import financing, the external current account would remain in deficit throughout the program period.

Early Indications

Economic developments four months after the adoption of the program suggest that it is on track. As expected, real output contracted further in the third quarter of 1992, reflecting lagged effects of declining real incomes owing to the terms of trade shock, the adjustment to the new relative price structure, and the continued disruptions of trade with the former U.S.S.R. However, the output decline leveled off during the quarter. Meanwhile, although officially recorded unemployment remained low, at about 1 percent of the labor force, the slack in the labor market has began to increase, and unemployment is likely to rise sharply in coming months as a number of enterprises close.

Recent price statistics are encouraging. Monthly inflation declined from 20 percent in the summer to 6.6 percent in September and 7.7 percent in October, roughly in line with the path envisaged in the program. Because part of this inflation resulted from further price liberalization, the core rate of inflation was significantly lower in these months. Nominal wages increased in line with consumer prices over the three-month period July–September, implying broadly unchanged real wages. Maximum wage increases announced in September and November were in line with the program's wage guidelines.

Fiscal policy has maintained its momentum and, despite higher-than-expected corporate tax arrears, the general government fiscal balance did not deteriorate in the third quarter of 1992. Monetary conditions have remained tight, and confidence in the currency board continues to be strong. Net international reserves (excluding gold)—an indication of the strength of the currency board—increased from $62 million at the end of June to $96 million by the end of October. The stock of broad money increased by only 5 percent over the three months that ended at the end of September, or substantially less than the rate of inflation. Domestic credit has remained broadly unchanged. Short-term nominal interest rates on loans have remained at about 50 percent in recent months, implying a move toward positive real interest rates on these loans if the slowdown of inflation continues as expected.

Positive developments have also been recorded in foreign trade. Most notably, after the currency reform, Estonia's share of foreign trade with industrial countries, which was negligible in previous years, increased to nearly 50 percent of the total by the third quarter of 1992. In particular, exports to the Scandinavian countries have increased rapidly.

Tasks Ahead

The new Government, which took office in October, has made a strong commitment to adhere to the stabilization and reform program. However, despite the promising start, the tasks ahead are demanding. The immediate task is to deal with strains in the banking sector. On November 17, the Bank of Estonia closed three major banks experiencing difficulties that stemmed mainly from the freezing of their deposits at the old Soviet foreign trade bank (*Vneshekonombank*) in Moscow and from nonperforming loans. A spe-

Estonia: A Country Profile

Estonia lies on the eastern shore of the Baltic Sea and is bordered by Russia to the east, and Latvia to the south. It is the smallest of the Baltic republics, in area (45,215 square kilometers) and population (1.6 million at the end of 1990). Sixty-two percent of its people are ethnic Estonians, while 30 percent are of Russian origin. An independent nation between the two World Wars, Estonia was integrated into the Soviet Union in 1944. It regained its independence on August 20, 1991. After adopting a new citizenship law and constitution, Estonia held its first general elections in September 1992. The new Parliament (*Riigikogu*) consists of 101 seats, with 52 representatives backing the newly appointed center-right coalition Government.

Industry accounts for about one half of Estonia's total output and agriculture for about one fifth. Recently, the country composition of Estonia's foreign trade has changed dramatically—almost 50 percent of external trade is now with industrial countries. Estonia's main exports are textiles, furniture, timber, and milk products.

cial commission has been formed to recommend early remedial measures.

Beyond this immediate task, the success of the stabilization program will depend largely on the results in the fight against inflation. In this respect, maintaining the budget in balance and strict incomes policies are the main challenges. Principal risks lie in the inertia of inflation expectations and tight monetary conditions implied by the currency board arrangement. The former, as was seen during recent wage negotiations, will make a successful incomes policy difficult to attain, and the latter will maintain pressure on the budget as the squeeze on bank credits will push enterprises to seek finance, as in old days, from the Government.

In the area of structural reforms, accelerating the privatization process and restructuring the enterprise and banking sectors are the key challenges. Here, the initial results are encouraging. A particularly important and urgent task is to improve the existing social safety net because the success in lowering inflation is bound to create unemployment in the short term. In the longer term however, provided sound economic policies continue, living standards should rise, particularly because Estonia's well-educated and potentially highly productive labor force could help attract substantial domestic and foreign investment.

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NATIONAL ECONOMIES

Latvia Is First Former Soviet State to Adopt a One-Year Stand-By Arrangement

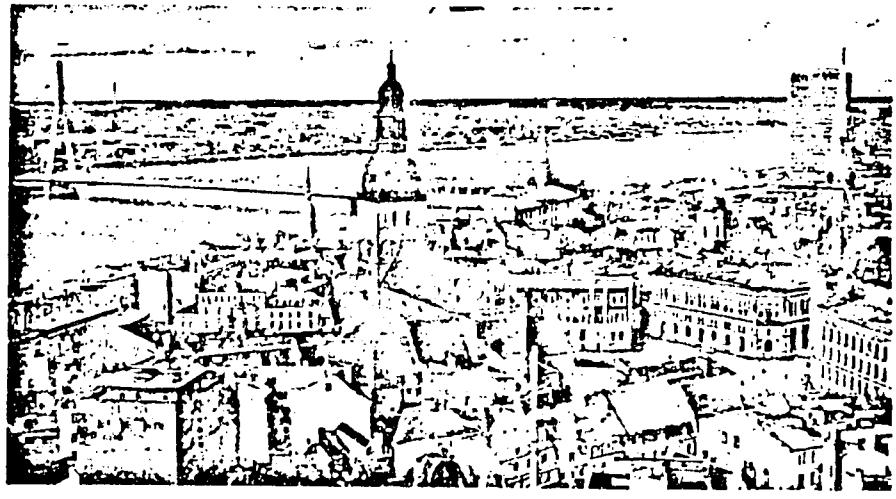
The Government of Latvia is transforming its formerly centrally planned economy into a full-fledged market system. Between September 1991, when it was recognized as an independent state, and early 1992, Latvia took steps to liberalize prices and trade. But the economy continued to suffer from the sharp contraction of trade with states of the former Soviet Union and from the worsening of the terms of trade brought about by the switch to trade at world market prices for energy and raw materials. The Government is committed to continuing with the reforms, which the IMF is supporting through a 12-month stand-by arrangement in an amount equivalent to SDR 54.9 million.

In the following article, Ashok Lahiri of the IMF's European (II) Department describes Latvia's economic and structural problems, the measures it adopted under the IMF-supported program, the outlook until mid-1993, and the risks and uncertainties the country can expect to encounter on the way.

Reform Amidst Disruption, Output Collapse, and Inflation. At the beginning of 1991, after four decades of central planning, the Latvian economy was inefficient, distorted, and experiencing growing macroeconomic imbalances. Most enterprises were almost totally dependent on imported raw materials from other former Soviet republics and exported most of their output to the former republics. The disruption of trade with the former Soviet republics led to a shortage of imported raw materials and other inputs, and real GDP declined by 8½ percent in 1991. The GDP decline was also partly due to the uncertainties attending the transformation of a formerly centrally planned economy into a market-based system. The Government freed farm procurement prices and retail food prices in mid-December and the prices of most industrial goods in January 1992. Combined with the problem of monetary overhang, these price liberalizations fueled inflation, which reached 262 percent a year by the end of 1991.

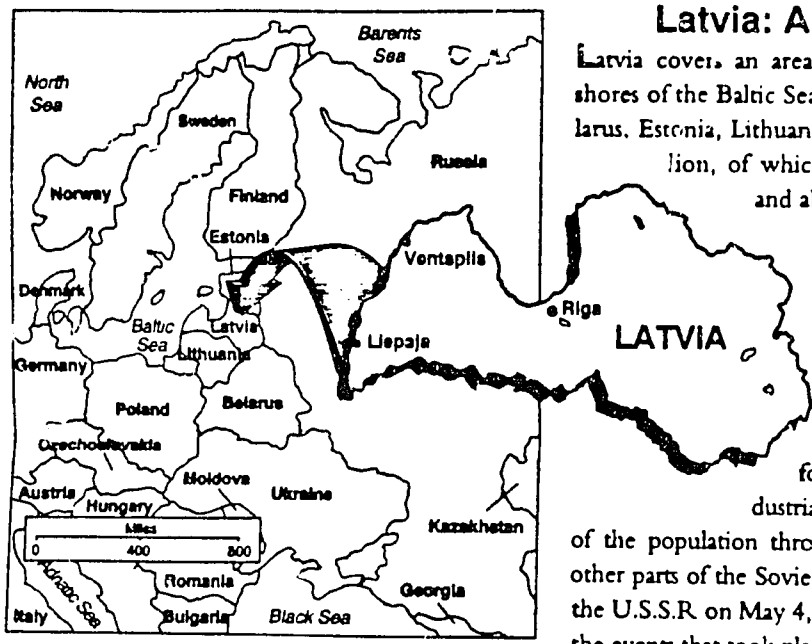
The economic situation deteriorated further during the first half of 1992: industrial production fell by 31 percent, leading to supply shortages, particularly of petroleum products. Open unemployment, however, continued to remain low as enterprises reduced working hours rather than laying off workers. A severe drought during the spring lowered crop yields. Although the monthly rate of inflation, after peaking at 64 percent in January 1992, moderated somewhat to 15 percent in June, wages continued to rise rapidly.

Although a liberal trade system, with no quantitative controls and virtually no tariffs on imports, was in effect, exports were subject to quotas and licensing and, in a few cases, to taxes. A proportion of foreign exchange earnings had to be surrendered until February 1992. The traditional surplus in interrepublican trade increased substantially in 1991 because of the improvement in the terms of trade and import compression toward the end of the year, and it significantly outpaced the deficit in trade with other countries. The switch to trade at world market prices for energy and raw materials in 1992, however, led to a large adverse terms of trade shock and turned the external current account into a deficit, estimated at about 4 percent of GDP in the first half of 1992.



Latvia's capital, Riga, is an ice-free port through which many of Russia's exports—notably those of oil—are channeled.

Latvia: An Industrial Baltic State



Latvia covers an area of 64,589 square kilometers on the eastern shores of the Baltic Sea and the Gulf of Riga, and is bordered by Belarus, Estonia, Lithuania, and Russia. It has a population of 2.7 million, of which slightly more than half are ethnic Latvians and about a third are Russian.

Following a brief period of independence between the two World Wars, Latvia was constituted as a Soviet Socialist Republic in 1940. Rapid industrialization during the Soviet era transformed its agrarian economy into an industrial one—although it remained dependent on the rest of the former Soviet Union for supplies of inputs and the sale of output. Industrialization also changed the ethnic composition of the population through large-scale immigration from Russia and other parts of the Soviet Union. Latvia declared its independence from the U.S.S.R on May 4, 1990 and gained international recognition after the events that took place in the Soviet Union in August 1991.

Industry accounts for about one half of Latvia's net material product, and agriculture for about one fourth. The diversified industrial structure is dominated by mechanical engineering and metalworks, textiles and clothing, and chemical industries. The main agricultural products are poultry and dairy, grains, potatoes, and vegetables. Mineral resources are limited to peat, dolomite, limestone, gypsum, amber, gravel, and sand. A little less than half of the country is arable and about another two fifths is covered by forests. On the coastline are situated the ice-free ports of Riga, Ventspils, and Liepaja; many of Russia's exports to the West, particularly of oil, pass through these ports.

Latvia became a member of the IMF on May 19, 1992. Its quota is SDR 61 million, and its currency is the Latvian ruble. Since July 20, 1992, the Latvian ruble has been floating against all currencies, including the Russian ruble.

Peasant farms had been permitted since 1989, and a number of them had already emerged in the agricultural sector by September 1990, when the Government undertook to promote entrepreneurship by enacting a law granting rights to diverse forms of property ownership. As a result, the privatization of state and collective farms accelerated. In 1991, the Government privatized a number of small shops and service establishments and also introduced antimonopoly and bankruptcy laws, as well as a liberal foreign investment law providing for repatriation of capital and transfer of shares. But uncertainties about the granting of citizenship and about the restitution of property to previous owners continue to hamper the privatization process.

Program to Stabilize and Sustain the Reform

Initially, the Government relied mainly on tight fiscal and monetary policies to contain the macroeconomic imbalances and to prevent the liberalization of prices from degenerating into a wage-price spiral. In January 1991, it established the main elements of a new revenue system. Tight expenditure controls, together with revenue gains from price liberalization, resulted in a general government surplus of 7 percent of GDP in 1991. In January 1992, the Government introduced a value-added tax (VAT) and an independent social security system to be funded by contributions from employers and employees. But weak revenues (particularly from the profits tax and the new VAT) and increases in the public sector wage bill resulted in a general government deficit equivalent to about 3½ percent of GDP in the first half of 1992.

The policies and measures that Latvia adopted by early 1992 represented important steps toward developing a market economy. However, further measures were necessary to stabilize the economy, to obtain external finance to sustain the reform, and to ensure the successful completion of the transformation process. Thus, in mid-1992, the Government decided to

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adopt policies to enable the economy to adjust rapidly to the worsening of the terms of trade, to accelerate privatization, and to improve economic efficiency through a host of structural measures while drastically reducing inflation by the middle of 1993. The Government's program for 1992–93 includes the following main components:

• *An Independent Monetary Policy*: The Bank of Latvia (BOL), which has been functioning as the central bank of Latvia since September 1991, enjoys a substantial degree of autonomy and is barred from engaging in commercial banking activities. On May 7, 1992, the BOL issued the Latvian ruble (LR) as a supplementary currency to circulate simultaneously, and at par, with the Russian ruble. The latter had been in short supply, which had led to delays in the payment of wages and pensions—as in other parts of the ruble area. On July 20, the LR was delinked from the Russian ruble and became the only legal tender in Latvia. This created the necessary conditions to allow the BOL to adopt an independent monetary policy to pursue a more ambitious inflation objective than in neighboring Russia. Toward this end, a restrictive monetary program was established for the second half of 1992. The Government and the BOL intend to replace the interim LR with a national currency, the lats, once the exchange rate for the LR is stabilized.

The BOL's refinance rate was increased to 50 percent from 15 percent on June 1, and further to 80 percent on July 1, 1992. The interest rates for deposits in the branches of the BOL were freed on April 1, and lending rates at these branches were liberalized on July 1, 1992.

• *A Stronger Fiscal Policy and Social Safety Net*: Measures to strengthen the fiscal position in the second half of 1992 include a tax package adopted in July, the main elements of which comprise an increase in VAT rates and the introduction of a flat rate of import duty.

The transition to a market economy will place a heavy burden on the social security system because unemployment could rise and much of the cost of adjustment will be borne by vulnerable groups. By the end of 1992, a network of social assistance offices and a new method of means-testing will be operational, and a system of training and benefits for the long-term unemployed will be introduced.

• *An Incomes Policy*: To help contain the danger of a wage-price spiral, a tax-based incomes policy has been adopted for state enterprises, under which permissible increases in the wage bill will be significantly below targeted inflation. Increases in excess of the targeted levels will be taxed at high and steeply progressive rates. To keep wage costs within budget limits in organizations maintained through the budget, the Government decided to keep the minimum wage unchanged until October 1, 1992.

• *Trade and Price Liberalization*: The Government abolished all export quotas and licensing on June 1, 1992 and replaced them with a system of export taxes. It also lifted limits on profit margins in retail trade. Then, in July, it abolished several price controls and transferred to local governments the responsibility for determining public utility prices. Currently, less than 8 percent of goods and services (as measured by their weight in the consumer price index) remains subject to administrative control.

• *Structural and Other Measures*: A special department is being set up within the Government to prevent the abuse of monopoly power in the emerging market economy. Specific plans for breaking up enterprises with monopoly power will be established by the end of 1992. A new law establishing internationally accepted accounting standards will be implemented for the 1993 accounting year to assess enterprise performance, improve financial discipline, and enforce the bankruptcy laws. In view of the sharp increase in inter-enterprise arrears, in mid-June, the BOL instructed the banks to stop paying creditors in order of chronological seniority; now, debtors decide in which order creditors should be paid.

Outlook

Developments during the last three months suggest that the Government's

An open air market in Riga: the Government freed prices of most industrial goods in January 1992.

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Latvia: Key Economic Variables

	1990	1991	1992 First Half
	(percent change)		
Real GDP	-0.2	-8.3	-32.0[1]
Consumer price index [2]	10.5	262.4	818.0
Broad money [2]	10.9	153.1	173.4
	(percent of GDP)		
General government			
Revenue	48.3	46.8	39.2
Expenditure	46.1	39.8	42.8
Surplus/Deficit	2.2	6.9	-3.6

[1] Relative to the first half of 1991.
[2] End of period.

Data: Latvian Government and IMF staff estimates

program is containing the destabilizing influences arising from the restructuring process, the collapse of interrepublican trade, and the adverse terms of trade shock. Although inflation remains high, the LR has shown considerable resilience by strengthening against the Russian ruble—from parity in mid-July to LR 0.6 per Russian ruble at the end of September—and remaining stable against the U.S. dollar since early September.

The international financial community has shown considerable confidence in Latvia's program by committing resources to support it. Although the restructuring process will involve large costs in terms of lower output and higher unemployment, the external financing made available to Latvia should ease constraints on imports of inputs, raw materials, and investment goods and limit the decline in real GDP to below 20 percent.

Conclusion

Recognizing that there is a synergy between macroeconomic stabilization and structural reforms, the Latvian Government is seeking to emphasize both at the same time. Latvia's prewar economic record, the comprehensiveness of the Government's effort, and the support of the international community lend credibility to the program. Given broad political support and determined implementation, there are good prospects of a reduction of inflation in the short run, followed by a resumption of growth and the establishment of medium-term external viability.

Correction: In the chart on page 325 of the *IMF Survey*, Issue 20 (October 26, 1992), the legend labels "Current account" and "Errors and omissions" should be reversed.

IMF SURVEY

A PUBLICATION OF THE INTERNATIONAL MONETARY FUND

August 3, 1992

Panelists Discuss Hyperinflation in Former Centrally Planned Economies

Can the release of a monetary overhang trigger hyperinflation? This question was posed by Michael Deppler, Deputy Director of the IMF's European Department I, at an IMF Vistors' Center forum held on June 25 entitled Is Hyperinflation in the Former Centrally Planned Economies Still a Threat? The other participants were Alan Gelb, Chief, Socialist Economies Reform Unit, the World Bank, and Kent Osband and Shoukang Lin of the IMF's Research Department. The panel was moderated by Shailendra J. Anjaria, Director of the IMF's External Relations Department.

The question about a monetary overhang triggering hyperinflation was originally posed in a paper by Lin and Osband, who concluded that such a development was not very likely. Deppler concurred with this view on a technical level. The monetary overhang stems from "an imbalance between the price level and the stock of money," he stated. "And hyperinflation, in order to be sustained, has to involve some flow conditions where credit is increas- *(Please turn to page 249)*

Deppler: the danger of budget deficits.

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IMF Extends ESAF Lending Period

The IMF has decided to extend the life of its concessional lending window—the enhanced structural adjustment facility (ESAF) by one year. As a result, low-income countries now have until November 30, 1993 to agree with the IMF on, and to adopt, three-year structural adjustment programs under the ESAF. At present, 72 countries are eligible to borrow under the ESAF. *(See story on page 251)*

Assessing the Risk of Hyperinflation

(continued from front page) ing at an accelerating rate. He also agreed that it was unlikely that the monetary overhang along with the process of liberalizing prices would lead to hyperinflation.

The more interesting question, he continued, is whether there is a risk of hyperinflation in the formerly centrally planned economies or, at least, of inflation getting stuck at an uncomfortably high level. This would result not only from the combination of monetary overhang and price liberalization shock but also from other features of these economies. In this context, Deppler pointed to some empirical evidence for Eastern Europe, specifically Bulgaria, Czechoslovakia, Hungary, Poland, and Romania.

It is generally accepted that Czechoslovakia and Hungary had the lowest—if any—monetary overhang when they implemented price liberalization, while Bulgaria and Romania had the largest. Poland also had low or nonexistent inflation but experienced hyperinflation before undertaking price liberalization.

Thus, said Deppler, if one compares the inflation rates of the two pairs of countries, the former had inflation records that were far superior to the latter a year after the price liberalization. Inflation in Czechoslovakia had dropped to about 1 percent a month and in Hungary to about 2–3 percent, whereas in Bulgaria and Romania, inflation rates ranged from 5 percent to 10 percent a month. "Therefore, from a policy point of view, I would say that monetary overhang is something which you have to worry about in terms of its tendency to generate sustained inflation in the context of the broader circumstances faced by these countries. Those risks appear to be, in a sense, proportional to the extent of the monetary overhang at the beginning of the process," he concluded.

Deppler maintained that the critical issue was not the monetary overhang itself but the policies that these countries follow once they undertake the price liberalization process. In this regard, the importance of the wage response to the initial price shock has often been emphasized. Deppler agreed but pointed to other considerations that can create a sustained demand for credit. First, the locus of power within the state enterprises is shifting from the founding ministry to the workers in the process of moving to a market economy. That, together with their underlying competitive weakness, leads to a huge loss in these enterprises' profitability, to the benefit of workers in the first instance, according to Deppler. This, in turn, generates a demand for credit to finance future wages. "So there is a built-in demand for credit from state enterprises," he pointed out.

Perhaps an even greater danger comes from budget deficits, contended Deppler, pointing to the case of Poland. Between 1990 and 1992, the Polish state budget lost 10 percentage points of GNP worth of revenues, in large part because of the fall in profitability of enterprises, while social expenditures rose to 21 percentage points of GNP from about 12 percent. The resulting shock to the budget—on the order of 20 percentage points of GNP—if unchecked, will cause Poland to rely on bank financing, and will result in hyperinflation. These countries, he continued, do not have capital markets that would permit them to finance deficits of this magnitude other than through money creation.

Deppler observed that it is essential to take account of the fundamental structural weaknesses of these economies during the transition process in deciding whether there is a significant risk of hyperinflation, or of continuing high inflation. "It is clear that financial policies must be quite vigilant in curbing those tendencies," he concluded.

In Gelb's view, the release of a monetary overhang signals a fundamental change in the way the system

Gelb: the inability to manage fiscal and monetary policy poses a serious risk.

operates. He agreed with Lin and Osband that the initial monetary overhang is a stock problem and that inflation is a flow problem. "There are three choices in dealing with the overhang," according to Gelb. "You can confiscate it, you can inflate it away, or, if you had thought about it at the beginning, you might have arranged something like swapping part of frozen financial assets for real assets which are privatized by the government."

Although some reform programs have proposed one or more of these

approaches, he continued, they have not actually implemented any of them. The political dynamics of reform tend to work against that sort of approach."

As for the former Soviet Union, Gelb also agreed that the overhang was not a major problem in the continuance of inflation and that the flow problem was far more serious.

In the all-important area of monetary stability, Gelb cited four potential threats. First is the tax base; the administrative capacity of the country to tax on a broad enough scale becomes more difficult as the structure of the economy changes and as the reliance on state enterprise profits is suddenly reduced. A second problem is unemployment. In many instances in which companies have been privatized, there have been dramatic declines in the work force.

Third is the problem of bad debt. Gelb believes that a serious fiscal threat is building up as credit is tightened after an initial period of very low interest rates. This is explicitly or implicitly a liability of the government that has to be met. Fourth is the problem of shrinkage of the tax base for the inflation tax. In the former Soviet Union, falls in the ratio of money to output will imply that imbalances are harder to finance through money creation without inflation.

Gelb then discussed the impact of economic disintegration on inflation. One problem is the new states' inability to manage fiscal and monetary policy. The removal of subsidies to some states as a consequence of the transition to a market economy is also exacerbating inflation. Gelb drew an analogy between the economic disintegration of the former Soviet Union and the collapse of the Austro-Hungarian empire after World War I.

Currency Units per SDR

Currency	JULY 10	13	14	15	16	17	20	21	22	23
Deutsche mark	2.16738	2.14877	2.14799	2.1467	2.1	2.1382	2.12454	2.15842	2.147	2.14513
French franc	7.30726	...	...	7.24343	7.2	7.22177	7.16786	7.29346	7.23938	7.24436
Japanese yen	180.507	181.126	181.014	181.23	180.8	182.106	181.311	180.	180.832	182.28
Pound sterling	0.753064	0.752035	0.753461	0.753541	0.75	0.748277	0.748569	0.759081	0.756644	0.755514
U.S. dollar	1.43773	1.44689	1.44753	1.44695	1.44718	1.45278	1.45886	1.4377	1.44239	1.44152
Argentine peso	1.42407	1.43298	1.43378	1.4332	1.4334	1.43898	1.4448	...	...	...
Australian dollar	1.92598	1.93719	1.93442	1.93779	1.94588	1.9645	1.95428	1.9267	1.92988	1.92949
Austrian schilling	15.2615	15.1138	15.1166	15.1200	15.1271	15.046	14.9425	15.231	15.1134	15.0954
Bahrain dinar	0.540586	0.543968	0.544271	0.544053	0.544128	0.546246	0.548468	0.540578	0.542339	0.542012
Bangladesh taka	56.0715	56.4209	56.4537	56.4311	56.4329	56.6584	56.8877	56.0703	56.2532	56.2193
Belgian franc	44.6379	44.1783	44.2799	44.3128	44.2088	44.0966	43.7087	...	44.2742	44.2186
Brazilian cruzeiro	5283.03	5341.98	5391.69	5426.41	5484.48	5563.69	5624.74	5682.22	5659.29	5705.03
Canadian dollar	1.71349	1.72532	1.72706	1.72578	1.72312	1.72837	1.72436	1.71431	1.71688	1.71298
Colombian peso	1095.28	1102.65	1103.84	1103.92	1104.61	1108.4	...	1098.53	1102.61	1102.52
Danish krone	8.34077	8.25554	8.28974	8.28089	8.25671	8.24236	8.17578	8.27108	8.2786	8.28588
Finnish markka	5.92776	5.87356	5.87987	5.89343	5.86675	5.84308	5.81276	5.89168	5.89505	5.88428
Greek drachma	265.693	263.681	263.957	263.982	264.539	263.086	261.275	264.364	263.929	263.712
Indian rupee	37.2228	37.4548	37.4766	37.4815	37.4867	37.6126	37.7647	37.2221	37.3436	37.321
Indonesian rupiah	2924.34	2942.57	2942.83	2941.68	2942.06	2963.5	2984.	2822.84	2832.39	2832.05
Iranian rial	92.3	92.3	92.3	92.3	92.3	92.3	92.3	92.3	92.3	92.3
Iraqi dinar	0.448929	0.448714	0.448975	0.449795	0.449887	0.461607	.463486	0.44892	0.448377	0.448107
Irish pound	0.81269	0.80479	0.808154	0.804834	0.808067	0.802186	0.796777	0.809926	0.804726	0.805228
Italian lira	1840.46	1826.48	1827.73	1828.1	1830.58	1834.	1816.28	1843.	1831.28	1828.9
Korean won	1130.92	1138.89	1139.79	1138.78	...	...	1147.08	1131.04	1136.02	1133.9
Kuwaiti dinar	...	0.417389	0.417049	0.417734	0.417788	...	0.420079	0.416817	0.417817	0.418803
Libyan dinar	0.398429	0.398429	0.393429	0.398429	0.393429	0.398429	0.398429	0.398429	0.398429	0.398429
Malaysian ringgit	...	3.61412	3.61376	3.6152	3.61527	3.6288	3.643	3.68363	3.6041	3.60322
Maltese lira	0.436297	0.433244	0.433107	0.43379	0.433629	0.4332	0.431186	0.431133	0.432436	0.433292
Nepalese rupee	61.2911	61.7737	61.8096	61.7848	61.7833	62.0337	62.2848	61.3838	61.5801	61.5529
Netherlands guilder	2.44328	2.41857	2.42186	2.41829	2.42817	2.41031	2.38826	2.4323	2.41746	2.41988
New Zealand dollar	2.64289	2.64622	2.641	2.64283	2.64513	2.65398	2.65742	2.62258	2.6297	...
Norwegian krone	8.50489	8.42191	8.44127	8.44586	8.43327	8.4145	8.34426	8.44577	8.45457	8.44298
Omani rial	0.552807	0.556252	0.556575	0.556362	0.556429	0.558564	0.560656	0.552798	0.554588	0.554264
Pakistan rupee	38.2206	38.4463	38.4678	38.4529	38.4579	38.5987	38.7479	38.2198	38.338	38.3161
Portuguese escudo	182.715	182.351	182.843	182.806	183.112	181.596	181.533	184.128	183.27	182.671
Qatar riyal	5.23334	5.26586	5.26801	5.2689	5.26763	5.28812	5.30952	5.23323	5.2503	5.24713
Saudi Arabian riyal	5.3843	5.41785	5.421	5.41883	5.41958	5.4308	5.46288	5.38419	5.40175	5.39649
Singapore dollar	2.32323	2.33409	2.33458	2.33308	2.33166	2.33986	2.34849	2.31969	2.3247	2.3216
South African rand	3.9687	3.96879	3.97708	3.97842	3.96852	3.9747	3.97412	3.97309	3.97879	3.96101
Spanish peseta	137.763	136.669	136.722	136.732	137.469	136.712	136.064	138.863	137.619	137.071
Sri Lanka rupee	83.332	83.7267	83.7637	83.7381	83.747	83.9658	84.2102	83.3307	83.5373	83.5278
Swedish krona	7.84657	7.77688	7.79436	7.78761	7.78856	7.76658	7.70758	7.80096	7.81371	7.79718
Swiss franc	1.96468	1.84797	1.94188	1.94253	1.93918	1.91684	1.87438	1.92282	1.90488	1.89992
Thai baht	36.3889	36.5434	36.5367	...	36.565	36.8827	36.7728	36.3307	36.4492	36.4706
Trinidad and Tobago dollar	6.12563	6.1538	6.16730	6.16481	6.16876	6.18875	6.2149	6.1258	6.14649	6.14176
U.A.E. dirham	5.27791	5.3108	5.31388	5.31175	5.31249	5.33318	5.36474	5.2778	5.29601	5.29182
Venezuelan bolivar	96.3968	97.0008	97.1293	97.236	97.1761	97.4818	97.9193	96.5418	96.8421	96.726

Notes: 1. The value of U.S. dollar in terms of the SDR is the reciprocal of the sum of the dollar values, based on market exchange rates, of specified quantities of the first five currencies shown. The exchange rates used for this purpose are noon rates in the London foreign exchange market. When the London market is closed, noon rates in the New York market are used. Frankfurt fixing rates are used when the New York market is closed. 2. The value in terms of the SDR of each of the other currencies shown above is derived from that currency's representative exchange rate against the U.S. dollar as reported by the issuing central bank and the SDR value of the U.S. dollar, except for the Iranian rial and the Libyan dinar, the values of which are officially expressed directly in terms of the domestic currency units per SDR.

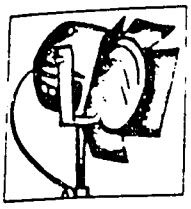
Data: IMF Treasurer's Department

In both cases, successor states to these empires created obstacles to trade; industrial bases contracted, as did personal incomes, and governments resorted to the printing presses to solve their financial problems; unemployment rose sharply, and exchange rates came under considerable pressure.

Lin pointed out that whether or not a country's monetary, fiscal, or labor market policies are destabilizing has little to do with the monetary overhang. Whether price decontrol will lead to hyperinflation, he continued, does not depend on the initial money stock. Rather, it depends on the flow variables, such as nominal interest rates, government transfer payments, and consumption. "However," he added, "given a degree of monetary overhang, price decontrol can lead to a significant price surge initially and, therefore, a significant drop in real wages."

Osband agreed with Gelb's assessment that the inflationary threat in the former Soviet Union stems from a flow, rather than an overhang, problem. He noted, however, that many leading economists—Martin Feldstein and Rudiger Dornbusch, for example—have argued that it is an overhang problem. He pointed out that the major problem is that the statistical real wage (the nominal wage divided by the official price level) in the Soviet Union rose about 50 percent during Gorbachev's term in office without a corresponding increase in productivity. "That has to be corrected," concluded Osband, "and you can't correct that through confiscation of existing monetary balances."

Gerald R. Rosen,
Editor, *IMF Survey*



Poland

Grant Kirkpatrick and Val Koromzay

'It is difficult to find examples in economic history where so much has been accomplished in such a short time.' This is one of the opening remarks in the economic survey which the OECD and its Centre for Co-operation with European Economies in Transition has devoted to the Polish reform under the Partners in Transition Programme – a reform boldly launched on 1 January 1990 which, in two years, has produced such important changes that a reversal of the process is out of the question.[1]

Five examples will show how much progress has been made. Shortages have been eliminated: the stores that once were desperately empty, and outside which endless queues used to stretch, are now plentifully stocked with a variety of products; and new shops are changing the look of Polish towns. Inflation, running at 600% in 1989, is now down to 40%. The convertibility of the zloty has been established and maintained, with a resulting surge in trade with western countries. The national currency has also become a credible savings instrument since interest rates are sufficiently high to prevent the erosion of the real value of zloty deposits. Finally, the private sector is asserting its presence in a growing number of sectors of the economy.

This spectacular progress is the result of a radical policy of transition to the market economy, conducted at three levels. First, the legal framework, through the establishment of property rights, competition and labour legislation, new laws on commerce, banking, and so on. Second, the institutional framework, through the introduction of a system of social insurance and unemployment compensation, and the emergence of such new actors as private insurance companies and financial intermedianes. Third, instruments of economic policy, through the emergence of a genuine system of regulation by prices, a modern tax system, monetary control and transparent budget processes.

The magnitude of such an undertaking implies countless difficulties and uncertainties, and many problems remain unresolved. Recently, clouds have been gathering over the Polish reform programme, with a distinct decline in popular support for the change and an increasingly precarious financial position for enterprises, banks and the central government budget. The persistence of major structural blocks has meant that macro-economic equilibrium is far from being achieved.

The 'Shock Therapy' and its Effects

The programme of transition to a market economy aimed also to achieve economic stabilisation. To control inflation that had been aggravated by two 'systemic breaks' – price liberalisation and a new, steep devaluation of the zloty – the authorities opted for two anchors: convertibility of the currency and control of nominal wage growth. A hardening of monetary and fiscal stance was clearly essential in order to maintain these anchors for any length of time. The simultaneous removal of all import restrictions was another weapon in the fight against inflation.

The policy of fixed exchange rates, essential during the first year of the reform as a curb on price expectations, was maintained until May 1991, when the zloty was devalued by 16%. In October 1991, a 'crawling peg' system was introduced, consisting of an automatic monthly depreciation of 1.8%. All the same, and even allowing for the new 12% devaluation in February 1992, the zloty has appreciated steadily in real terms since January 1990, making it difficult for enterprises to maintain their external competitiveness.

Control over wage growth proved to be of only limited effectiveness. The excess wages tax (*Popiwek*), which penalises pay awards above the norms set for each state enterprise, was made the object of numerous exemptions. The fact that firms which had exceeded the norms in 1990 had higher ceilings applied to them the following year further reduced the credibility of the *Popiwek*. More generally, the feeling that financial failure was unlikely did not help enterprises to come to a true awareness of the reality of budget constraints and hence to recognise the importance of a tight wages policy.

After a very good start, matters deteriorated also on the fiscal front. By the end of 1990 the budget was already back in deficit as a result of higher welfare expenditure and declining tax revenue, because of the recession and an increasing incidence of tax arrears. In 1991 the budget deficit amounted to 3.8% of GDP.

The performance of the Polish economy was severely affected by the reform programme. Sales by state-owned industrial enterprises fell by 30% in the first two months of 1990. Over the year as a whole, the fall in GDP was 11.6%, with declines of 9% in investment and 13% in consumption. The surge in prices had the effect of reducing real wages in the state sector by one-third. They caught up modestly (+2%) in 1991 as inflation eased. Because of this, and also reflecting a fall in household savings, consumption picked up last year (6–8%). But another decline in investment (down 8%) and a fall in net exports caused GDP to shrink by a further 8% in 1991. The recession would have been deeper had it not been for the rapid emergence of a private sector, whose output grew strongly in 1990 and '91. Unemployment skyrocketed, its rate rising from 0.3 to 11.4% in two years. But this does not seem to have made any real dent in overmanning in the large state enterprises, since mass redundancies accounted for only about 23% of the jobless total at the end of 1991.

Understandably, therefore, the top priority of the government formed in December 1991 is to put an end to the recession. For 1992 this will mean achieving zero growth of GDP and real wages while bringing the average rate of inflation down from 70% last year to 45% this year (that is, 36.5% over twelve months). This goal will require a much tighter fiscal stance.

The 1992 budget bill aims to limit the budget deficit to 5% of GDP (65,000 trillion zloty). On the revenue side, pending introduction of VAT at the beginning of 1993, a

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1. **OECD Economic Studies: Poland**, OECD Publications, Paris, 1992.

broadening of the tax base and higher turnover tax and excise duty rates are planned; and improved tax collection procedures are to be implemented. Income tax should also produce some additional revenue.

On the expenditure side, the government intends to make savings on welfare programmes by reviewing the rules of pension eligibility, creating selectivity in unemployment compensation, managing the distribution of subsidised medicines more efficiently and charging for certain medical services that used to be supplied free. Lastly, the automatic index linking of civil service pay to enterprise wages is to end.

But there are reasons for asking whether the fiscal goal can be achieved. Parliament has still to complete its work on the measures required to implement the budget, and other measures will be necessary to take account of some rulings of the constitutional tribunal that have adverse budgetary implications. More generally, further progress in structural reforms will be required if the programme is to move ahead satisfactorily.

Resistant Enterprises

The ambitious macro-economic programme that has now been under way for two years is far from achieving all its aims, largely because, at the micro-economic level, enterprises have not adapted themselves adequately to the new conditions. Business management has not had the incentives to behave in a manner that would normally be considered rational in a free-market system. Faced with a steep fall in profits, state enterprises have paid far too little attention to cutting costs. They have barely reduced overmanning and have put up little resistance to wage demands. Yet they have seldom hesitated to raise their prices. As a result, increasing international competition, as witnessed by the surge in imports in 1991, has meant that they have had to reduce their output. At the end of 1991, out of 1,800 firms under the supervision of the Ministry of Industry, 718 were in a difficult, even desperate, financial situation.

Obviously, a process of adjustment on such a scale takes time. The new economic policies mean an unprecedented shock, to which Polish firms must respond although they lack the financial, technological and, above all, human resources necessary to break the straitjacket of structural rigidities bequeathed by forty years of central planning.

Price liberalisation, the sharp reduction of subsidies and the convertibility of the zloty have brought about a complete upheaval in relative prices, driving some up (clothing, textiles, electronics and precision equipment) and others down (food, non-ferrous metals, energy). The rise in relative prices of fuel and power alone was a particular shock to Poland's energy-hungry industry. The surge in interest rates, furthermore, has made borrowing unaffordable for firms whose own output prices are flat or falling.

In an economic environment that in many aspects has deteriorated sharply and in any event is much more uncertain, Polish enterprises are further hampered by two specific handicaps: a comparatively old capital stock (the proportion of equipment under five years of age is even smaller than in the other ex-Comecon countries), and a serious lack of competitiveness. (This second handicap, temporarily obviated by the initial steep devaluation of the zloty, resurfaced with the rise in nominal wages and the further decline in productivity associated with the fall in output during the past two years.) The wide dispersion of activities undertaken within enterprises is another obstacle that bars the way to efficient management. For example, firms have to provide their employees with a wide range of social services (housing, recreation, health care). Finally, there is the regional dispersion of industry which often produces 'one big firm in a small town'. In political and social terms, therefore, the adjustments to be made are painful.

These handicaps are all the more difficult to overcome in that Poland's state enterprises are only partly conscious of the urgency of adjustment. Budget constraints often remain theoretical since the liquidation of enterprises is rarely initiated and, even when it is, it seldom leads to their closure, and bankruptcy is seen as an improbable menace. The authorities have often shown themselves to be accommodating in rescheduling tax arrears, and the banks generally continue to lend to loss-making firms – they even capitalise the interest when instalments are not met – counting on the government to provide assistance eventually.[2]

Another obstacle to the restructuring of state-owned enterprises is their decision-making procedure. During the 1980s the power of the workers' councils increased considerably, to the detriment of management which, in the absence of a real representative of 'capital' in the enterprise, did not encourage the adoption of profit-maximising strategies. To overcome these short-term or systemic handicaps, the government has firmly opted for a rapid development of the private sector, both through the creation of new enterprises and through the privatisation of state-owned firms.

The Expanding Private Sector

In the event, the expansion of the private sector has been spectacular: there were 11,700 private enterprises in 1989 and almost 41,500 by September 1991, while the number of unincorporated entrepreneurs rose from 813,000 to 1.4 million. This shift to the private sector was concentrated on those sectors in which earnings were likely to grow most rapidly. Private-sector activity accounted in September 1991 for 75% of trade, 45% of construction and 80% of road transport.

More often than not, the emergence of the private sector has been through 'small privatisations', which have made for a rapid transformation of retailing in particular – an activity in which Poland has a big lead over the other central and eastern European countries. The communes usually turned small shops over to their employees, renting or leasing but not selling them, which made these privatisations somewhat precarious.

In 'large privatisation' Poland has opted for a flexible, multi-track procedure. The first approach, privatisation by 'liquidation', has already moved into an operational phase, with nearly 500 enterprises (mostly SMEs) privatised in 1991. Liquidation can take one of three forms: sale of

2. See pp. 19–22.

assets; contribution of all or part of the assets and liabilities to a joint venture set up with a Polish or foreign partner; sale of assets and liabilities to a new firm established by management and workers (buy-out). This last method has accounted for 90% of privatisations-through-liquidation. It usually involves some form of leasing, for which favourable financial arrangements are available. To ensure their effective participation, the new owners are required to put up a sum equal to at least 20% of the capital of the former enterprise.

Second, there is capital privatisation. Since 1991, fewer than twenty firms have been privatised in this way because the flotation of shares has proved to be difficult. In fact, capital privatisation has mostly taken the form of direct sales to investors, the majority of them foreign.

After a few months' experimentation, it became clear to the Polish authorities that the various methods proposed were not going to lead, within a reasonable period, to a massive transfer of medium-sized and, above all, large enterprises to the private sector. Whence a third approach: mass privatisation, whose implementation has so far been delayed by the lack of political consensus. At all events, under this scheme the government will initially keep 30% of the capital of the firms selected, with employees being allocated 10% of the shares through their free distribution. The remaining 60% are to be shared between some 15 to 20 National Investment Funds.

The Funds will function like holding companies and are to be run by management firms with foreign professional partners; initially, each fund will receive an equal portion of 27% of the capital of all companies. After assessing the prospects of each firm, the funds will then bid, by auction, for additional shares, enabling them to obtain 33% of the capital of specific companies (twenty on average), the remaining shares being spread among the other funds. The second part of the process will involve the distribution of shares in the funds to all adult Polish residents. These shares will be tradable only after publication of the first yearly results for each fund.

3. Jeffrey Owens, 'Options for Tax Reform', **The OECD Observer**, No. 170, June/July 1991.

Persistance and New Fronts

Poland is irreversibly committed to the process of transforming its economy, but is still in mid-stream. To avoid becoming bogged down, and to ensure that it reaches the other side safely, it will have to speed up the structural changes while at the same time persisting, of necessity, with macro-economic stabilisation.

First, fiscal control. The officially forecast deficit for 1992 (5% of GDP) must be seen as an absolute maximum, in particular because increased debt service, stagnant growth and positive real interest rates make an explosive mix.

Second, inflation has to be further reduced. The year-on-year target of 36.5% by end-1992 represents an improvement, but it is not sufficient in terms of lowering interest rates and curbing speculative behaviour. In this respect, there is little room for macro-economic policy manoeuvre – whence the importance of improving control over wages. Amending the *Popiwek* system (the tax on excess wages) to favour the extension of bonuses and remuneration linked to the performance of the enterprise would help. Yet the best instrument for reducing inflation would seem to be micro-economic measures that aim at cutting production costs. For example, employees could be more directly involved in improving their firm's profitability by establishing a clear link between the increase in value of the firm and the participation of workers in its capital at the time of privatisation.

At the same time, a number of specific structural measures are advocated. First, with regard to pensions: to prevent an eruption of the deficit of the social insurance funds, the conditions of entitlement to full-rate disability pensions have to be tightened and the maximum retirement pensions paid by the state gradually lowered so as to encourage saving through complementary insurance schemes. Second, in housing finance: costs are too high because the existing system of repaying loans from the savings bank involves a ceiling on payments by households, with budgetary support from the government covering the gap between the ceiling and the total interest due. The savings bank will have to become more independent and adapt housing loans more closely to its own resources.

Where taxation is concerned, the object is to introduce VAT without further delay and to improve direct and indirect tax collection.[3] Improving the efficiency of monetary instruments by strengthening the banking system is also essential.

As for privatisation, the range of available procedures means that the general framework is satisfactory. The public could nonetheless be better informed, and the rules on sectoral privatisation clarified. The mass privatisation of the 240 enterprises already selected should be launched as soon as possible, since their current intermediate situation is not conducive to sound management. Similarly, liquidation procedures should take less time.

Finally, the growth of foreign investment depends more on stable rules of the game than on preferential and discriminatory conditions which, since they inevitably proliferate, would run the risk of distorting the liberal trading system now prevailing in Poland.

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Although Poland is at present going through a period of uncertainties, particularly political, there is no cause for excessive pessimism. Brisk development is within the compass of the country, which for the past two years has been engaged in far-reaching and courageous reform, provided the Polish authorities abide by the principles which have guided their efforts thus far and persist in adopting a pragmatic approach to the difficulties that arise. This is the way the Polish government has been proceeding, and its efforts deserve the recognition and support of the international community. ■

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EAST EUROPEAN STUDIES
NOVEMBER - DECEMBER 1992

LESSONS FOR WESTERN AID TO EASTERN EUROPE; KOSOVO'S DEEPENING CRISIS; ROMANIA'S POLITICAL CLIMATE BEFORE THE ELECTIONS

WESTERN AID TO POST-COMMUNIST EUROPE: LESSONS LEARNED AND WHAT IS TO BE DONE #70

"The West should focus its efforts not on assistance designed to make the West feel it has done its charitable duty, but on exchanges and building partnerships that would marry post-Communist economies to Western ones," said Janine R. Wedel, Fulbright Scholar and Adjunct Associate Professorial Lecturer at George Washington University, at a September 30 Noon Discussion.

Since 1989, the European Community, the United States, Britain, Germany and other Western governments have allocated some $38 billion to help ease Eastern Europe's transition to democracy and a free-market economy. With the end of the Cold War, the West committed billions more in aid to the republics of the former Soviet Union. Specifying that her focus was on Western governmental grant aid, rather than on export credits, macrostabilization assistance, or loans, Wedel raised questions about the efficacy of the attempts of Western governments to help Eastern Europe through technical and humanitarian assistance, for which most grant aid is being spent, and for which an increasing portion of overall funding to the region is being allocated.

Wedel noted that the outcome of any aid effort is a result both of how the donor structures and implements it, and of how the recipient is set up to handle it. Before delving into the mechanics of the aid effort, she recalled the climate of Eastern Europe following the autumn of 1989, during which the Communist governments of the region were toppled. This is the setting in which aid began to be delivered. "For a short time," Wedel said, "many East Europeans expected that their new leaders could transform the devastated economies overnight, with a little monetary help from their friends in the West."

Meanwhile, misleading information was circulating in Eastern Europe about Western aid. In Poland, $30 billion was often cited as the amount of aid the West was sending, usually without explanation that this figure includes export credits, stabilization funds and loans, and that most grant aid is for technical assistance in the form of advisers and consultants going to the region to offer their services. It is not surprising, said Wedel, that disillusion is sweeping the region as swiftly as hope did nearly three years ago.

While many in Eastern Europe thought of the United States as "a rich Soviet Union," Westerners tended to view transition in Eastern Europe as the recovery of people with whom we have close cultural bonds: "We do not speak of donors and recipients, as in aid to the Third World, but of 'partners' and 'partnerships.'" Yet many of the same donor organizations and institutional mechanisms employed by the West in the Third World are now being employed in Eastern Europe, resulting in many of the same problems in design and implementation.

Most grant aid to Eastern Europe is technical assistance. Yet "many East European officials have concluded that their countries are 'technically over-assisted,'" said Wedel, "because of the West's emphasis on technical assistance, the areas in which it is being concentrated, and the way in which it is being delivered." Marek Kozak, a Polish official who monitors foreign aid, thinks that the main benefit derived from the consultants' presence "is not from the expertise they provide, but from the presence of Westerners carrying hard-currency in the local economy."

Wedel noted that aid almost always comes with strings attached and outlined three areas that frustrate the aid efforts of the major donors: contracting procedures; the considerable gap between commitments and disbursements of funds, which creates a perception of "who stole the goods" among East Europeans; and turf battles among donors of bilateral aid who are drawn to "demonstration projects" that yield high visibility, thereby competing with one another at the expense of projects that might truly help.

Wedel outlined the following problems with US assistance. Aid recipients are seldom allowed to contribute to the process in a way that would make a difference. In this regard, U.S. aid programs in Eastern Europe generally have the worst reputation and have been the least effective because, compared to European Community and British programs, the U.S. programs allow recipients the least leverage to set terms or to select experts. Another problem Wedel noted is that, in some cases, U.S. aid works

around the institutions it is supposed to help. Although direct aid to private sectors makes sense when the goal is to promote private businesses, the U.S. insistence on avoiding governments almost entirely is counterproductive when the goal is to privatize state-owned resources.

Wedel also pointed out the following additional problems: U.S. assistance has been scattershot and the organizations and consultants carrying out grant aid projects, which are administered through the Agency for International Development (AID), do not follow any coherent, overall strategy. AID, whose management problems are well-documented, has little expertise in Eastern Europe; nevertheless it is in charge of U.S. assistance. Washington is the center of assistance decision-making, creating a myriad of coordination, implementation and political problems. The aid was designed as short-term even though the United States would have had to make a long-term commitment from the outset for this aid to have an impact on the region. Finally, the "regional approach" to administering programs makes planning and monitoring of aid difficult for the East Europeans. Some of these difficulties, particularly those arising from Washington-based control, short-term planning, and the regional emphasis are being reconsidered for the aid effort to the former Soviet Union, Wedel said.

Wedel also outlined some conditions on the recipient's side that frustrate aid implementation and monitoring, including fragmentation in governance and public administration, and the fact that East European ministries often lack familiarity with the protocol and politics of donor organizations. She addressed three areas that donors have targeted as priorities and examined how the interplay between donor prerogatives and local conditions can prevent aid efforts from having the intended effects.

First, the major donors have made privatization a priority because it is seen as a yardstick of progress in the new democracies. Yet consultants' studies on how to privatize a particular factory can do nothing if they are ill-informed, if conditions soon change and the studies become outdated, or if the resources or political will to implement them are absent. Foreign assistance for privatization may be a waste of money, and, in some cases, even encourage corruption. Wedel offered several examples, including that of an East European truck factory undergoing privatization with the help of Western consulting firms hired using aid money. "Does this aid help to produce the results that the West itself looks to as a yardstick of progress?" Wedel asked.

A second troublesome area targeted as a priority is that involving projects to build democratic institutions and to encourage "pluralism" and "civil society." In some cases, donors have funded political groups and parties directly. Wedel cautioned that, "While seeking to encourage an active political process, the West instead may be supporting only a handful of parties that East European voters have legitimated." Another way of funding political groups, Wedel said, is through supporting East European non-governmental organizations (NGOs), some of which are active political players even if they were set up for non-political purposes. Wedel cautioned that, although NGOs are playing a role in political, economic, and social change in Eastern Europe, it is a confused role.

Third, Wedel questioned the helpfulness of humanitarian aid to the emerging democracies of Eastern Europe and the former Soviet Union. Although the food, medicine, and clothing provided by humanitarian aid are almost always seen as helpful by the donors, some East European and Russian recipients are questioning this premise. Wedel said the following questions need to be addressed by donors: Are the goods being offered useful and suitable? What are the possible economic side effects of aid? How will the goods be distributed in the recipient country? What impact will aid have on the political situation in the recipient nation? For example, there is little starvation in Russia and aid may serve to distract the Russian government from itself nurturing domestic institutions that can survive--and thrive--long after the last aid dollar has been spent.

Finally, Wedel argued that more aid is not necessarily better. East European officials generally are impressed with the effectiveness of the British Know How Fund, for example, although it is much smaller than U.S. and EC aid efforts. What seems critical is how the aid is structured and implemented. She observed that "Aid that is driven by the considerations of the donor and not much help to the East Europeans also is not much help to America's image in the region." She further noted that several prominent East European officials recently have spoken out against foreign assistance.

Wedel predicted that the actual implementation of Western assistance in Eastern Europe will become increasingly critical to policy makers grappling with what the role of foreign aid should be in the post-Cold War era, and to a public questioning the wisdom of providing assistance to post-Communist Europe during times of domestic

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economic hardship. She emphasized that technical assistance can not substitute for investment or trade, and that the most helpful form of aid is technical assistance that encourages investment, such as helping to set up workable banking and financial institutions. Wedel believes that technical assistance needs to be much better targeted and structured. It should concentrate on institution building, especially in fields such as accounting, financial services, taxation, and banking. Rather than sending Western consultants to Russia for one-time training sessions, what is needed are programs that ensure that Russian institutes that train sanitary engineers, for example, can link up with comparable groups in the United States that can offer long-term partnership and consultation.

Technical assistance is most successful on a people-to-people basis of local community exchange through projects that the people design themselves. No technical assistance can be truly successful unless both donors and recipients are motivated to form partnerships. Donors have to learn their partners' needs and abilities.

Moreover, Western countries have a key role to play in promoting partnerships within Eastern Europe and the former Soviet Union by sponsoring projects and conferences that gather people from the region together, a process that can help to build valuable ties across isolated class, ethnic, and geographic lines. Janine R. Wedel

POLITICS AND POLIO IN KOSOVO #71

News accounts of the deepening disaster in the former Yugoslavia often refer to the "crisis in Kosovo," but only in geopolitical terms. If the sports sequence suggested by some black Yugoslav humor is correct and the quarter finals and semifinals of the civil war in Croatia and Bosnia respectively give way to the finals in Kosovo, then neighboring states will almost inevitably be drawn into a third Balkan war. This is in fact the subtitle of BBC correspondent Misha Glenny's sadly instructive eyewitness account, The Fall of Yugoslavia (New York and London: Penguin Books, 1992). True, and frightening enough, but what are the specific conditions of that crisis in Kosovo itself? Over what issues does the impasse between the territory's Serbian administration, responsible primarily to President Slobodan Milošević's ministries in Belgrade, and a population nearly 90 percent Kosovar (Albanian) threaten to explode? Is there some prospect for resolving just part of the impasse?

Dr. Alan Ross from Doctors of the World, USA, addressed these broader questions in reporting on Kosovo's crisis in medical care, one that has already confronted the Albanian population with an outbreak of polio. Dr. Ross is a specialist in pediatric emergency medicine who first treated patients in Kosovo in 1986. In a September 24 Noon Discussion at The Wilson Center, he gave a moving description of the difficulties confronting the vaccination program that Doctors of the World has attempted to conduct there since April, 1992. Ross first obtained support for the enterprise from "Republic of Yugoslavia" Prime Minister Milan Panić and the Serbian health ministry. He arrived in Kosovo to find that Albanian families were refusing to be treated in any way by the Serbian staff that has taken over public facilities for health care in the province, let alone respond to a notice in Serbian cyrillic to be injected with vaccine of Serbian manufacture that would, Albanians feared, make boys sterile and girls barren. Even the total number of Albanian children was uncertain, given the 90-95 percent born at home in recent years to avoid Serbian doctors (that percentage was not insignificant even when Albanian doctors staffed public hospitals).

Ross reckoned that perhaps 15 percent of children under two had been vaccinated against polio by last April, despite a disturbing rise in the number of cases reported and the presumption that many more were unreported. His project targeted an estimated 120,000 unvaccinated Albanian children under two and a still larger number over two. Only careful, cautious negotiation with local, often religious, leaders of the Albanian community led to a breakthrough in several towns and then in more. Overcoming superstitious anxiety about injections and local resistance to any outside authority proved to be essential, even after all Serbian ingredients in the program had been removed. By July, however, Ross and his team had succeeded in vaccinating some 175,000 children of all ages. The outbreak of polio was stopped in its tracks.

Now what? Medical supplies, like those in sanctioned Serbia proper, have become dangerously short. Dr. Ross wondered whether even aspirin was still available. Many people wonder whether they will survive the winter. He called despair the predominant emotion among the Albanian population, even though youth feeling they have nothing to lose may yet risk violent demonstrations against the Serbian administration. But when

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Ibrahim Rugova, head of the League the for Democratic Action told him that Kosovo was dead, Ross responded that doctors assume every patient entering the emergency room is alive, even if apparently dead. The doctor's goal is to open a private English-speaking hospital and nursing school in Kosovo as soon as possible, with international support and without Serbian or Albanian control.

Again, the support and therefore the survival of the Panić "federal" government will be essential. This is after all the government that is attempting, against resistance from the Milošević government of a Serbian territory that includes Kosovo, to reopen Albanian-staffed schools and reestablish Albanian-staffed press and television. This medical project would, however, have the advantage of working in the private sector and outside the fatal presumption that any facility in the province must be exclusively Albanian or Serbian.
John R. Lampe

ROMANIA'S POLITICAL CULTURE AND PROBLEMS ON THE EVE OF NEW ELECTIONS #72

The recent situation in Romania two weeks before the general elections was as complicated as it was two and a half years ago reported Mircea Mihaieş, editor-in-chief of Orizont, in a September 9 Noon Discussion at the Wilson Center. In December 1989, Romanian society faced overnight upheaval: in a single day the entire political and administrative structure of the Communist party disappeared. But what did not disappear and what lies at the root of the continual social turmoil in Romania is the Communist mentality that has fueled the exacerbation of national feelings and inter-ethnic clashes. This is not peculiar to Romania, but exists elsewhere in Eastern Europe in the polarization between partisans of a liberal, Western-oriented society and those of a closed, self-sufficient society. One sees the direct result of such a mentality in Yugoslavia, noted Mihaieş; he argued that none of the East European countries is completely immune to the nationalist madness that has engulfed what was once the most liberal country of the old Eastern Bloc.

Mihaieş suggested that *nationalist perestroika* might be an appropriate label for the post-1989 period in Romania. The nationalist component of the Romanian *perestroika* became evident after the failed August 1991 coup in Moscow. The Romanian leaders preserved the entire ideology of perestroika, but safeguarded their power and privileges by fanning the old embers of nationalism.

The nationalism now prominent in his country is rooted, according to Mihaieş, in the Romanian subconscious. For decades, Romanians have pictured themselves as a martyred nation and sought relief by blaming "the outsider" for their misfortunes. There is a disproportionately large number of folk sayings about the dangerous stranger, the sinister foreigner, which reflect the deep traditional conservatism of the Romanians.

Unfortunately nationalism in Romania is being used as a means to ignore serious problems and to muzzle opposition. President Iliescu and then Prime Minister Roman, in their desperate search for allies in face of charges of "neo-Communist" made by democratic forces, reactivated former architects of the Ceausescu personality cult. For instance, the owner/publishers of Romania's most rabid nationalist magazine, Romania Mare, are Eugen Barbu, a long-standing member of the Romanian Communist Central Committee, Corneliu Vadim Tudor, one of his deputies, and Adrian Paunescu, a Maiakovsky-like minor poet who penned interminable odes to Elena and Nicolae Ceausescu. They have orchestrated a written war against democratic change in Romania and resorted to anti-Semitic and anti-Hungarian accusations. Poet Mircea Dinescu (who announced Ceausescu's flight on Romanian television) was denounced by Romania Mare as a spy working simultaneously for Russia, the United States, Israel, and Hungary, and as a Gypsy, a non-Romanian (a "white-Gypsy" as they quite originally described him). Romania Mare also proclaimed 1991 "the year of international struggle against Hungarian terrorism" and, far from being censured, the magazine was cited by Interior Minister Doru Viorel Ursu for "journalistic objectivity."

Despite the anti-Semitic, anti-Hungarian, and anti-dissident fervor growing in Romania, democracy has made undeniable progress. One sees the presence of active political parties, which have developed philosophies and platforms and can address their constituencies. There is an independent television station (SOTI), although the government limits its broadcasts to only one hour late in the evening, received by only a small part of the country. There are also some local stations, but they are directly supervised by the local authorities.

The independent print media, generally of good quality overall, can barely reach the

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countryside or even remote urban areas because the distribution channels are controlled by the National Office for Press Distribution, which reports to the Ministry of Post and Telecommunications. With such absolute control over distribution, it is easy to bankrupt even the most popular magazines and newspapers. As editor of an independent weekly, Mihaieş also testified that the repressive tactics of the government distribution office started precisely after the tragic events of June 13-15, 1990, when the miners marched on Bucharest. The majority of the print media violently attacked President Iliescu for his contribution to the miners' violence, but the government's response was simple: the papers did not reach their readers.

On the eve of the general election, Mihaieş saw Romania as divided between two strong forces: the nostalgic, neo-Communist forces embodied by President Iliescu, and the democratic forces allied in the Democratic Convention. Supporting Iliescu are the nationalist groups, such as "Vatra Romaneasca," which recently spawned an unexpected but very dangerous political personality, Gheorghe Funar, the Cluj-Napoca mayor, whose views, Mihaieş believed, have been inspired by Nazi-like ideology.

Mihaieş also singled out the Romanian Service of Information, a direct descendant of the old Securitate, and its mysterious leader, Colonel Virgil Magureanu, who played a leading role in the miners' ritualistic visits to Bucharest. Despite its relative invisibility, no one believes this institution is neutral or objective. A recent but poorly distributed report revealed that the bloody ethnic clashes in Tirgu Mures in March 1990 were engineered at a high level. The violent forces that clashed were not townspeople, but Romanians and Hungarians living in the vicinity transported to the town by buses supplied by the Romanian Service for Information.

This situation in Romanian has not gone unnoticed by the international community. A letter to President Iliescu signed by sixty-two members of the U. S. House of Representatives reiterated that prior to restoration of Most Favored Nation status to Romania, it was expected that there would be free and fair elections, an independent media, civilian control of the Romanian Intelligence Service, and protection of human rights and civil liberties, including the rights of ethnic minorities. However, abuses and irregularities of these democratic expectations are growing.

The nomination of Emil Constantinescu as the presidential candidate of the Democratic Convention did nothing to strengthen this umbrella-like party. Constantinescu was unknown nationally as well as within the party, and this plus the absence of a clear political program led to a last-minute increase in nationalist suport before the election (which was won with a large majority by President Iliescu and a narrow margin by his National Salvation Front). Dissatisfied with the National Salvation Front, Iliescu's party, and unable to identify with the pro-Western philosophy of the opposition, Mihaieş feared that the electorate was becoming more and more seduced by nationalism.
Mircea Mihaieş with Kristin Hunter

EES CURRICULUM REVIEW MEETING

East European Studies and the American Council of Learned Societies are sponsoring a December workshop for the members of the ACLS Joint Committee on Eastern Europe and the EES Academic Advisory Council to review how the American disciplines most concerned with Eastern Europe are to proceed after the collapse of the Communist regimes that were previously at the center of attention. Five papers on history, political science, economics, international relations, and literature will review the strengths and weaknesses in courses, textbooks, and research, and What Is To Be Done in a roundtable forum. EES intends to publish the revised papers quickly as an Occasional Paper that will be available free of charge. Plans are underway for a further set of workshops, discipline by discipline, with colleagues in the East European universities.

NEW PUBLICATIONS

EES announced publication of two books in September 1992. Creating Capital Markets in Eastern Europe (order number 0-943875-42-0), edited by John Lampe, is published by Johns Hopkins University Press, and may be ordered for $10.25 by calling 1-800-537-5487. Private Agriculture in Eastern Europe: Prospects for the 1990s and the Lessons of Pre-War Cooperatives and Land Reforms, also edited by John Lampe, is available free of charge through East European Studies. Please call 202-287-3000, extension 330, or write to EES, 370 L'Enfant Promenade, Suite 704, Washington, DC, 20024.

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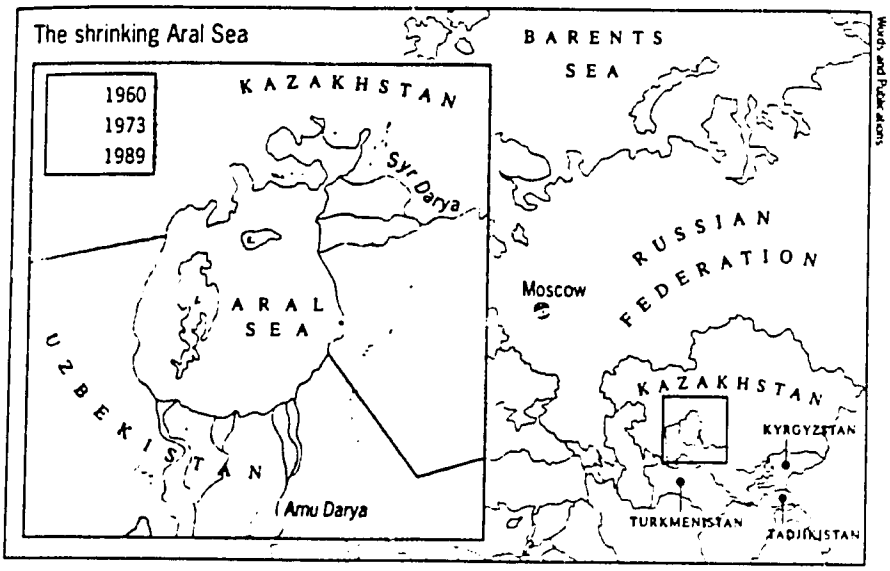
OPTIONS FOR SAVING THE ARAL SEA



Imagine a container 55 km long, 1 km wide and 1 km high, and brim full of water. That is the amount of water put into the Aral Sea by its two main tributaries every year between 1926 and 1960. By the end of the 1980s, that flow, from the Amu Darya and Syr Darya rivers, had fallen from 55 km^3 a year to 'virtually nothing', according to a recently-completed UNEP report.

The Aral Sea was fed by tributaries from the central Asian republics of the former Soviet Union—Kazakhstan, Uzbekistan, Tadjikistan, Kyrgyzstan and Turkmenistan. The water from these tributaries began to be diverted for agricultural irrigation in 1956. As a result of the diversion and of destructive irrigation practices over the next 36 years, the sea has been reduced in volume by 70 percent, had its surface area reduced by 54 percent and its salinity increase to 29 percent, approximately three times the salinity of the open ocean (it was always slightly brackish), while the shoreline has receded by 80–100 km. Wind erosion of the exposed dry sea bed now removes about 43 million tonnes of salty grit each year. When the grit is deposited by the wind it increases the salinity of the soil for hundreds of kilometres and inhibits plant growth, in some cases stopping it entirely.

The irrigation was almost exclusively for massive cotton farms, rice being the only other major crop. With such limited crops the same fertilizers, pesticides and herbicides were applied, causing significant pollution of the sea from irrigation water run-off. The rise in salinity and chemical levels has seen fish life completely eliminated from virtually the entire Aral Sea, and the collapse of the fishing catch which, prior to 1960, had been about 44 000 tonnes per year. It is a bitter irony that the sea was sacrificed to supply water to canals where up to 40 percent of the water was lost through leakage (most were not lined with anything) or through evaporation. Even the water which reached agricultural land was wasted as inefficient flooding of fields saw too much water used, causing water logging, and surface salt accumulation when the soil eventually dried out.

The options

Saving the Aral Sea is relatively simple, concludes the report: increase the water-flow down its tributaries. Unfortunately, the report adds, the population explosion in these central Asian republics, based on the cotton industry, means that any reduction in irrigation would, in the short term, send unemployment 'sky-rocketing'. Even then it is estimated that the sea needs in-flows of 55 km^3 of fresh water a year, but better canals and irrigation techniques, such as spray or trickle-feed irrigation, would only put 21 km^3 of water into the sea a year. The problem is that lining canals and making them deeper to reduce evaporation, then installing more efficient irrigation, would be extremely expensive.

Improved water management is another option. There has been no system of charging for the water, so there has been no incentive to conserve it on the part of the users. Although the report foresees problems for the newly independent republics to coordinate improved management, and high costs for building systems which allow better control over the distribution and use of water, '... the individual Aral Basin countries will have to consider this possibility'.

The introduction of more varied food crops with lower water needs is perhaps the cheapest option, but so much of the infrastructure is devoted to cotton that a massive loss of jobs would be inevitable. It is possible that cotton and rice varieties with lower water needs are now available and could be used in the Aral Basin.

One simple option for reducing the water draw-off is to take the poorest lands out of production. The report's authors estimate that if 5 percent of land were taken out of production, approximately 7 km^3 of water would be saved each year. Fifteen percent of land currently cultivated is of low productivity, and if nothing is changed will stop producing anyway.

The report is to be discussed at a UNEP-organized meeting of representatives from the surrounding republics, the Russian Federation and UN agencies in Geneva from 31 August to 4 September. Meeting organizer Habib El-Habr hopes that concrete proposals will be agreed on at the meeting so that work can then begin estimating likely costs and, eventually, sources of funds.

WHERE COMMUNISM'S MOST ENDURING LEGACY . . .

BY MARGARET KRIZ

PRAGUE—Brown coal's legacy is written large everywhere on the facades of this baroque city of castles and cathedrals. The dirty smoke has democratically painted black streaks on everything from the elaborate 600-year-old buildings in the medieval quarter to the cheaply built, Communist-era apartment blocks on the outskirts of town.

Years after Americans stopped using it to stoke their furnaces, coal is still shoveled into storage rooms in Prague's [illegible] fashionable diplomatic neighborhood as residents prepare for what's expected to be a long, cold winter.

Czechoslovakia's Communist government virtually ignored growing environmental problems in favor of cheap energy and higher production quotas. Heavy industry was encouraged to exploit an abundance of high-sulfur coal and other raw materials, causing Czechoslovakia to use three to five times as much energy per unit of output as other industrialized nations used.

It wasn't that Czechoslovakia had no environmental laws, but that the overly ambitious regulations were riddled with loopholes and backed by halfhearted enforcement, explained Jan Plechaty, water management department director for the country's Agriculture Ministry. "The philosophy of protecting water was very good," he said. "The practice was very bad."

The devastating environmental consequences helped fuel the 1989 Velvet Revolution that overthrew the totalitarian regime. According to a January 1992 World Bank study:

- Nearly 70 per cent of Czechoslovakia's rivers are heavily polluted, and the drinking water in many cities does not meet international standards.
- The average life expectancy of the country's citizens is five to seven years below Western standards.
- Most of the country's animal species are considered endangered.
- Five per cent of the nation's forests have been killed by acid rain damage and another 70 per cent are sick or dying.

In some regions, environmental degradation has reached truly epic proportions. Northern Bohemia, part of Eastern Europe's heavily polluted "black triangle," has experienced airborne sulfur dioxide levels that are seven times above those permitted in the United States. Many central Bohemian children are evacuated to other regions twice a year to let them breathe cleaner air for a while.

But although environmental problems helped energize the country politically, they have since taken a back seat to other crises. Czech Prime Minister Vaclav Klaus has described environmental protection as "icing on the cake" of Czechoslovakia's economic development.

A major civil conflict will ease at the stroke of midnight on Dec. 31, when the 74-year-old country officially splits into two nations, the Czech Republic and the Slovak Republic, also known as Slovakia. "After Slovakia is split from the Czech Republic, there will no longer be the big political controversy in this area," said Jaroslav Marousek, executive director of SEVEN, a Prague-based energy-efficiency group. "Then all of the resources will be focused on the economy."

But the republics' political divorce may be less traumatic than their economic metamorphosis. The two are taking different courses: The Czechs favor a free-market philosophy; the Slovaks, a more socialistic approach.

Environmental activists argue that the division of the republics provides a rare opportunity to adopt environmentally sensitive policies for rebuilding and managing their economies. Czech officials, for example, hope to couple economic reform with pollution cleanup by privatizing regional electric utilities and wastewater treatment plants. "The problem is to get the money to improve the drinking water, to improve the equipment in our stations," Plechaty said. "Privatization is a good way to improve systems more quickly."

The Czech Republic's move to a market economy has meant forcing citizens to pay the real costs of heat, water and electricity. As government subsidies have been reduced, electricity prices have more than doubled; water costs nine times more today than it did in prerevolution days.

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. . . IS ENVIRONMENTAL DEGRADATION ON AN EPIC SCALE

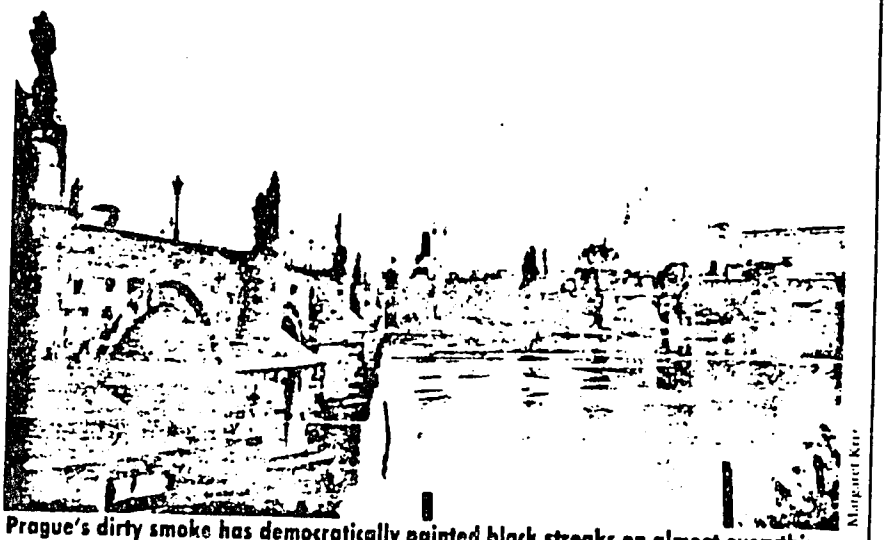
Environmental experts predict that as the cost of energy and other natural resources increases, consumption and pollution will decline. The World Bank estimates, for example, that higher energy prices will cause a 25 per cent reduction in sulfur dioxide emissions by the end of 1993.

Opportunities abound in Eastern Europe for energy-efficiency projects, said Marousek, whose group seeks to attract Western investment in the new republics. "We believe that energy-efficient businesses will have a very optimistic future," he said.

But officials in both republics, worried about falling output and rising unemployment, are reluctant to clamp down on polluting businesses or to make them absorb all of the higher energy costs. Although many industrial facilities are obsolete and may be phased out, the officials want new investment in place before enforcing strict rules that could force their shutdown.

Local officials in the two republics lack not only financial backing, but training as well in such basic skills as writing budgets and managing resources. Those abilities will become even more necessary as municipal and regional governments begin taking control of water and electricity systems. In the past, the national government dictated all management policies.

"We have a relatively skilled labor force in the technical areas," Marousek said. "What we don't have is a sensitivity for money flow and profit. We don't recognize which types of activities have a very short payback period and which will never be profitable. It is a black box for our experts; everything was controlled from above."



Prague's dirty smoke has democratically painted black streaks on almost everything.

Dozens of international groups, along with the U.S. Environmental Protection Agency and other Western government agencies, are sending help. Despite such assistance, the Czechs and Slovaks are struggling to learn the fundamentals of individual responsibility and public problem-solving.

The battles under way here and elsewhere involve far more than environmental protection, according to an analysis by Margaret Bowman of the U.S. Environmental Law Institute and David Hunter of the Center for International Environmental Law.

"The task facing Central Europe is immense: completely restructuring its entire social, cultural, political, economic and legal systems," Bowman and Hunter wrote in a recent article in the *Michigan Journal of International Law*. "The hard reality of today's Central Europe is that the emerging democracies in the region have taken a place in line behind all the other industrialized nations in what is at best a slow trudge toward sustainable development." ■

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FALL/WINTER 1992
LATIN AMERICA

WASHINGTON
ECONOMIC
WATCH

A Digest of Development Policy Information

January 22, 1993

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Dear Readers:

Welcome to the first edition of the 1993 series of Washington Economic Watch. We are pleased to announce that funding has been reinstated and quarterly production will resume in 1993. As in previous issues, WEW covers the important economic policy debates in Washington. This inaugural edition provides insight on issues of concern to developing countries, as monitored during the pre-election and transition period in autumn of 1992.

Herein you will find statements made by senior U.S. government officials, summaries of U.S. congressional hearings, press commentary, and excerpts from policy research and analysis published by Washington 'think tanks' and multilateral financial institutions. The material is organized according to six functional categories; within each are subject groupings, with policy statements generally appearing first and commentary and analysis following. Also included is a bibliographic listing of participating institutions. Please direct requests for publications to the respective organizations.

ODC has experienced a few administrative changes as well. Dawn Murphy recently joined ODC as the new WEW Coordinator to whom all future correspondence should be directed.

We look forward to an exciting year with the new administration in place and hope that this issue proves to be an informative resource for your institution.

Sincerely,

Christine Contee

Christine E. Contee
Director of Public Affairs
& Fellow

ODC

A Project of the Overseas Development Council

John W. Sewell, President

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GOVERNOR CLINTON AND LATIN AMERICA

Mark Falcoff
Resident Scholar
American Enterprise Institute

Just a few days ago Governor Bill Clinton, the Democratic candidate for the presidency, sent shock waves throughout the hemisphere by suggesting that he did not know whether he would support the draft trade agreement just concluded between the United States and Mexico. If approved by Congress, this document would add Mexico to the existing U.S.-Canadian North American Free Trade Area (NAFTA). It would also constitute a giant step toward the creation of a hemisphere-wide free trade zone, as proposed by President George Bush in his Enterprise for the Americas Initiative (EAI). Conversely, rejection of Mexican association would doom the entire concept of the initiative. For if a country of the enormous geopolitical weight of Mexico cannot clear the obstacles, what is the hope of countries smaller and more distant from our borders?

Suddenly made aware of the diplomatic and political impact of the governor's remarks, Senator Lloyd Bentsen (D.-Texas), chairman of the Senate Finance Committee, rushed to his candidate's defense in the pages of the *Washington Post*. Bentson's view — since reiterated by the Clinton campaign — is that the Democrats support *a* free trade agreement with Mexico, just possibly not this one. It all depends, he added. After all, the document in question runs to 2,000 pages, and nobody can be expected to digest something that long, and technical, overnight. The point is certainly well taken, but in a presidential campaign whose every squiggle is magnified by the press at home and abroad, the Latin concern is understandable.

Not that Governor Clinton is not justified in playing a bit of politics with the treaty. According to the latest surveys, the outcome of his presidential quest may well be determined by several crucial industrial states in the Midwest. There, many workers (rightly or wrongly) fear the export of their jobs to Mexico, where wages and environmental standards are palpably lower. Put simply, these are the people Clinton has to reassure to win the presidency. Once in the White House, he may well support the treaty, whether in this form or some other. Nonetheless, Latin diplomats and businessmen studying the 1992 Democratic platform cannot help noticing a strain of ambiguity in the text. "Multilateral trade agreements can advance our economic interests by expanding the global economy," it reads. "Whether negotiating the North American Free Trade Area (NAFTA) or completing the GATT negotiations, our government must assure that our legitimate concerns about environmental, health and safety, and labor standards are included."

> *"For the first time in memory, the Latin American political class seems to prefer the re-election of a Republican president."*

The sudden concern over Governor Clinton's attitude or NAFTA underlines the somewhat sui generis nature of this political year. For the first time in memory, the Latin American political class seems to prefer the reelection of a Republican president; several Latin American presidents have ever said so publicly. For the first time in a generation, Latin America has all but disappeared as a contentious issue between the two parties; except for the reference to NAFTA cited above, the Democratic platform does not even mention Latin America (although it does mention the Middle East and Northern Ireland). As Governor Clinton maintains his lead in the polls, Latin Americans are searching the horizon for some clue to how his regional policies would differ from those of the Bush administration — if at all. It is by no means certain that they would. But the confusion is understandable. The world — including Latin America — has changed a great deal since the last election. The purpose of this letter is to put some of those changes in perspective.

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The Democrats and Latin America

Though historically Latins have expressed a preference for Democratic presidents, for many years the differences in hemispheric policy between the two parties were more apparent than real. Franklin D. Roosevelt endorsed the principle of nonintervention but also propped up dictatorships in the Dominican Republic, Cuba, and Nicaragua; John F. Kennedy introduced the Alliance for Progress but also dabbled in covert action, counterinsurgency, and even attempts to assassinate foreign leaders. Under Lyndon Johnson, more aid and concessional lending were disbursed to the region than ever before or since, but 20,000 American soldiers and marines were landed in the Dominican Republic — and the Organization of American States was nearly destroyed by Johnson's insistence on an artificial multilateralization of the adventure post hoc.

The big change occurred sometime between the end of the Vietnam War and the advent of the Carter administration: Republicans continued to believe (as Democrats once had) that our policy in that region should advance the U.S. national interest in both economic and security matters (even if they did not always know a national interest when they saw one). But Democrats now argued that our policies were good only to the extent that the Latin Americans approved of them. By "Latin Americans" they meant the ones they happened to know — populist demagogues like Venezuela's President Carlos Andrés Pérez or Mexico's President José López Portillo or Panama's roguishly charming dictator Omar Torrijos — whose vaguely leftist domestic policies and neutralist foreign policies (and even, to some extent, their anti-Americanism) seemed a guarantee of both their authenticity and their historic legitimacy. (The chorus of Latin populism-neutralism-cum-anti-Americanism also resonated nicely with a wave of national guilt and self-hatred that swept over much of liberal America in the immediate post-Vietnam era.)

In theory, the Carter administration (1977–1981) favored all good things in Latin America and opposed all bad ones, loftily proclaiming its support for human rights, nonintervention, cooperation rather than confrontation, and multilateralism. In practice, these goals often proved impossible to reconcile (human rights versus nonintervention) or invited the rigorous application of a double standard (cooperation with adversaries, confrontation with allies). Carter's conscientious pursuit of multilateral solutions could not always cancel out real differences of size, power, and perception; thus, in cases like the Nicaraguan civil war, he was utterly unprepared for [the] irresponsibility of other governments, which expected the United States to act decisively should their own nerve fail them.

The Past, Not Necessarily the Future

The Carter administration left office twelve years ago, and there is no particular reason to think that a Clinton administration would necessarily partake of the same notions or repeat the same mistakes. For one thing, Democrats have since learned that administrations that appear to value the interests or views of other countries ahead of our own tend to be voted out of office at the first available opportunity. For another, with the disappearance of the Soviet Union and what used to be called the Eastern bloc, the term "nonalignment" has lost all meaning; there is no need to court neutrals, much less adversaries, since there is no other camp to which they might tilt. For yet another, since 1989 the Latin American political classes have staged a remarkable turnabout: far from wishing to distance themselves from the United States, in every country they are seeking what they call a privileged relationship with Washington. Their greatest fear these days is that after the cold war, the United States will turn away from the region and give a higher priority to some other area (particularly Eastern Europe).

"Latin America tends to attract some of the more leftward components of the Democratic party's foreign policy constituency."

The proliferation of elected civilian governments throughout the region (the only exceptions are Haiti, Cuba, and, by some lights, Peru) has made the human rights issue less inflammatory and certainly less ideological. Finally, many of the leading Latin practitioners of boom-and-spend populism have turned over a new leaf and are now sponsoring market-oriented economic reforms far more radical than anything the Carter people, in their fear of provoking "confrontation," would ever have dared to suggest. One of these is the reformed populist who used to boast that he was Carter's principal adviser on the region, Carlos Andrés Pérez, now completing his second presidential term in Venezuela.

If there were any dissonance over Latin American policy in a Clinton administration, it would in all likelihood come from within rather than without. Latin America tends to attract some of the more leftward components of the Democratic party's foreign policy constituency: the human rights lobbies, environmentalists, population control people, and social engineers of every kind. A recent meeting in Washington between two senior Clinton advisers and some of the party's Latin Americanist constituency revealed a serious cultural gap (or perhaps a time warp). Clinton's people were critical of Bush policy, but in an entirely pragmatic way; many of the Latin Americanists in the room were still bogged down in the same old wars. One urged the governor to make a major speech denouncing President Bush for "failing to restore democracy to Haiti;" another wondered whether Clinton might not contemplate converting Bush's enterprise initiative into a vehicle for the massive infusion of foreign aid into the region. There was much hand wringing about the use of military force to

(continued on page 12)

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Falcoff (continued from page 5)

solve the drug problem, though no clear alternative was proposed. (Cuba, the favorite lost cause of these people, did not come up at all — possibly because Governor Clinton has already endorsed the Toricelli bill, which would tighten the existing embargo.) There is obviously a serious separation between the Democratic candidate and his closest advisors, on one hand, and many Latin American specialists who expect (rightly or wrongly) to play a role in his administration on the other. As Anna Quindlen suggested more generally (*New York Times*, September 16), a lot of American liberals, in anticipating a Clinton victory, may be setting themselves up for some serious disappointments.

Legitimate Latin Concerns

Despite the barrage of reporting by both print and electronic media, including CNN's Spanish-language network, Latin Americans continue to be somewhat perplexed by the U.S. electoral process. Distances, both geographical and cultural, distort images, so that many things that seem obvious to Americans are far less so to their southern neighbors. How President Bush can be nearly fifteen points behind an unknown Southern governor simple escapes their understanding. Most hemispheric leaders, including some who in the past have been cool and distant to the United States, have invested considerable energies over the last four years in coming to terms with the Republican administration in Washington. The idea of starting all over — with a whole new set of people, many of whom they may not know — is not particularly inviting. Apart from lingering fears that labor constituencies in this country will prevail over Governor Clinton's stated commitment to NAFTA, there is also considerable discomfort over the possibility that a new Democratic administration might not inspire the kind of business confidence needed to fuel a U.S. recovery and with it, the continued flow of capital to Latin America's growing private sector industries.

This last is a perfectly understandable concern, although it is difficult now to say how justified. But it underlines the degree to which Latin American politicians and intellectuals, who once regarded bilateral relations as an inevitable zero-sum game, have come to identify the welfare of their own countries with that of the United States. It also marks the extent to which the Latins have retreated from their perennial call for each new administration to reinvent the wheel. For their part, the Democrats' reluctance to deal directly with Latin America in their platform may bespeak not neglect, but an implicit admission that the current policies deserve to be continued. If so, it means that one of the most contentious issues in recent American foreign policy has finally found its way to a more productive phase than at any other time since World War II.

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Office of the President-Elect
and Vice President-Elect

REMARKS OF PRESIDENT-ELECT BILL CLINTON
TO THE ANNUAL CONFERENCE ON TRADE, INVESTMENT AND DEVELOPMENT
IN THE CARIBBEAN BASIN
MIAMI, FLORIDA
LITTLE ROCK, ARKANSAS
WEDNESDAY, DECEMBER 2, 1992

Thank you very much. Thank you very much. Congressman Guarini, Congressman Fascell, the other members of the United States Congress, I want to say hello to you and to all of your friends there from the countries of the Caribbean for the people, for the public and private sector who are gathered to talk about how together we can continue to work to advance democracy and economic progress.

It's an honor for me to be able to speak to you today. This is a very impressive gathering. I have reviewed the list of attendees, as well as the progress which has been made over the last few years.

Just yesterday, I had the honor of speaking to the Rio Summit in Buenos Aires to underscore to them my commitment to mutual efforts among all of us in this hemisphere to promote democracy and economic progress. I want to underscore again today the enormous importance I place on those common efforts.

I want to work to make the United States a stronger partner in our endeavors, first by rebuilding the strength of our economy here at home. We cannot hope to be fruitfully involved in the things which you are discussing today unless we are strong enough to be an economic leader. There is much we have to do at home, but I want to assure you, too, that I have no intention of withdrawing from our historic commitments or our unique opportunities at this moment in history to move forward in a whole broad range of areas of concern to all of you. I want to work with you to help the nations within our hemisphere strengthen our economies, our commitments to democracy, and to human rights.

Today we face an unprecedented convergence of ideals and historic trends that gives new hope and aspirations to all of our people. Much of what brings us together is not only clear shared economic and security interests, but also common values and principles. We believe strongly in democracy for our people and reject those who would use violence against democratically-elected

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governments. We believe in competitive economic policies that foster mutual growth and progress within our hemisphere.

That's why I support the efforts to develop a North American Free Trade Agreement, and continued efforts to expand trade and other economic opportunities within this hemisphere. We must also reach out to the small market economies of the Caribbean Basin to ensure that they, too, are part of our efforts to expand trade and prosperity. And we must not forget that many of you bear heavy debt burdens which hamper these goals. I look forward to working with you to make progress in both these areas.

Each of us also shares a belief in social justice and greater opportunity for all our citizens. That's why more efficient health care and education, housing and job opportunities are important to all of us as we strive to improve the quality of lives of our people within our own countries.

Being with you today is the beginning of what I hope will be a long, consistent, and very, very productive relationship. Together, we can seize the opportunities that are before us and prepare all our people to make the most of the beginning of the 21st century.

Improved economic growth in the Caribbean Basin is in the direct interest of the United States. It helps to create jobs and exports for us. It helps to promote the ideals of democracy, which are important for us not only in our own nation, but throughout this hemisphere.

When I take office in January, I look forward to working with you from day one on these common objectives. Together we can advance our shared agenda, not only of economic progress and political democracy, but also of protecting our environment, resolving regional conflicts, strengthening and promoting democracy where it does not yet exist, and ridding our hemisphere of the scourge of drug trafficking. Together, we can construct a genuine hemispheric community of democracies, one where open markets and accountable governments provide the foundations of freedom and prosperity.

I look forward to getting to work with you on these important goals. I thank you for having me with you today, and I thank especially the members of the Congress who are there who will be my full partners in our common endeavors to advance the quality of life for all our peoples.

Thank you very much.

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Office of the President-Elect
and Vice President-Elect

For Immediate Release:
December 1, 1992

Contact: Dee Dee Myers
501-399-7175

President-elect Clinton Addresses Rio Group
Summary of Remarks

Governor Clinton spoke today to the Rio Group's summit of Latin American leaders. The group, formally known as the Permanent Mechanism for Latin American Political Consultation and Cooper tion, holds annual summits and periodic meetings of its foreign and economic plan ing ministers.

Governor Clinton spoke with the group's chair, Argentinean President Carlos Menem, between 12:45-1:00pm through a translator. Below is a summary of his remarks:

President Menem gave general opening remarks and exchanged greetings with President-elect Clinton. The President-elect said it was a great honor and a pleasure to join with President Bush in addressing the summit. He called the meeting of the Rio Group "a real testament to the commitment that all of you have made to progress throughout the hemisphere: to democratic elections and institutions and to the promotion of economic growth."

President-elect Clinton told the leaders that he looked forward to a new era and spirit of cooperation to promote free markets and to expand and strengthen our economic ties on mutually beneficial terms. He noted the that there was much work left to do before the new democracies are consolidated but that the people of this hemisphere can take great pride in what they have accomplished on the road to democracy.

President-elect Clinton reiterated his belief that a strong, cooperative relationship with the nations of this hemisphere is crucial to the well-being of the U.S. "I campaigned for the presidency of the U.S. because I believe we cannot be strong abroad until we rebuild our economy ... But [i]t is also one of America's most important and fundamental interests is to ensure that our friends and neighbors in this region are economically prosperous and politically stable."

President-elect Clinton spoke of his support for working together to expand opportunities for trade and investment, of his support for NAFTA and for building free trade agreements with other nations in the hemisphere. Among other subjects mentioned were the debt burden, proliferation and environmental protection.

In closing, President-elect Clinton said, "One of the strengths of any democracy is the continuity it allows our governments as our leaders change... As I work with [President Bush] over the coming weeks, I want you to be assured that I intend to build on the relationships of the past four years and make the next four years even stronger in their cooperation for our mutual commitment to democracy and economic progress."

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THE STERN GROUP INC.

International Trade Advisors

REMARKS BY THE HONORABLE PAULA STERN
PRESIDENT
THE STERN GROUP

BEFORE THE ECONOMIC SUMMIT
INTERNATIONAL/LATIN AMERICA AUDIT

LITTLE ROCK, ARKANSAS

DECEMBER 14, 1992

Thank you so much. Mr. President-elect, Mr. Vice President-elect, I thank you for including me in this teach-in. As an aging baby boomer its been a long time since I've attended a teach-in, and I think that one on economics is just right for today.

Over the past year you've drawn the tight connection between domestic and international issues, and in Putting People First you link world growth to the health of the U.S. economy. Today I'd like to take a minute of my time to put my assigned area, Latin America, into this global context as it relates to the long term health of the U.S. economy. Our first order of business must now be reviving the domestic economy, and trade -- trade with Latin America in particular -- is an important factor in making that recovery sustainable.

America's economic vitality depends more than ever on economic conditions abroad. In the last 20 years, trade has doubled as a percentage of our entire national product to one fourth of the total, and we export one fourth of all the goods we make. Exports have become crucial for American economic growth and job creation, particularly since the effectiveness of other policy tools has been severely hampered by past economic mismanagement. Just since 1984, export expansion added one million manufacturing jobs. About one third of all U.S. growth in the last six years has come from cutting the trade deficit. And in 1991, the recession would have been twice as deep in the absence of continued trade gains.

However, continued strong export growth and improvement in the U.S. trade deficit now face major challenges. The greatest threat to U.S. export performance is the economic slowdown affecting most of the industrialized world. Japan's economy is faltering, and Germany's recession is hampering economic growth throughout the European Community. As a result, our main export markets are stagnant and a drag on

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the tentative domestic recovery we may be experiencing. Additionally, the yen's current undervaluation threatens U.S. trade performance. To illustrate the significance of overseas growth on the U.S. economy, every 1% of growth in the rest of the industrialized nations is worth $10 billion to our trade position -- or about 200,000 jobs.

Now, that's the bad news. The good news is in emerging markets particularly in Latin America. Developing country markets have provided nearly three quarters of U.S. export growth this year.

Sales to Latin America alone grew by 18 percent in 1991 and are expanding almost three times as fast as U.S. exports to the world as a whole. That's almost four times as fast as the increase to the European Community, and seven times as fast as the increase to all developed countries. Now, if you break the figures down a little further, they show that 15 percent of our exports go to Latin America now, and about half of those go to Mexico. Improvement in the trade balance with Mexico accounts for more than 70 percent of the overall improvement with Latin America since 1983.

Compare the picture today to the disastrous consequences of the debt crisis of the 1980s in Latin America. Then, Latin America sought relief from its crisis by cutting imports while increasing exports. Our exports, U.S. exports, to that region dropped drastically in that lost decade, costing hundreds of thousands of U.S. jobs and creating a massive U.S. trade deficit with the region. During my 9 year service at the International Trade Commission which overlapped with this period, I took the opportunity to note in testimony on Capitol Hill that U.S. firms and workers were suffering grievously and were seeking relief from the surge of imports which followed in the wake of Latin American contraction.

But today, Latin America is turning around. After the lost decade of huge resource outflows, hyperinflation, and shrinking incomes, the region is regaining lost ground. In what has been likened to a "silent revolution," market-oriented economic development strategies are now being adopted by most Latin American countries. Governments throughout the hemisphere, shunning the statist past, have restrained budgets, cut inflation, curtailed controls on prices and markets, privatized and deregulated economic production, and removed barriers to trade and foreign investment.

This economic pluralism is a breeder of political pluralism in that region, while fostering better relations between the United States and our southern neighbors. And as an extra dividend to these developments for the United States Latin America is now our strong partner in efforts to achieve strengthened trading rules in such areas as services, investment, and intellectual property rights protection at the Uruguay Round of multilateral trade talks.

Freer trade and economic integration are at the leading edge of these positive developments in Latin American economic policy. The peoples of that region are, of

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course, the greatest beneficiaries of that change, but we too are benefitting. Long established market presence puts U.S. business in a strong position to profit from renewed economic growth, freer trade, and from expanding consumer markets. Latin America spends 50 cents of each import dollar on U.S. goods, and for Mexico it is 70 cents. Nowhere else does the U.S. have that kind of advantage.

Revived U.S. exports to Latin America have reversed the staggering U.S. trade deficits of the 1980s. In 1984 our trade with Latin America left us $17 billion in the red, but this year, we're running a surplus, with exports of over $75 billion. And exports mean more jobs.

It is clear, then, that Latin America is important to the economic health of our own country. However, trade with Latin America is not enough. Trade with the region is a relatively small part of our total trade. The rapid growth rate of exports to Latin America is unsustainable because of the huge external deficits that many of these countries are developing once again. Moreover, the largest economy of the region -- Brazil -- continues to drift. And problems loom on the horizon as disaffection grows with the slow pace of economic gains for the lower income groups in that region.

In sum, while strong export growth to Latin America and the rest of the developing world is a welcome cushion, it cannot make up for the slowdown in developed countries. Nor can it compensate for the fact that U.S. imports are once again increasing. Latin America -- and particularly its best performers, Chile, Mexico, and Argentina -- has shown that tough economic reform programs -- stressing fiscal discipline, freer markets, and industrial restructuring -- can create the conditions for recovery and sustained growth.

As our experience with Latin America has shown, the pace of economic growth abroad -- together with a competitive exchange rate and overseas market access -- has a significant impact on production and jobs at home. The lessons we can draw have to do with the need 1) to promote faster growth abroad, 2) to promote a competitive exchange rate for American business, and 3) to bring down trade barriers and expand international trade, not just in this hemisphere but globally.

Trade is not a cure-all for our economic needs. But trade expansion -- in sync with domestic policies that strengthen us here at home as competitors in the global marketplace -- can play a crucial role in building a sustainable, long-term recovery. Thank you.

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AN INTERNATIONAL DAILY NEWSPAPER THURSDAY, DECEMBER 24, 1992 50¢ ($1.00 CANADIAN)

THE CHRISTIAN SCIENCE MONITOR

VOL 85 NO 21

An Agenda for the US and Latin America

A community of democracies would make the nations of the Americas more productive and globally competitive

By Peter Hakim and Richard Feinberg

THE Inter-American Dialogue – an assembly of 100 opinion leaders from the United States, Canada, Latin America, and the Caribbean – last week issued its new policy report on US-Latin American relations, *Convergence and Community: The Americas in 1993*. The report calls for the formation of a Western Hemisphere Community of Democracies, offering concrete recommendations to set the building blocks of such a community in place. What follows is a summary of the Dialogue's proposals.

Economic integration

The nations of the Americas now have the opportunity to construct an economic community that would make every nation more productive and globally competitive. We propose a five-point program for grasping this opportunity:

1. The US, Mexico, and Canada should ratify the NAFTA agreement, making sure that appropriate attention is given to the environment and to workers' rights.

2. Latin American and Caribbean governments should intensify efforts to forge sub-regional trade pacts while sustaining domestic economic reform initiatives.

3. The NAFTA partners should begin consultations with other governments to establish criteria, procedures, and timetables for building NAFTA into a hemispheric trade pact. Requirements for membership should include a commitment to democratic practice.

4. NAFTA membership should promptly be extended to Chile and other countries that can meet the entry requirements.

5. The governments of the Americas should establish a new multilateral organization to guide progress toward a hemispheric economic community. Existing regional economic organizations should play prominent roles in the new body, along with private business, trade unions, and other nongovernmental organizations.

Collective defense of democracy

To sustain progress toward democratic community, two fundamental challenges must be confronted. First, democratic institutions throughout the Americas must be made more responsive and participatory. Second, the nations of the hemisphere must fortify their resolve and capacity to respond to violations of constitutional order. We propose a six-point strategy:

1. Hemispheric governments must promote negotiated settlements of Latin America's remaining guerrilla conflicts to end the violence and counterviolence that undermine democratic institutions and values. They must also work to stop human-rights abuses by vigorously pursuing the recommendations of credible human-rights organizations.

2. The governments of the Americas should together take a fresh look at the missions, size, weapons, and costs of their armed forces and establish regional norms to govern civil-military relations.

3. The inter-American community must respond rapidly to breakdowns of democratic rule – as demanded by recent resolutions of the Organization of American States. All nations of the hemisphere must work collectively to repair the democratic process. The capacity of the OAS to take leadership must be strengthened by expanding its new Unit for Democracy.

4. The inter-American community should not try to impose a predetermined solution following a democratic breakdown. In some cases, decisive action might reverse an illegal takeover. But if a rapid turnaround appears unlikely, inter-American efforts should foster negotiations among contending forces to restore constitutional rule.

The struggle against social and economic inequity is the most important challenge facing the Americas today.

6. When an illegally constituted government refuses to engage in negotiations to restore democratic order, the inter-American community should consider stronger sanctions. The selection, sequencing, and escalation of sanctions must be orchestrated on a case-by-case basis.

6. Hemispheric action must aim quickly to restore democracy. However distasteful, this may require a compromise solution that accommodates some of the demands of those who illegally took power.

Poverty and inequality

The struggle against social and economic inequity is the most important challenge facing the Americas today. Democracy must be anchored in social justice if it is to endure. The Americas must forge a future that is shared by all Americans. We propose seven measures:

1. The countries of the Americas should give as much priority to expanding social and economic opportunities as they do to promoting growth.

2. All governments must sustain sound, growth-oriented macroeconomic policies. Spending must be kept in line with tax revenues and inflation must be controlled.

3. Anti-poverty strategies should emphasize raising the productivity of the poor, particularly women. Investments in health and education are required.

4. Income transfer programs should be targeted to the neediest groups.

5. Local governments, community groups, and private business and professional associations should be intensively involved in the provision of social services.

6. Programs to reduce poverty and inequality must be consistent with macroeconomic stability and therefore should be financed through some combination of increased taxes, the reallocation of existing expenditures, and external aid. Opening opportunities for the poor requires that the better-off pay their taxes.

7. External organizations should put their financial, intellectual, and political muscle behind national anti-poverty programs.

We believe the nations of the Americas have an unparalleled opportunity to shape their common future. It will take many years, but an important start has been made.

■ *This summary was compiled by Peter Hakim and Richard Feinberg of the Inter-American Dialogue, who are regular contributors to the Monitor.*

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"Peru Has Moved Back from the Brink"

Statement of Ambassador Luigi R. Einaudi
U.S. Representative to the Ad Hoc Meeting of Foreign Ministers
on the Situation in Peru
Organization of American States
December 14, 1992

President (Alberto) Fujimori's April 5 suspension of the Congress and the Courts put Peru on an uncertain path -- one that held a grim prospect of tragic consequences. Since then, Peru has moved back from the brink, due, in our view, in no small measure to the actions of this body, as implemented by the Secretary General (Joao Clemente Baena Soares), with the support of the distinguished foreign minister of Uruguay (Hector Gros Espiell, chairman of the Peru MFM).

The United States believes that it is vital that such a pattern of mutually supportive cooperation between this Organization and Peru continue, and we believe that the resolution introduced by Foreign Minister (Guido) Di Tella of Argentina, based on the lengthy drafting debates that took place here last week, meets our basic needs.

Let me attempt to explain why. I will not repeat the maddening succession of fits and starts which made up the complex process from President Fujimori's offer to hold an election for a Constituent Congress to the actual celebration of the election on November 22. Let me note, however, that when in September the Secretary General and the chairman of this meeting were able to accept Peru's invitation to observe, the Secretary General -- thanks to substantial support from my Government, from other members of this Organization, and, I would note, from at least one important observer -- was able to back up the commitment by developing an extraordinary communications, logistical, and security system to support his normal political acumen so as to deal with some of the most difficult circumstances that external elections observers have ever had to face.

Between September and the holding of the elections, not only were more than 200 observers put on the ground, but -- and I think that those of us who were present note with particular gratitude -- they were armed with an independent and autonomous system of communication and a highly developed technology for checking the actual voting and results.

The conclusions that I and others from the United States who had the good fortune to participate in the observation -- and I would note that at least three, of my fellow U.S. observers, five of whom were staff members from the U.S. Congress, are here with us today -- and what we saw matched essentially the report given to us in much greater detail by the Secretary General.

The elections took place freely, fairly, with a good level of popular participation, in spite of major security concerns, though not without irregularities that stem largely from inadequate training from electoral officials.

We felt that the way which our Secretary General managed this most complex situation was exemplary. I congratulate him, as indeed I congratulate the Government and people of Peru for the fairness and good humor with which the elections were carried out that November Sunday.

(over)

Now, this said, the election of the Constituent Congress was an important first step. Yet it is only that: an important first step. There is still a great deal to be done. The return of democracy requires a truly representative and independent congress. Two of Peru's traditional political parties did not participate in the Constituent Congress elections, but have joined other parties now in announcing that they will contest municipal elections scheduled to take place in January.

We hope that the international community and the Permanent Council will closely follow both the activities of the Constituent Congress and the conduct of the municipal elections. While mindful of Peruvian sovereignty, and of the prerogatives of our Secretary General as he acts in accordance with the Charter, it is our view that the OAS has a clear, constructive role to play in assisting Peru to strengthen the foundations of democracy. The United States is interested in supporting an OAS role in these areas.

We applaud President Fujimori's recent statements in Ayacucho in support of human rights -- and I note that Ayacucho is the home base of the Sendero insurgency. We hope that the situation with regard to both the defense of human rights and the defeat of terrorism continues to show improvement.

We recognize that it is difficult -- extraordinarily difficult -- to deal with the Shining Path. Nonetheless, we believe that it is incumbent upon the Government of Peru to set an example of fairness and respect in its treatment of all Peruvians, including human rights workers, political critics, and the press.

Peru has taken an important first step, as I have just said, yet as Secretary (Larry S.) Eagleburger said at the Meeting of Foreign Ministers on May 18, "The devil is in the details." These details will be seen in the effective work of an independent congress, the elaboration of a constitutional order under which the rule of law is observed, and separation of powers and the full exercise of political rights are respected.

Peru needs strong, representative institutions to confront the intractable problems that afflict its people. And only a democratic Peru can attract the extraordinary degree of international support that it needs and deserves.

In conclusion, something real has happened in Peru. I think it is incumbent upon us that something real happen here. The resolution that has been presented creates a framework for continued attention and for continued cooperation. We believe that under those circumstances once the Constituent Congress is instituted, the extraordinary Meeting of Foreign Ministers (MFM) can, in fact should, close. If occasions arise that warrant reopening (the MFM), it clearly can and will be reopened. But in the meantime, I think that we should throw our weight behind practical cooperation and hard work to consolidate the gains already made.

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THE WASHINGTON POST, November 20, 1992

Rowand Evans and Robert Novak

Lone Rider in Peru

LIMA—In the face of car bombs shattering windows and nerves here this week, Peruvian President Alberto Fujimori is taking another step toward regenerating Peru under his own brand of democracy that will not play well in U.S. and European government circles.

Fujimori is expected to run strongly in Sunday's first elections since he dissolved the congress, fired judges and assumed personal rule in a "self-coup" last April. His party is likely to win a majority of seats in the new 80-member congress charged with writing a new constitution. But Peru's two main traditional parties are boycotting the election, which clouds its authenticity in the eyes of outsiders, even though the parties are discredited in Peru.

Fujimori is impatient with such carping. "That was not democracy," he said of the corrupt old Congress in an interview with us. He pointed to his sustained popularity in the polls, contrasting it with his rejection in world capitals.

President Bush's State Department was unable to cope with Fujimori's deviation from a rigid democratic model, and U.S. policy under Bill Clinton is apt to be even stricter. Washington's judges of hemispheric morality should consider what works for the people on the scene, even if it falls short of Jeffersonian ideals.

When political unknown Fujimori was elected in June 1990 in a stunning upset, Peru was imploding after a generation of decline brought on by feckless leftist governments. Even his critics credit him with two remarkable achievements as president: curtailing wild hyperinflation and halting the bloody Shining Path guerrillas.

Fujimori's austere anti-inflation strictures have won over the light-skinned Castilian aristocracy that supported novelist and free-market advocate Mario Vargas Llosa against him in the 1990 election. Fujimori has also maintained surprising loyalty from the bottom rungs of Peruvian society: the dark-skinned mestizos who voted for him as "one of us"—the son of poor Japanese immigrants who made it on his own and whose campaign propounded an anti-austerity philosophy. The poor today hate Fujimori's economics but still like Fujimori.

All social classes felt immensely relieved when Shining Path leader Abimael Guzman was captured in September and imprisoned for life. The Maoist guerrilla organization demonstrated that it can spread terror without its leader by launching a bigger-than-expected bombing campaign in Lima Tuesday leading up to Sunday's election. Nevertheless, the threat of Shining Path is greatly diminished.

But even more important than the curbing of inflation and the terrorists as a source of Fujimori's popularity is precisely what makes him so unpopular in Washington and Madrid: his dissolution of congress.

The lawmakers, voting themselves salaries lavish by Peruvian standards, were accountable to nobody but their party leaders because they ran at-large nationally. According to the polling firm Apoyo, this country's citizens define democracy as an elected president and a free press, with no mention of representative institutions.

Even Peruvians pleasantly surprised by Fujimori's abandonment of rabble-rousing populism once he was elected worry about what they consider to be his authoritarian tendencies. He admires the free-market, strong-government Four Tigers of East Asia, and his ideal is reputed to be Singapore's autocratic Lee Kuan Yew. Fujimori did not deny to us that he wants a constitutional change to permit now-forbidden election to a second term.

The more serious problem is that Fujimori is a lone rider, carrying by himself hopes for a stable Peru. The coup attempted against him last week was no laughing matter, reflecting major aggravation within the military and perhaps intervention by drug traffickers.

U.S. diplomats in Lima have misgivings about Fujimori, but they recognize what he has accomplished and know his overthrow now would be disastrous. These facts of life should restrain Clinton from knee-jerk passion for democracy and human rights. Indeed, Fujimori wants to visit the new president in Washington to show he is no Mussolini and explain how the war against drugs is failing—the subject for a second column from this country too long ignored by its big neighbor up north.

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The World

Democracy In Peru: Fanning a Faint Ember

Americas: The U.S. cannot restore democracy to Peru, but working with the OAS, much can be done to contest the autocratic regime of Fujimori.

By Peter Hakim

WASHINGTON

President-elect Bill Clinton's campaign pledge "to stand up for democracy" in the world faces a stiff challenge in this hemisphere. After a decade of extraordinary political renewal in Latin America—when military regimes gave way to freely elected governments throughout the region—democratic rule today appears increasingly at risk in many places.

On Nov. 27, military officers in Venezuela launched their second coup attempt in less than a year. Both failed, but they revealed wide public antipathy toward the civilian leadership. They also underscored a bitter truth: If democracy could come under siege in Venezuela, with its great oil wealth and more than 30 years of constitutional rule, few governments in Latin America can feel secure.

And it is no easy task to restore democracy once it is overturned by force. Washington has been working with other hemispheric governments, under the mantle of the Organization of American States, for more than a year to revive democracy in Haiti—with virtually nothing to show for it.

A similar OAS effort in Peru, following elected President Alberto Fujimori's imposition of one-man rule last April—when he suspended the constitution and closed down Congress and the courts—has accomplished far more. But it has not returned democracy to Peru.

It is a tribute to international pressure that Peruvians went to the polls Nov. 22 for a special election that was supposed to restore constitutional rule. But it was Fujimori—not democracy—that emerged the winner. His candidates gained a decisive majority of seats in a newly created constituent assembly, which is charged with redrafting the constitution and serving as an interim legislature.

There are several reasons for skepticism about the democratizing effect of these elections. Fujimori is a man of autocratic tendencies who has built strong ties with the nation's security forces. His government has not yet resorted to the outright repression that many had feared, but Fujimori has used his special powers to intimidate political adversaries. He has boasted he would shut down the new assembly if he was unhappy with its performance.

Blame for the foundering of democracy in Peru cannot be pinned on Fujimori alone. Opposition political forces have been unable to mobilize any popular resistance to Fujimori's takeover or offer any other effective challenge. Still discredited by their failures in the 1980s, Peru's two major parties sat out the assembly elections—not out of principle, but because they faced voter rejection. No opposition candidate secured more than 8% of the votes. Peruvian politics resemble a clear-cut forest with one tree—Fujimori—left standing.

Fujimori is a popular president with more than 70% support in recent polls—and his popularity is not hard to explain. Before he took office, the nation's economy was devastated, the brutal Shining Path insurgency was spreading, human-rights abuses were rampant and narcotrafficking was Peru's leading industry. Although his government has not ended Peru's prolonged depression, it brought annual inflation down from 8,000% to 50% and captured the head of the Shining Path and most of its senior leaders.

All this does not mean these elections were without consequence. Although the assembly will enjoy limited authority, it will provide an official platform for opposition voices and perhaps some check on otherwise unbridled presidential power. It should also serve as a reminder to Fujimori that authoritarian solutions are no longer acceptable internationally.

BARBARA CUMMINGS / for The Times

The OAS roundly condemned Fujimori's power grab and called for the prompt restoration of Peru's constitutional order. The United States immediately suspended most economic assistance, and persuaded other governments and international financial institutions to cut their aid. With his fledgling economic program endangered, Fujimori grudgingly agreed to hold the assembly elections and invited the OAS to monitor them.

Neither the United States nor the OAS sustained its strong initial response. The OAS sent 200 observers to Peru to watch the elections, but appeared to lose sight of the broader objective of rebuilding democratic politics. This may have been a product of a weakening U.S. role.

The U.S. ambassador in Lima was routinely transferred to Washington a month before the vote, while the nomination of his successor languished in the Senate. The remaining embassy staff lacked the authority to swing much weight with the Peruvian government. Only one senior U.S. official was sent to observe the elections. Many Peruvians saw a waning of U.S. resolve and feared the United States was getting ready to declare Peru a democracy again and restore normal relations.

So far, Washington has resisted that temptation, which would signal that U.S. commitment to democracy is largely rhetorical. Without U.S. engagement, the OAS cannot be an effective force for democratic change in Peru or anywhere else. Multilateral initiatives to safeguard democracy in the Americas, which were gaining ground, would be severely set back. And Peru needs sustained international support if it is to have a chance to reconstruct democracy.

What, then, should Washington do?

First, it should make sure Fujimori understands that the United States considers his elections only a modest step toward democratic rule. Relations with the United States will depend on what happens next: whether the new assembly has the autonomy to challenge presidential authority; how the government manages the nationwide municipal elections scheduled for January, and what happens with the elections for provincial leaders, which should be held next year. Satisfactory performance on all these fronts should be a requirement for renewed U.S. economic assistance.

Another crucial requirement should be consistent respect for human rights. The extra-constitutional powers assumed by Fujimori leaves every Peruvian citizen vulnerable—particularly political opponents. U.S. military aid to Peru must be conditioned on the curtailment of human-rights abuses by the armed forces and a willingness of the Peruvian government to prosecute past and present violations.

The United States and other nations should insist on keeping an OAS mission in Peru to monitor events. The mission should actively engage the government and opposition political forces and encourage dialogue between them.

Peru demonstrates how difficult it is for outsiders to protect democracy. The United States cannot make democratic practices take root in Peru—or anywhere else. What the United States can do is place constraints on the authoritarian impulses of Fujimori-style regimes and thus provide greater space for initiative by national democratic leaders. That requires patience, restraint and sustained engagement—qualities that, unfortunately, have not traditionally been associated with U.S. foreign policy south of the border. □

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Expanding Trade and Creating American Jobs
Remarks by Governor Bill Clinton
North Carolina State University
Raleigh, NC
October 4, 1992

Thank you. Thank you very much. Thank you. Thank you very much. Thank you.

You've brightened up a cloudy day. I want to say how delighted I am to be here with my good friend, Jim Hunt.

When I was elected Governor and took office in 1979, he was the leader of the Democratic Governors, and he befriended me and helped to educate me, and I can honestly say, in the years that have elapsed, I have served with about 150 governors of the United States, having now served longer than any other governor, and Jim Hunt is one of the very finest with whom I ever served in any state in America.

He was our leader in education. He was our leader in economic development. He made me think of North Carolina as a state of the future, a state with a partnership between business and government and education; a state committed to competing in a global economy; a state committed to educating its people.

The legacy of Terry Sanford and Jim Hunt inspired a whole generation of young people from all across the south, including me, and for that I will always be very, very grateful.

I'd also like to say, I'm glad to be back here at North Carolina State, especially in this comfortable auditorium.

A few years ago I came here to the Democratic Convention and we had it in the place where the Wolf Pack plays basketball. It was 90 degrees outside; this is literally true. It was 100 degrees inside, and then we all got up to speak on a podium that had bright lights like this, but brighter and closer, so it was about 120 on the podium. Today it is raining on us; that day I rained on the people in the crowd.

Ladies and gentlemen, I came here to North Carolina today to talk about a difficult and important issue for our country. I wanted to come here because I think of North Carolina as a mixture of the best in America's economy, its traditional industries and

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farms, and its modern hi-tech future.

When I announced my candidacy for President a year and a day ago, I did it not just to challenge Mr. Bush, but to challenge the American people, and here I come today to talk about one of our greatest challenges--how we can compete and win in the global economy.

Because I have been a governor during the entire decade of the 1980s, because I have served in the 1970s, the 1980s, and the 1990s, I have literally been required to be obsessed with the competitive realities of my state and this nation, with what we do well and what we do poorly, with what policies work, and what policies don't. But always at the core of all my concerns are the American people, the kind of people I've seen on these bus trips that Hillary and I, and Al and Tipper Gore, have taken. We're taking another one in Florida tomorrow. People who come out with hope in their heart and pain in their eyes; people who have worked hard and played by the rules. Some of them are winning, but too many of them are losing.

The whole purpose of what one person once called the dismal science of economics, is to enable us to make good decisions that will reward people who work hard and develop their God-given capacities.

I came here today to tell you why I support the North American Free Trade Agreement.

If it is done right, it will create jobs in the United States and in Mexico, and if it is done right and it is part of a larger economic strategy, we can raise our incomes and reverse the awful trend of now more than a decade in which most Americans are working harder for less money.

If it is not done right, however, the blessings of the agreement are far less clear, and the burdens can be significant. I'm convinced that I will do it right. I am equally convinced that Mr. Bush won't.

We live in a world that has been revolutionized almost beyond comprehension. We have seen, in the last few years, the Soviet Union disintegrate, the fall of the Berlin Wall, freedom fighters released from their prisons in Eastern Europe and South Africa, and the end of the Cold War. That was the era in which I was born and in which Mr. Bush came of age, and over the last generation, less obviously but no less dramatically, we have seen unbelievable changes transforming the global economy, which have had their impact here at home.

A little more than a generation ago, international trade and investment were a seemingly insignificant portion of our nation's income, but today our exports and imports of goods and services amount to about a quarter of our entire economy.

A little more than a generation ago, American workers, consumers, and companies lived almost entirely within the American economy. Today we live within the world economy, and foreign trade accounts for almost as high a proportion of our economic activity as it does in Japan and Western Europe.

A little more than a generation ago, we were virtually unchallenged in the world market place, but today we are challenged as ever before not only by Japan and Western Europe, but by other countries as well.

A little more than a generation ago, the world was a far simpler place. We could support free trade and open markets and still maintain a high-wage economy because we were the only economic super-power, and our capacity to control our destiny was largely totally within our own hands.

Now, because money and management and production are mobile and can cross national borders quickly, we face unprecedented competition from developing countries, as well as wealthy ones.

You know that in North Carolina and so do I. A textile worker in Carolina has to compete against a textile worker in Singapore perhaps to sell sweaters in Germany.

It's also hard to tell who the players are. An American car may have more foreign parts in it than a foreign car that happens to be made in an American assembly plant.

This, in other words, is not a simple debate. The world is changing in complex ways. The choices before us are difficult, and it is imperative that at least we understand what is going on, and that we have an honest and forthright discussion of all the forces at play.

For a high wage country like ours, the blessings of more trade can be offset, at least in part, by the loss of income and jobs as more and more multi-national corporations take advantage of their ability to move money, management, and production away from a high-wage country to a low-wage country.

We can also lose incomes because those companies who stay at home can use the threat of moving to depress wages, as many do today. Other countries like Germany and Japan have, quite frankly, managed this problem much better than we have.

How have they done it?

First of all, by maintaining a more highly-skilled work force, not just among their university graduates, but up and down the line among all their workers.

Secondly, by investing more in modern plant and equipment, and in research and development, and developing better systems of moving ideas from the laboratory to the market place, so that if they lose one kind of manufacturing job, there are always other kinds opening up. In contrast to what you often have here, where when people lose their manufacturing jobs, they look around until their unemployment runs out, and then eventually take jobs making half what they used to make.

Thirdly, these countries do a better job of controlling their external costs like health care and energy. The average German factory produces the same amount of output as the average American one for 1/2 the energy input, and our country spends 30 percent more of our income on health care than any other nation with which we compete.

Next, other countries do a better job of exporting more and of continuously increasing productivity by working together more closely, business and labor, government and education. But also let's be frank--Germany and Japan have policies that are tougher in keeping high-wage jobs at home, at least for the home market. The Europeans have an absolute ban on foreign car sales that exceed 16 percent of the market now in Western Europe. The Japanese distribution system means that only 3 percent of the cars sold in Japan are not Japanese. We have an auto parts export surplus of $4 billion with every country in the world, but when you add Japan in, we have a $9 billion deficit.

For some time now--as you see, this is a very complicated thing, and for some time I have felt that one of the most difficult problems in modern politics, and therefore in this presidential election, is the simplistic and superficial labeling of complex issues.

As network news sound bites have shrunk--by one study they're down to less than 9 seconds now, public discussions of important issues have gotten the short shrift. On, perhaps no other issue has the decline of discourse been more pronounced than on the issue of trade, an issue of great impact to you here in North Carolina, in positive and negative ways on farmers and textile workers, on furniture makers, on engineers, and scientists in the research triangle.

Too much is at stake here to avoid the real issues and yet, time and again, that is what we do.

The issue here is not whether we should support free trade or open markets. Of course, we should. The real issue is whether or not we will have a national economic strategy to make sure we reap the benefits, and the answer today is--we don't.

Too many Republicans would say that it's a simple issue--free trade always equals economic growth. Well, it can, but only if we have a comprehensive national strategy to promote that kind of growth.

Some Democrats would say that free trade today always equals exporting jobs and lowering wages. Well, it sure can if you don't have a comprehensive economic strategy to maintain a high-wage, high-growth economy.

It is in that context that we have to look at this North American Free Trade Agreement. Is it good for Americans? Will it help us to develop a high-wage, high-growth economy here at home? Or, by opening Mexico to more U.S. and foreign investment, will it simply encourage more United States companies to abandon their workers and communities here and move to Mexico? Will it depress wages of those who are left here, and will they even have, ironically, less money to buy the products that Mexico will send back to this country?

Well, if you look at the experience of the mequiladora plants, those who have moved to Mexico right across the border, there is certainly cause for concern. We can see clearly there that labor standards have been regularly violated; that environmental standards are often ignored, and that many people who have those jobs live in conditions which are still pretty dismal not just by our standards, but theirs.

So there is some reason to fear that there are people in this world and in our country who would take advantage of any provisions insuring more investment opportunities simply to look for lower wages without regard to the human impact of their decisions.

Still, you must look at the other side of the coin. Changes in Mexico under President Salinas have ballooned our two-way trade with them and have eliminated the trade deficit we once had with Mexico, thus creating jobs here in America even as our investment policies have cost them.

I can also say, based on my own experience, that a good economic policy can grow manufacturing jobs even in tough global competition.

In our state, thanks to highly productive workers and creative business leaders, good cooperation between the government and the private sector, good incentives and aggressive support for educating workers, promoting quality management and

marketing more products, we have grown manufacturing jobs at 10 times the national average for several years now. You heard Governor Hunt say that we now rank first in the country in private sector job growth. There are many and complex reasons for this, but we did have a definite strategy that involved partnerships with a deliberate decision not to give up our manufacturing base. That is very important.

In the United States of America today, only about 16.5 percent of the work force is in manufacturing. In my state, it's 22 percent. In this state, I think it's still about 28 percent, the largest in the United States.

I want to make it very clear--I am committed to maintaining a strong manufacturing base in this country. My granddaddy used to say that during the Depression, people were so poor they took in one another's washing for a living.

That would be the equivalent of an economy that was only a service economy where nobody in America ever made anything.

The great economic powers in this world are the people who make things. We have 16.5 percent of our work force in manufacturing; Japan has 28 percent; Germany has 32 percent. We must do better and we can.

I believe NAFTA can contribute to this effort, not undermine it, as long as we move aggressively to address the serious omissions from the agreement.

I believe we have to do more for our own workers, to protect the environment on both sides of the border, both because it's good for the environment and because if they don't do it, it will further lower their cost of production, to promote prosperity on both sides of the border.

If we do these things and, again, if we develop a serious economic policy at home, then NAFTA can be a very good thing for the United States.

We simply cannot go backwards when the rest of the world is going forward into a more integrated economy. We cannot go inward when our opportunities are so often outward. For all our history, America has moved ahead and reached out, colonizing a wilderness, exploring a continent, always seeking what President Kennedy called the New Frontier.

And today we must forge ahead again. As president, I will seek to address the deficiencies of the North American Free Trade Agreement through supplemental agreements with the Canadians and the Mexican government and by taking several

key steps here at home. I will not sign legislation implementing the North American Free Trade Agreement until we have reached additional agreements to protect America's vital interests. But I believe we can address these issues without renegotiating the basic agreement.

This agreement, however, is only one piece of a larger puzzle. Even the present negotiations recognize th as there are other issues being discussed all along. We need not only to reduce trade barriers, but to prepare our entire workforce not only to compete in the global economy, but to live with the changes in it and to make sure nobody gets left behind.

I remain convinced that the North American Free Trade Agreement will generate jobs and growth on both sides of the border if, and only if, it's part of a broad-based strategy, and if, and only if, we address the issues still to be addressed.

If we don't do those things, we can kill NAFTA, but we'll still lose jobs. And that's the important point I want to make. I have been governor of a state that has seen jobs go on a fast track to Mexico and to other countries. If we do nothing on this agreement and we don't address the serious worker retraining and economic investment issues in this country and we don't change our economic policy, we will still lose jobs because money, production, and management are mobile, and there are people, unfortunately, in this world who would rather move for cheap wages than stay and work for productivity.

We have got to face the bigger issue. We cannot overload NAFTA and make it the symbol of either all our hopes, as Mr. Bush has done, or all our fears, as some of the opponents have done. We have got to see this as a part of a real, big effort to rebuild the American economy from the ground up.

This is not an abstract question. It has real consequences for real people.

For more than a decade, our country has been led by yesterday's men, who were out of touch, out of ideas and out of step with the developments in the global economy, who refused to recognize, not only new opportunities, but new challenges and new responsibilities.

Americans have paid a terrible price for their policies. Trickle-down economics have given us a weakened economy, declining wages for more than two-thirds of our workers, longer work weeks, lost jobs, greater inequality, greater poverty, one in 10 Americans on food stamps today, 100,000 Americans a month losing their health insurance, and the real sense that we may be raising the first generation of Americans

to do worse than their parents.

Without a national economic strategy, this country has been allowed to drift. Meanwhile, our competitors have organized themselves around clear national goals to save, promote and enhance high-wage, high-growth jobs.

In a Clinton administration, we will approach trade and every other issue with a single-minded focus, to do what is best for ordinary Americans who are willing to work hard to get ahead.

But that focus must also recognize the new rules of the global economy. When Japan discovers a way just to make cars a little better, or when the European Community closes its markets to American pork, or when our president refuses to issue export credits and European farmers take away a Russian market that was meant to be for us, or when a country in South Asia or South America violates copyright standards for software, the impact is felt in factories and farms and families all across America.

But when people line up in Paris to watch an American movie, when families around the world eat American food, when a jet made in Seattle lands or takes off from an airport in Seoul, American jobs and paychecks are more secure.

Our prospects and our prosperity depend upon our ability to win in this kind of environment, an environment in which what we earn depends on what we can learn, in which Americans who only finish high school and have no further education and training face far grimmer futures than their parents, an America in which if we do not equal our competitors in research and development and our skill in bringing ideas into manufacturing jobs here at home, unless we have a conversion plan to take all the money by which we reduce defense and invest it in an American economy for the 21st century--in transportation, communication, and environmental cleanup technologies, in biotechnology, in the new frontiers that will provide tens of thousands, indeed, hundreds of thousands of high-wage jobs if we seize the opportunities--unless we do that, whatever we do on this trade agreement will not guarantee or undermine the future we are otherwise going to have.

We've got to understand what the big rules are and start following them. Our competitors know it. The Germans and the Japanese do more with education, from public school to apprenticeships to training in the work force, than we do. The average German factory spends five times as much money retraining its workers as the average American employer on an annual basis.

They do more on research and development than we do. They spend a higher

percentage of their income.

But when our companies do have well-trained workers and competitive products and services and high levels of cooperation and productivity, they do very well indeed. We still have some of the finest companies in the world, that dominate their marketplaces in spite of the fact that they live in a country which doesn't encourage investment in new plants over investment in new Maseratis or third or fourth homes. They do well in spite of the fact that they live in a country which won't control health care costs and in spite of the fact that they live in a country which doesn't guarantee that workers will always have the opportunity to have high, high, high levels of education and training.

But no matter what we do in preparing our workers and investing money, we've still got to have markets for our products. As much as we export, the Germans export a far higher percentage per capita than we do. We need more markets. And today, regional economic blocs are emerging, very formally in Western Europe and less formally, but still surely in Asia, organized by Japan and Japanese investment. It is too early to say whether the integration of Western Europe will be a plus or a minus for America. If they keep opening trade, well, that's good.

We now have a $17 billion surplus with Europe. But they also limit car imports to 16 percent, and they recently restricted imports of American agricultural products on the flimsiest of excuses.

So while we don't know what will happen with these other regional trading blocs, we know enough to know that we need stronger ties to our neighbors, both for positive opportunities and to protect us in the event that other countries become more protectionist.

We can only do that with Canada, which is already at roughly our standard of living, and with Mexico, which is way below our standard of living, if we find a way to grow our economies together in ways that are good for both of us.

So I advocate this treaty as a beginning of that process. I hope that one day we'll have a global agreement for the General Agreement on Tariffs and Trades which will be fairer to our country and which will open markets around the world. But in the meantime, we need to do more in our own region.

If we can make this agreement work with Canada and Mexico, then we can reach down into the other market-oriented economies of Central and South America to expand even further. But these three economies together will give us, in terms of

population, the largest trading market in the world today.

It will provide more jobs through exports. It will challenge us to become more competitive. It will certainly help Mexico to develop, but still, that is also in our interest: A wealthier Mexico will buy more American products; as incomes rise there, that will reduce pressure for immigration across the border into the United States, which depresses wages here.

President Salinas has taken some important steps. He's privatized corporations, he's reduced his debt, he's tamed inflation and he's brought down trade barriers. As I said, the unilateral initiative of the Mexicans has led to a huge increase in the products we sell there and the evaporation of the trade deficit. They also encouraged us to enter these negotiations.

Now, what we have to do, I will say again, is to have a new kind of leadership to make this work. We have to have an overall trade policy that says to our trading partners, particularly our wealthy ones, if you want access to our market, you've got to give us access to yours.

When the president went to Japan, it was sort of sad. He took the auto company executives and pleaded with the Japanese to buy cars. But his United States trade representative had given him a report that said that if Japanese markets were as open as American markets, they would buy $10 billion more products from us every year, everything from agriculture to auto parts to electronics, in ways that would create 300,000 high-wage jobs in America.

So we have to say that trading blocs are not enough. We need fair treatment in other countries if we are giving them fair treatment in ours.

But let me come back to this agreement. Although it is unpopular with some people and organizations that I admire, and who represent the very Americans I am fighting so hard for in this election, I think we should go forward with it because it advances our interests, the interests of ordinary Americans, more than it undermines them if we also do the other things needed to deal with the deficiencies in this agreement and if we have a good, new economic policy.

The agreement reduces and eventually eliminates trade barriers in place, especially in Mexico, against a number of major American exports. It opens up larger markets for our goods and services. It will phase out virtually all tariffs between the U.S. and Mexico over the next 15 years, with some of the most sensitive products being given the longest transitions.

Yet, as I said, there are critical issues which remain unaddressed, from workers' rights to farmers' needs to environmental protection. Despite the promises he made to really address these in a forthright way, Mr. Bush has failed, most important, to provide adequate assistance to our workers, those most likely to be hurt by economic integration with Mexico.

American farmers could also suffer without stronger safeguards for their interests. And the environmental provisions are still too weak. This agreement does nothing to reaffirm our right to insist that the Mexicans follow their own labor standards, now frequently violated--this is a very important issue--and not aggravate the wage differentials which already exist.

As we move toward free trade, we must always remember why we're doing it--to help the working men and women of America. We should not do things that are not in the interest of our people over the long run.

There are apparel workers, fruit and vegetable farmers, electronic workers and auto workers who are at risk, not only of short-term dislocation, but of permanent damage if this agreement is not strengthened and improved. Industries that have already been hard hit by the flow of jobs to Mexico will continue to be hurt unless we negotiate tougher measures to protect them and to make ourselves more competitive.

The shortcomings in the agreement are really a reflection, however, of the shortcomings in the Bush economic policy as a whole, not just in his approach to trade with Mexico or to world trade, but in the whole approach to the economy and the environment.

This agreement underscores the core of the differences between me and Mr. Bush. From the national economic recession to the dislocations caused by defense cutbacks, his attitude has been that we should have trickle-down economics and let the market have its way, keep taxes lowest on the wealthiest Americans, then get out of the way. He seems to be saying, so what if some workers get hurt or some farmers get hurt or some environmental damage is done? So what? Sooner or later, it'll all come out in the wash. Well, a lot of Americans are being washed away by that economic philosophy.

I want America to go forward with expanded trade with our neighbors. I also want an America that has a national economic strategy that makes sense. And I believe there are some things we need to do to make this agreement stronger, but I think they can be addressed without renegotiating the basic free trade agreement.

As president, I will ensure that adequate measures are taken, however, before Congress acts to implement the free trade agreement. I don't want to give up all our leverage to help our workers and to make sure our environment is protected by basically ratifying the agreement through legislation. I think that we don't have to reopen the agreement, but we do have to insist that protection for our workers and for the environment proceed on parallel tracks. We should do it all at once.

President Bush has many tools at his disposal to protect our interests in addition to the things that ought to be done to the agreement. But he has failed to use them. As president, I will aggressively pursue the remedies available in our current trade laws and in the proposed agreement to protect our jobs, our businesses, our farmers and our environment from unfair practices. In addition, I think there are five unilateral steps we should take, and there are three supplemental agreements we should negotiate with Canada and Mexico to achieve an acceptable package. Here they are: First, what we have to do; we've got to address the long neglected needs of our working people, both skilled and unskilled, who are on the front lines of new economic conditions and who may be displaced. The most glaring omission in the president's package is its lack of meaningful assistance to vulnerable workers and community.

For those who need training, we must provide it. Mr. Bush's record on these issues is not a good one. In the last three budgets, he has proposed totally eliminating the training assistance that goes to people whose jobs are displaced by foreign competition.

In his 1993 budget, he cut employment and training programs by $40 million. In a cynical election year ploy, his labor department proposed some more money for job training and other trade assistance to Michigan workers who've lost their jobs. It amounted to about $4.60 a worker.

In our administration, the Clinton/Gore administration, we won't play politics with the lives of working men and women.

We will give you real programs to deal with the real problems--trade adjustment assistance that includes training, health care benefits and income supports, and assistance to communities to create jobs. You can train people all you want, but if they don't have anything to do, it will be like being all dressed up with no place to go.

While Mr. Bush has, in the 11th hour, made a proposal more generous than anything he has said before, it is still way too little, too late. I will do more; it will be better. The American working people will be proud of it. It will ensure dignity and the

opportunity to continue to be a productive member of the American workforce.

The second thing we have to do is move to protect our environment.

The Bush administration on this score is so bad that Mr. Bush's own cabinet secretary sent a memo to all of his employees saying what a bad job the president had done at the earth summit. And he's even stopped calling himself the environmental president.

It's not surprising that they did little to deal with this issue in the negotiations. Before we implement this, we have to be sure, first, that there will be environmental cleanup and infrastructure investments in our country sufficient to do what we have to do.

The third thing we have to do is to make sure we do something for the farmers who are at risk here. I am convinced, having read this agreement with some care, that some of the farmers will do better under it than they fear that they will and that the losses in some sectors have been somewhat exaggerated. However, there will certainly be some dislocation.

Assistance should be provided to farmers who are threatened. We can assist them first by strict application of American pesticide requirements to imported food.

We should help some growers shift to alternative crops, and those who may lose out to competition should be just as eligible for transition assistance as workers in businesses and communities are.

Fourth, we ought to make sure that NAFTA, the trade agreement, doesn't override the Democratic process.

For example, in the provisions on the environment, the current agreement contains no mechanism for public participation in defending challenges to American laws if we apply our environmental laws against Mexican products, or in bringing challenges to the practices of other parties.

I think the new Congress should pass legislation to provide for public participation in crafting our position in ongoing disputes, and to give citizens the right to challenge objectionable environmental practices by the Mexicans or the Canadians.

Fifth, I think we have to make sure this agreement's provisions allowing foreign workers to cross our borders are properly implemented. We have to assure that certain professional workers aren't brought in here as strike breakers. The recent experience where Canadian workers were brought into the country to break our

nurses' strike by American nurses is an example of this. That should never be repeated.

As president, I have said repeatedly, I would support a law to outlaw the use of permanent replacement workers, and I certainly will negotiate to stop the use of replacement workers from Canada and Mexico.

I also think--I want to note that this agreement allows Mexican truckers to drive in the United States without having to satisfy all the U.S. safety and training standards. That troubles me, and I think that you have to say that we must do everything we can under the agreement, and there are some things we can do, to assure there is adherence to U.S. standards through tough inspections.

There are several areas now that we have to negotiate, supplemental agreements which I would want to present together with the agreement that's already been negotiated. Before implementing the agreement, we must establish an environmental protection commission with substantial powers and resources to prevent and clean up water pollution. The commission should also encourage the enforcement of the country's own environmental laws through education, training and commitment of resources, and provide a forum to hear complaints.

Such a commission would have the power to provide remedies, including money damages and the legal power to stop pollution. As a last resort, a country could even be allowed to withdraw.

If we don't have the power to enforce the laws that are on the books, what good is the agreement?

We must have some assurances on this. This is a major economic, as well as an environmental, issue.

Best of all, I'm going to ask Senator Gore to take charge of ensuring that an effective commission is established and that it does work to protect the environment.

The Bush administration has talked about setting up a commission, but it's too little, too late. It won't even be up for final discussion until next year. By then, the incentives the other countries have to do anything meaningful will have evaporated if the agreement is already adopted.

That is unacceptable. Al Gore and I will ensure that the environmental protection commission is up and running when the free trade agreement is up and running.

A second commission with similar powers should be established for worker standards and safety. It too should have extensive powers to educate, train, develop minimum standards, and have similar dispute resolution powers and remedies. We have got to do this. This is a big deal.

Perhaps the toughest issue of all is how to obtain better enforcement of laws already on the books on the environment and worker standards. It's interesting that the agreement negotiated by the Bush team goes a long way to do this in protecting intellectual property rights and the right to invest in Mexico, but is silent with respect to labor laws and the environment.

I want to remedy that. I'm interested in the impact of this agreement on the rest of the people, not just those investing in Mexico, but the rest of the people in this country and the rest of the people in their country.

So we need a supplemental agreement which would require each country to enforce its own environmental and worker standards. Each agreement should contain a wide variety of procedural safeguards and remedies that we take for granted here in our country, such as easy access to the courts, public hearings, the right to present evidence, streamlined procedures and effective remedies. I will negotiate an agreement among the three parties that permits citizens of each country to bring suit in their own courts when they believe their domestic environmental protections and worker standards aren't being enforced.

Finally, I want to ask Congress to grant the authority to the president to continue negotiations on the impact of this treaty. What if we have a global agreement? How will that impact this? And most important, what happens if there is an unexpected surge in imports in one sector or another that displaces huge numbers of people in this economy?

We have in our present trade law, believe it or not--a lot of people don't know this--we have in our present trade law the capacity to protect our own workers if there is, quote, an unexpected surge in exports--or imports into our country in some sectors of the economy, where the displacement is too great for us to manage, too great for us to retrain, too great for us to put people to work in other sectors.

That provision is contained, for automobiles only, in the North American Free Trade Agreement, and the remedy is weakened substantially.

I believe we should negotiate a parallel agreement that deals with the fact that neither the Mexicans nor the Americans know what the full consequences of this agreement

are going to be. You can't get anybody to agree on how many jobs we're going to lose or how many jobs we're going to gain out of this. And I think it's fair to say that we don't want to do anything that's unnecessarily crippling to them, and they shouldn't want to do anything that's unnecessarily crippling to us.

So I will ask the Congress to give me extended authority to negotiate another agreement to deal with the ability of both countries to move in the event there is an unexpected and overwhelming surge in imports into either country which would dislocate a whole sector of the economy so quickly that there's nothing we could do about it to overcome the economic impact.

Now, I want to say one more time, none of this will make a difference unless we have a new economic policy. This administration has no strategy to create and preserve jobs in middle America, but they offer job training, low cost loans and technical assistance to companies that'll move to Central America. I know that most of you saw or now have heard the television show which documented the fact that the United States Agency for International Development has spent at least $289 million for programs to encourage American businesses to shut down here and move to Central America and the Caribbean. In fact, your tax dollars paid for this advertisement. And I quote--you paid for this: Rosa Martinez produces apparel for the U.S. markets on her sewing machine in El Salvador. You can hire her for 57 cents an hour.

How do you feel about paying for that? You paid for low-interest loans to a plant in Tennessee to shut down in Tennessee, put 304 people on the street, and move to Central America. But that fellow running that plant couldn't get the same low-interest loan to modernize plant and equipment in Tennessee to keep those people working.

You paid for an employee of the United States government who was photographed in an interview saying that the workers in the country he was working in were more reliable than the workers in Miami, Florida. You paid for that.

It is no wonder that the American working people are so frightened of having this administration implement this trade agreement.

We've got to stop using our own taxpayers' money to export their own jobs. And it's unbelievable to me that we have actually spent more money under the Bush administration last year to train workers in Central America than we spent to train people in middle America who had lost their jobs because of foreign competition.

Now, those are their priorities. But let me say again; it's not enough just to stop what

they are doing wrong. We have to do some new things right. And let me reel them off quickly:

We've got to change the tax system in this country. We should give people more incentives if they invest in new plants, new equipment, new small businesses, research and development, housing, the kinds of things that put the American people to work, and we should remove from the tax code the incentives to shut plants down here and move them overseas. That's what we should do.

This is entirely consistent with what the other wealthy countries do. This is the only country--you look at Germany and Japan--look at their tax code--that would say we're not going to give you an investment tax credit to modernize your equipment and your plant; but shut your plant down, move it overseas, and we'll give you a tax deduction for shutting the plant down; we'll give you loss carried forward for the losses in the earlier years; keep your money down there and you'll never have to pay income tax on it in America.

It's all backward. We need a tax system that's an investment job-oriented tax system that says we want people to make money in America, but we want them to make it the old fashioned way--make millionaires by putting other Americans to work. That's very, very important.

I mentioned this once before and you clapped so I know you got it, but we've got to have a conversion strategy to do something with the defense money. The defense budget is going to be cut no matter who wins this election.

But look what has happened. What has happened under the present administration is all that money is going to the S&L bailout and higher health care costs. I want to put it into jobs for Americans. It's important.

We've got to have--we have got to finally join the other advanced nations and have a national system to bring health costs in line with inflation and provide basic health care to all Americans; one that preserves the strengths of our system, but deals with the problems.

We've got to bring energy usage into competitive lines with more efficiency and alternative uses of energy, more use of cheap American natural gas, renewable energy sources, and efficiency.

If we could be as efficient in every factory and office building as our foreign competitors, it would free up billions of dollars to reinvest in this economy.

If we could bring health care costs in line with inflation, it would save the average American family $1,200 a year and hundreds of billions of dollars for this economy, which could be reinvested for new jobs by the end of this decade--hundreds of billions of dollars.

And let me point out that that is why our campaign has been getting such broad-based support. The Teamsters endorsed the Clinton-Gore ticket, the first Democratic ticket they had endorsed in two decades. In the hi-tech center of America, Silicon Valley, 21 computer and electronic executives endorsed our ticket; 2/3 of them were Republicans.

In Chicago the other day, 400 business executives endorsed our campaign; a third of them were Republicans--because they know that what's going on now is not working.

On the health care issue, Mr. Bush keeps dumping on me, but the Nurses Association endorsed our campaign; the first time they ever had.

The American College of Physicians, 77,000 doctors, issued a health care plan very similar to mine, and last week people who had been executives in both the Republican and Democratic Administrations said that Bush's health care plan would not control costs; that mine would save the average family nearly $1,200 a year by the year 2000 and that we would cover everybody, and his plan would still leave 27 million people uncovered.

There is a reason why this kind of support is being generated for this ticket. For all of its complexities, the debate over this treaty comes down to this:

It's clear what the benefits of trade are. It's clear what the hazards of investment across national lines are, and the issue you have to face is who do you trust to protect our workers, our communities, and our environment?

George Bush, whose administration encourages American corporations to move to other countries with low wages and lax environmental laws, and even spends your tax money to finance it, or Bill and Al Gore who have a long record of fighting for good jobs and a healthy environment?

Do you trust George Bush, who has amassed the worst economic record in 50 years, the first decline in manufacturing, 2/3 of the working people with their wages going down, 1 in 10 Americans on food stamps, quadrupled the debt in the last 12 years with our investment in the future going down, and no strategy for the future, or a different kind of Democrat who believes we can have both--open markets and a strong

domestic economy.

In the end, whether the North American Free Trade Agreement is a good thing for America is not a question of foreign policy. It is a question of domestic policy.

If we are not strong at home, we will inevitably be weaker abroad. We have to build a new economy in which incomes and employment are rising and companies are growing; a society in which opportunity is expanding and hope comes alive again.

And so I say to you, my fellow Americans, we have to have the courage to change, and a part of that change should involve a closer relationship with Mexico now under better leadership than ever in my lifetime. If we have the determination to reject failed policies and the old labels of the past, if we have the vision to see and work toward a better tomorrow, then we need not fear the future. If we seize this day and shape this change, we can make our great country what it was meant to be.

Thank you very much.

Why Clinton Is Right on Nafta

President-elect Bill Clinton has said he wants to put some teeth into the North American Free Trade Agreement to compel Mexico to do a better job at improving its notoriously weak enforcement of its labor protection laws and environmental legislation. Both before and after the election, Mr. Clinton has faced criticism on this position. This, critics argue, goes beyond the legitimate scope of a trade agreement, challenges Mexican sovereignty, and makes questionable economic sense. The critics are wrong on all three counts.

Nafta, which was initialed by Canada, Mexico and the U.S., already covers far more than the trade of goods and services. The agreement will compel Mexico to

Counterpoint

By Karin Lissakers

change its regulation of the financial services industry and gives U.S. and Canadian firms the right to establish banking, securities and insurance operations in Mexico. It guarantees "Nafta investors" the right to 100% ownership in Mexican auto parts suppliers. It includes guarantees against non-compensated expropriation and ensures that Canadian and U.S. investors can transfer their profits out of Mexico without restriction.

It is silly to argue that the interests of investors can legitimately be addressed in a trade agreement but the interest of wage earners and the environmental concerns of the whole community cannot. Would any U.S. government contemplate signing a trade pact with Mexico if Mexican laws permitted child labor, union busting and blacklisting, and egregious pollution by Mexico's industries? Almost certainly not.

As the Cuomo Commission on Competitiveness noted in its report issued this week, companies that can produce in Mexico for the U.S. market without worrying about child labor laws, worker safety, minimum wage or industrial pollution regulations will enjoy a significant competitive advantage over domestic producers in Canada and the U.S., where such rules are enforced. Failure by Mexico to enforce its laws would be a form of unfair trade practice.

As for Mexican sovereignty, Nafta is a step toward regional economic integration. Such regional pacts are based on the acceptance of common rules and standards of behavior. Spain and Portugal were not permitted to enter the European Common Market until they permitted free, democratic elections. Mexico has just begun to reform its electoral process. And Spain and Portugal were required to begin raising their labor and environmental standards to the levels prevailing in the most advanced European economies. Is it too much to ask that Mexico begin to live up to the standards it has already set for itself in its own legislation?

Finally, the enforcement of labor rights, in particular, is central to the underlying economic arguments for the trade pact.

Nafta will guarantee Mexico privileged access to the most lucrative market in the world. This access will greatly enhance Mexico's ability to attract the foreign capital it needs to modernize its economy and finance its burgeoning trade deficit and large foreign debt. Much, if not most, of that capital is likely to come from the U.S. Fine, say the free traders. Foreign capital will improve Mexico's productivity, raise its wages and thereby increase Mexican demand for our goods. Any American jobs lost through plant shifts to Mexico will be more than offset by new jobs in the U.S. export sector. The standard of living will rise on both sides of the border, illegal immigration will lessen, and the wage and productivity gap between Mexico and the U.S. will narrow and eventually disappear.

The key to this happy outcome is the link between higher productivity — higher value of output per worker — and higher wages. The problem is that this link is broken under the labor market conditions that prevail in many developing countries, including Mexico.

According to The Wall Street Journal, average wages are $1.73 an hour in the export-oriented maquiladora sector, where most foreign investment has focused, compared with $2.17 in the Mexican economy

Is it too much to ask that Mexico begin to live up to the standards it has already set for itself in its own legislation?

as a whole. Workers who have tried to organize in foreign plants and negotiate for better wages have lost their jobs, even been put in jail. According to a recent study by Congress's Office of Technology Assessment, "The evidence suggests that the Mexican government and official unions have often used their power to block independent union formation." In other words, it is official government policy to protect foreign investors against unions and independent collective bargaining.

President Salinas appointed a commission on labor reform early in his term. It has yet to make any recommendations. The government has said "now is not the time," perhaps for fear of frightening away foreign investors.

The efficiency of foreign-owned plants in Mexico, meanwhile, has improved dramatically while wages have not. Mexican auto industry wages, including fringe benefits, average $4 an hour, compared with an average $30 in the U.S. Yet productivity in the Big Three's new Mexican plants is said to be 75% to 80% of the productivity in the average U.S. auto plant. With that kind of cost gap, no wonder Detroit auto makers are closing plants in the U.S. while pouring hundreds of millions of dollars into new production facilities in Mexico. The U.S. deficit with Mexico in the automobile trade has widened in the past five years. That's not what the free traders say is supposed to happen.

Unless Mexican workers get a bigger share of the economic benefits from incoming investment and free trade through higher wages, shorter workdays and weeks, and better vacation, health care and retirement benefits, the promised payoff for Americans will not come. Mexican workers will not be able to increase greatly their purchases of American consumer goods. Millions will continue to enter the U.S. illegally in search of a better life. And competition from cheap labor in Mexico will continue to exert a downward pull on wages and working conditions in the U.S.

The Bush administration is right that a free trade agreement can yield enormous benefits. It opens an important new market for American exports and gives Mexico a better chance to bootstrap itself out of the poverty and misery that weigh so heavily on the entire region. But an agreement on freeing the flow of goods, services and capital will succeed only if it is linked to the larger social issues that divide the continent. Nafta will succeed only if all three partners are held to a common higher standard of behavior.

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The Cuban Democracy Act and US Policy Toward Cuba

Robert S. Gelbard, Principal Deputy Assistant Secretary for Inter-American Affairs

Statement before the Subcommittee on Trade of the House Ways and Means Committee, Washington, DC, August 10, 1992

Mr. Chairman, I appreciate this opportunity to review with you US policy toward Cuba and our views on the Cuban Democracy Act (HR 5323). I commend the thorough review Congress has given this legislation. As you are aware, last week, I testified before the Subcommittee for Western Hemisphere and Peace Corps Affairs of the Senate Foreign Relations Committee and, in April, before the House Foreign Affairs Committee. This has been a truly bipartisan effort. On behalf of the Administration, I would like to thank you and the bill's sponsors for considering our views on how best to bring democracy to Cuba.

I understand that your interests are in the trade provisions of the Cuban Democracy Act, and I welcome a full discussion of these issues. However, I would like to begin by putting the legislation into the context of US policy toward Cuba.

A Successful Policy

In the last few years, our policy has succeeded in helping to significantly diminish Cuban support for insurgency abroad and terminate Cuba's special relationship with the former Soviet Union. Today, Cuba stands alone. No government has stretched out a hand to stop the inevitable decay and disappearance of the Cuban dictatorship. No government has attempted to replace the former Soviet Union's military and political ties with Cuba—quite the contrary. Russia's relationship with Cuba has withered to the point that it now has little inclination to support Cuban intransigence.

Cuba's position in the world community and at home is far different from what it was only a few years ago. Today, leaders around the world are pressing the Castro regime to adopt representative democracy and end its repression of human rights. In Madrid—as in Guadalajara—Castro's vision was rejected by his Latin American colleagues. A few weeks ago, at the Ibero-American summit, the leaders of Latin America, Spain, and Portugal made it clear to Castro they wanted change in Cuba when they called for "representative" democracy in the final communique. Not Cuban-style "democracy" but a true democracy in which the people of Cuba freely elect their leaders and democratic institutions give legitimacy to a successor government.

The UN Human Rights Commission has called on Cuba to stop abuses of human rights. The Russian ambassador to Geneva hosted Cuban human rights activists during last year's Commission meeting in Geneva, and Russia voted in that Commission to send a Special UN Rapporteur to Cuba to investigate the human rights situation there. Sadly, the Castro regime has refused to allow a UN review of its human rights record. Rather, it has continued to subject those who disagree with the regime to mob attack and arbitrary arrest.

Today, Cuba's attempts to establish productive relations with the successor states of the former Soviet Union are little more than cosmetic posturing and do little to conceal the final and irreversible removal of the residue of Soviet power in Cuba. Soviet—now Russian—troops are leaving Cuba. Soviet—now Russian—technical advisers, once estimated at 8,000, now can be counted in the hundreds. All economic aid and subsidized trade,

which peaked at an estimated $5 billion a year, have ended. Total two-way trade between Russia and Cuba in 1992 may amount to an estimated $500 million compared to $8.7 billion in 1989.

The withdrawal of support from the former Soviet Union and, now, Russia means that Cuba can no longer support insurgency abroad. Just a few short years ago, Cuba had 50,000 troops in Africa. They now number in the hundreds. Namibia is independent and democratic. Cuban troops are out of Angola, and it is not controlled by a Marxist-Leninist regime. Cuban troops have left Ethiopia and Somalia. Cuba has little influence in Africa. The same is true for Latin America. There is peace in Central America. Castro lost the election to [Nicaraguan President] Violeta Chamorro just as surely as did Daniel Ortega. The peace settlement in El Salvador was the death knell for Cuban-style communism in Latin America.

The significantly diminished Cuban support for insurgency and the demise of Cuba's symbiotic relationship with the Soviet Union did not just happen. It happened because of a strong and active Bush Administration policy to discourage Soviet—and later Russian—support for Cuba. President Bush and Secretary Baker wasted no words in letting [Soviet] President Gorbachev and, subsequently, [Russian] President Yeltsin know that we expected Soviet military and economic support to Cuba to end. President Gorbachev took the unprecedented measure of announcing to the world—without first advising the Cubans—that Soviet troops would be withdrawn from Cuba. President Yeltsin followed this initiative by terminating subsidized oil shipments to Cuba, by slashing military aid, and by placing aid projects on a commercial basis.

Cuba Today

In 1989, could anyone have predicted that Castro, who once deplored tourism, would, in 1992, be frantically struggling to keep Cuba's fragile economy afloat by begging for Western investment in tourism? Could anyone have told us that the Cuban economy would shrink by 50%, that Cubans would be reduced to bicycles and oxen as their principal modes of transportation, or that Cuba's military machine would be degraded? Cuba can no longer project its power abroad. Perhaps up to half its MiGs are mothballed, many tanks and artillery are in storage and, to save fuel, anti-aircraft guns are being towed by troops pedaling oversized tricycles. Cuba's self-proclaimed victories abroad must be ashes in the mouths of those who must till the field and harvest potatoes rather than sow the seeds of revolution.

Cuba's economic collapse—for in truth that is what we are witnessing—is happening for four reasons:

- The termination of Cuba's economic relationship with the former Soviet empire;
- The refusal of Fidel Castro to adapt to the wave of democracy that has swept the world. The Cuban economy—like its political system—cannot survive in isolation;
- Our long-standing American policy of economic and political isolation of Cuba; [and]
- Our firm and clear policy on the administration and enforcement of the embargo of Cuba.

The future is in the hands of the Cuban people. Will Cuba choose to join the democratic countries of this hemisphere? Will Cuba regain its economic health and political freedom? These choices must be made by the Cuban people. No matter how much we might want to see a peaceful democratic transition in Cuba, the decision is not ours to make. We can help promote change, but we cannot make the changes. We can suggest what measures might result in a better future for Cuba's children, but we cannot carry out these changes.

The Cuban Democracy Act

The Cuban Democracy Act is not a change of policy. It embodies many of the measures the Administration has taken to bring about a peaceful democratic transition in Cuba. It calls for political and economic isolation of Cuba. This is what we are doing and have been doing for over 30 years. It calls for a dynamic program of convincing other governments not to help Cuba. The continued exclusion of Cuba from the OAS [Organization of American States], the refusal of any country to replace Cuba's lost trade and aid, and the collapse of the Cuban economy are all testimonies to the success of our effort. It calls for progressively scaling back our isolation of Cuba if the government undertakes free and fair elections. And, finally, it calls for reintegration of Cuba into this hemisphere once it is truly democratic. This, too, is our policy.

In his April 18 statement on the bill, President Bush stated that he endorsed "the objectives of this legislation to isolate Cuba until democratic change comes to that embattled island." He also made clear his commitment

> to working with the Congress to pass a stronger, more effective Cuban Democracy Act which tightens the embargo and closes any unintentional loopholes that could benefit the Castro regime, while preserving the proper constitutional prerogatives of the Congress and the President.

In my testimony before the House Foreign Affairs Committee on April 8, 1992, I said that we share the vision of peaceful democratic change in Cuba with the sponsors of the Cuban Democracy Act. On that occasion, I also pointed out that the Administration differed not with the overall goal but with certain aspects of the strategy. I asked Congress to work with us to resolve these differences in approach. Today, I am pleased to be able to tell you that the Bush Administration supports the new House and Senate versions of the Cuban Democracy Act.

In my April 8 testimony, I cited the two provisions of the original House version of the Cuban Democracy Act which needed to be revised in order to reflect properly the prerogatives of the Congress and the President. We also suggested language that would close unintentional loopholes that could benefit Cuba in the areas of telecommunications and humanitarian shipments. In both cases, congressional leaders, the sponsors, and the State Department were able to work together to successfully resolve their differences. These changes are reflected in the legislation which you are considering today. We understand that

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there are discussions with [the] Treasury [Department] to resolve differences over the tax provision (Section 6 (b) (1)).

As with any project—especially with a legislative initiative of this magnitude—there are bound to be differences. However, with the expected resolution of the tax issue, none of the remaining issues should delay enactment of this legislation.

We are pleased that this legislation provides Treasury with civil penalty authority so that it may impose administrative fines for less serious violations of the embargo. We believe that the enforcement procedures are somewhat cumbersome and that the categories of travel exempted from civil penalties under the proposed legislation could permit a greater flow of travel funds to Cuba. Also, we would prefer that the provision on vessels (Section 6 (c)) reflect the President's April 18 statement which prohibits entry into US ports of vessels that are engaged in trade with Cuba.

There has been a good deal of debate on the provision to ban trade with Cuba by US subsidiaries located in foreign countries. It is Treasury's practice to license subsidiaries of US firms located abroad to trade with Cuba if no US funds are involved and if the final product is of less than 20% US content. The proposed legislation would revoke Treasury's licensing authority in this area. Our allies object to this provision and have told us that they will impose blocking legislation, which could hurt US companies.

Although modifications to the bill would make it even stronger, we support it as it stands. We believe this bill is important because it will make a statement to the Castro regime. Now, when the regime faces its most serious crisis, the Cuban leadership must understand that this is a bipartisan policy which enjoys the full support of the people of the United States, the Congress, and the Administration.

What's In the Future?

I commend the sponsors of the Cuban Democracy Act for their vision of a free and democratic Cuba. The legislation is clearly designed to promote change by providing incentives which will help the Cuban people undertake the huge job of regenerating a crippled economy and formulating a strategy to develop the basic documents that will govern their lives. For example, Section 7 permits the US Government to provide food and medicines to Cuba if the Cuban Government commits to elections in 6 months, respects human rights, and is not supporting insurgency abroad. This provision will help democracy get a start in Cuba, because it allows us to help once it is clear that the Cuban Government is committed to universal standards of human rights and democracy. Section 8 goes much further. It lists the actions we are prepared to take if the Cuban Government has held free and fair elections with opposition parties and free press, undertaken constitutional reform to establish a representative democracy, and is moving toward a free market economy. These measures include steps toward ending the embargo and opening negotiations for a trade and investment framework agreement, as we have done with other countries in Latin America and the Caribbean. In short, we are ready to help Cuba become a full and prosperous member of the world community. In my view, these provisions are really the heart of the Cuban Democracy Act, because they provide enormous encouragement to the Cuban people to strive toward a democratic system.

Neither this bill nor US policy is designed to hurt the Cuban people. Our mutual objective is freedom: freedom for the Cuban people to choose their leaders, to speak out freely, [and] to join the rest of Latin America in a truly democratic hemisphere. We know this will happen. But we are impatient; we want it to happen now. There has been too much suffering and loss. Families have been split apart—sons and daughters lost at sea—and those who remain behind are left without a future. It is time for a change. Cubans do not want "Socialism or Death," Castro's slogan. They want a voice in running their government so that they can meet together without fear of jail or beatings. It is time that the Cuban people were given back their voice, their vote, and the future of their country. When this time comes, we stand ready to stretch out a hand to help rebuild Cuba. Our help and that of the world community will be given to foster democracy and human rights, not [to] succor a failing dictatorship. We hope that our policy, and this bill, will contribute to the long-sought goal of a free and democratic Cuba. ■

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CUBA IN THE AMERICAS:
RECIPROCAL CHALLENGES

A Report of the
Inter-American Dialogue
Task Force on Cuba

October 1992
Washington, DC

SUMMARY OF RECOMMENDATIONS

With the Cold War's end, Cuba's isolation from the inter-American community is anachronistic. It is also unnecessary, damaging and, perhaps, dangerous. Our recommendations—to the governments of Cuba, Latin America and the Caribbean, Canada, and the United States—are aimed at building a future in which Cuba is committed to democratic practices and enjoys normal relations in the hemisphere and beyond. We reaffirm our respect for Cuba, and seek to join with Cubans in nurturing peaceful changes in their country.

To the Government of Cuba

- The Cuban people must decide on their own internal economic and political arrangements. But Cuba cannot participate fully in the inter-American community while it perpetuates repression and rejects democracy. We urge that the government of Cuba release all prisoners of conscience and permit free and fair elections, monitored by internationally accredited observers.

To the Governments of Latin America, the Caribbean, and Canada

- The governments of Latin America, the Caribbean, and Canada should strengthen cultural, artistic, and scholarly ties with Cuba and help to open the island to new ideas. They should also press directly for democratic freedoms and respect for human rights in Cuba.

- We also urge the Caribbean and Latin American governments to deal constructively with the Cuban government in international organizations. The Organization of American States (OAS) should reinstate Cuba to active membership when it commits itself to the democratic principles of the Organization's Charter.

To the U.S. Government

- The President and other senior U.S. officials should continue to make clear that the United States has no intention of invading Cuba and vigorously to condemn violent actions by exile groups.

- The United States government should actively promote the free flow of information and ideas to the Cuban people by exempting from its embargo all transactions that foster communications between the Cuban people and people from the United States and other countries, including tourism. Beyond communications and travel, the U.S. government should only ease its embargo in response to positive steps taken by the Cuban government. Washington can best encourage such steps by working cooperatively with other governments of the hemisphere—and allowing them to take the lead in some areas.

- Acting in its own direct interest, the United States should cooperate with Cuba on such specific issues as the fight against drug trafficking; inspections of nuclear power plants in Cuba and the southeastern United States; and weather forecasting and environmental protection.

- In its policy toward Cuba, the United States should give greater weight to humanitarian concerns by making it easier for charitable groups to deliver food and medicine to the Cuban people and for Cuban-Americans to assist relatives and friends in Cuba.

- U.S. broadcasting to Cuba must be responsible. Radio Martí should be a source of objective news, not propaganda, and TV Martí should be canceled because it violates international conventions.

- The United States should not allow its Cuba policy to hamper relations with other governments. We oppose legislation to prohibit all trade with Cuba by subsidiaries of U.S. firms in other countries.

We urge all governments to act in ways that would allow the Cuban people to choose their own future in peace, and to let history judge the wisdom of their course.

TREASURY NEWS

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REMARKS BY
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ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS
U.S. DEPARTMENT OF THE TREASURY
AT THE MIAMI CONFERENCE ON THE CARIBBEAN
SPONSORED BY CARIBBEAN/LATIN AMERICAN ACTION
MIAMI, FLORIDA
December 1, 1992

It is a pleasure to join you in Miami today for this conference. Today I would like to share with you my thoughts at this time of transition -- a transition in the U.S. political system and, for the Caribbean Basin, a transition in relationships and opportunities. A revolution has taken place in the hemisphere, one characterized by nations living largely in peace, benefitting from democracy, and undergoing an economic transformation based solidly on market forces. In the past year that revolution has moved forward. While the decade of debt and stagnation in Latin America continues to fade into the past, the future -- a future of new opportunities -- is challenging the leadership in the region. I would like to talk today about that future and about some of the challenges and opportunities I see facing the Caribbean Basin.

During the past year reform has continued to accelerate throughout the hemisphere. The self-generated commitment to market-oriented policies by the leaders of Latin America continues to bear fruit in the form of strengthened economies, new competitive opportunities, a more solid foundation for future growth, and stronger, more productive economic and financial relations internationally.

In early 1990, the United States decided that it was time for a new approach to our relationships in the hemisphere. From this recognition came the Enterprise for the Americas Initiative, announced by President Bush in June of 1990. The Initiative, based on a vision of free trade, open investment and growth, has helped serve as a catalyst for results that have exceeded many expectations. Capital inflows into Latin America and the Caribbean, which had more than tripled to $14 billion from 1989 to 1990, roughly tripled again in 1991 to some $42 billion. This unprecedented increase, led by a few countries such as Mexico, Venezuela, and Chile, has now been joined by major flows to countries like Argentina, Colombia, and even Brazil, where high inflation continues to seriously challenge the skills of the economic leadership.

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The Enterprise for the Americas Initiative is tangible evidence of our commitment to partnership with the region. Its proposals for action in trade, investment, and debt have been embraced throughout the region and have marked a change in the way the United States and the countries of Latin America and the Caribbean relate to one another.

Historically, United States attention to Latin America and the Caribbean was shaped in large part as a response to perceived threats to its national security -- threats to U.S. trading and investment interests, concerns over the advance of communism and terrorism, concern for the implications of unrestricted pressures on immigration to the United States and of course concerns over the spread of narcotics production and trafficking and other, more direct challenges to the rule of law and democracy. Such threats, together with more altruistic concerns for the quality of life, had prompted the United States to sponsor a variety of new programs to promote economic development in the region since World War II. Even into the 1980s, much of U.S. bilateral assistance to the region was directed to meeting immediate threats to peace and stability in countries like El Salvador and Honduras or keyed to counter narcotics production and trafficking in the region.

Together, we have broken out of this historical pattern with the introduction of Enterprise for the Americas Initiative. We are now actively engaged in economic diplomacy based on partnership and equality rather than on unilateral concessions and dependency -- themes that have all too often characterized policy approaches to the region in the past.

The theme of partnership has been uniformly welcomed in the region as the only credible basis for building strong and resilient economies for the long term. However, some of its consequences and implications have also generated anxiety and concern. In the Caribbean Basin, such concerns have become particularly evident in the area of U.S. trade policy and the implications of NAFTA for other countries.

NAFTA

The trade component of the Enterprise for the Americas Initiative envisions an open borderless trading system in the Western Hemisphere, one free of barriers and free of costly disincentives to fair competition. Trade has already helped build momentum for reform throughout Latin America and the Caribbean. Framework agreements on trade and investment have now been signed with nearly every country in the hemisphere, including CARICOM and each of the Central American countries. The Trade and Investment Councils established by these agreements have provided useful venues for discussion of trade and investment issues and have helped us work more closely together.

A number of countries, particularly in the Caribbean Basin, are concerned that ratification of NAFTA will signal the beginning of the end for their ability to compete for investment and export markets in the region. Ultimately they fear for their ability to maintain their standards of living. These are concerns we take seriously.

The NAFTA mirrors the new dynamic relationship between the United States, Mexico, Canada and our neighbors. It is not, however, an immediate panacea or transformation but a road map for a process of ordered economic cooperation and integration. Across-the-board duty-free treatment will not take effect overnight, but will be gradually implemented over a 15-year period. It will take that long to phase out tariffs and create an integrated regional trading bloc of 370 million people producing $6 trillion worth of goods and services each year. Nonetheless, NAFTA has already unleashed a surge of trading and investment activity with Mexico, already our third largest trading partner and our fastest growing export market.

Ratification of the North America Free Trade Agreement with Canada and Mexico will mark a major turning point in this process, moving the trade agenda from the theoretical to real world. At that point we will begin to fully reap the benefits of enhanced competition, less burdensome regulation and, importantly, improved employment opportunities.

Agreement on NAFTA was only made possible by a combination of sustained effort and the success of Mexico's impressive strides in creating an attractive and competitive environment for investors. Mexico's extensive trade liberalization measures and deregulation have revitalized industry and attracted new foreign participation. These reforms have taken determined efforts and courage by Mexico's leadership over an extended period of time.

For the countries of the Caribbean Basin, the NAFTA presents a formidable challenge. This challenge cannot be met by inaction or rigidity on the part of the region's economic and political leadership. It is a time for opportunity, courage, and action.

NAFTA can lead to a major acceleration of trade and investment for the entire hemisphere. The schedule of phased-in tariff elimination implies a timetable for action by other Latin American and Caribbean nations. This timetable requires advancement of national economic reform efforts and a more competitive position in international markets. It adds urgency to the process of integrating national economies while moving ahead to the broader benefits of regional economic integration and growth. The time for planning, consultation, and action within the region is now.

The Meaning of Partnership - A View to the Future

Responses to the challenges embodied in NAFTA will have to take place in a changed world; one in which the relationship between the United States and the region has evolved and matured.

Some observers have expressed a quiet but smug complacency with respect to NAFTA. While they complain of the potential increase in competition from Mexico, they resist any suggestions for needed adjustment or change. I can only conclude that they harbor a conviction that the United States will somehow make it all come out right, either by granting NAFTA trade benefits on a preferential basis or by earmarking additional resources for programs to offset any adverse impact.

Also encountered are officials who express a certain fatalism concerning NAFTA, depicting the region as powerless to do anything to mitigate potential diversion of investment and market shares to Mexico. These observers also plead for special and differentiated treatment, including calls for accession to NAFTA without fully meeting the obligations entailed in that accord.

The first view ignores the reality of the present situation. The second view assumes that national leaders are incapable of developing a political consensus to take needed reforms and to make their economies efficient and competitive.

There is long history of special support and assistance provided by the United States to the region, primarily in the form of unilateral concessions and financial support. While direct bilateral assistance ("foreign aid") has clearly diminished in the past decade, a wide range of other programs still provide extensive benefits to the region. These include such programs as the section 936 provisions for use of tax free Puerto Rican corporate earnings for reinvestment in qualified projects in CBI countries. Other programs, notably those giving preferential tariff treatment on goods assembled in the Caribbean and GSP have also extensively benefitted a number of countries in their efforts to broaden their economic base and improve their competitive access to the U.S. market.

These programs are unlikely to disappear. However, taken together they do not, in my judgment, point us in the direction which I believe our relationship is now moving – toward a partnership of shared advantages, open trade and mutual responsibilities. There is little question that the relative value of many of these programs will erode as Mexico gains improved access to U.S. markets under NAFTA. Although negotiation of other Free Trade Agreements with the United States have yet to get underway, the trend works against these types of programs. While Caribbean and Central American countries currently benefit from preferential access to developed country markets through the Caribbean Basin Initiative and the Lome Convention, the degree of preference will narrow over time as we move to more open markets throughout the hemisphere.

The time for energetic leadership and decisive action is now. Leadership in the Caribbean Basin must move quickly to position national economies to benefit from a more open trade and investment climate. These leaders must be willing to deal with the need to advance structural reforms to assure strong, market-based economic systems. They must assure that their countries are able to compete for investment and are able to produce exports competitive on world markets. Countries that do not move ahead will be left behind. But I trust that the leaders in the region will not let this happen.

The Role of Integration

There is another policy perspective in the region; one shared by a number of dynamic and forward looking leaders who have seen the Enterprise for the Americas Initiative and the NAFTA as unprecedented opportunities. These leaders are at the forefront in the mo ement towards a new economic integration of the Western Hemisphere. They have looked upon the breaking down of barriers to trade and investment as a

challenge. An opportunity to reach out and expand cooperation with other countries and to advance toward a broader vision of a hemisphere wide free trade zone. This leadership has produced tangible gains clearly reflected in a number of recent developments.

- Chile, in addition to seeking a bilateral Free Trade Agreement with the United States, has completed separate trade agreements with Venezuela and Mexico.

- Venezuela, in turn has entered into Free Trade pacts with both Mexico and Colombia.

- In Central America, El Salvador, Guatemala, and Honduras have moved rapidly to integrate their markets and replace protective tariffs and import quota regimes with a simplified structure of low rates.

- Despite the difficulties involved, both Brazil and Argentina remain committed to MERCOSUR, as does Paraguay and Uruguay.

In a number of cases these agreements go well beyond a simple pact to reduce bilateral trade barriers and tariffs. There also has been major progress in deregulation and advancing the development and integration of regional capital markets and reducing barriers to the free flow of investment -- both physical and financial. For example, the agreements between Colombia and Venezuela also call for the integration of the stock and bond markets of the two countries, an idea that is truly visionary in scope. Similar cooperation, coordination, and mutual access is being discussed by a number of other countries in South America and directly complement the more obvious efforts in trade. These efforts, which blend deregulation and a broadening in the ownership of national wealth will help spread the benefits of growth and adjustment to all level of society. This is absolutely crucial to ensuring a firm foundation for both democracy and the market.

The rapid growth of bilateral agreements and the ensuing web of interlocking trade and investment liberalization pacts are much more than simple reactions to the threat of competition from NAFTA. A broader and more positive agenda appears to be at play -- one in which countries can build on recent reforms to facilitate intra-regional trade, investment, and growth.

- The bilateral Framework Agreements on Trade and Investment adopted by nearly every country in the hemisphere with the United States have provided an opportunity to build a consensus among countries in the region. This consensus supports the fundamental principles of free and fair trade and, in turn, has facilitated trade and investment throughout the hemisphere.

- Just as sound macroeconomic policies and improved investment regimes have improved the competitive position and attractiveness of individual countries, it has also tended to highlight the need to reach beyond limited domestic markets.

- Similarly, increased economic stability and more closely harmonized national economic policies have highlighted the advantages of economies of scale in production, and this is now developing in MERCOSUR and between Colombia and Venezuela.

- The existence of more uniform rules and standards across countries has made these countries more attractive to the international financial community. The end result is more efficient and competitive capital markets.

The integration process in Latin America and the Caribbean has not been without difficulty. Reduced barriers to trade and investment and the move to free markets have increased cross-border sensitivity to divergent macroeconomic policies and strategies. It is difficult, for example to promote integration beyond a very basic level if two countries have widely divergent inflation rates and differing exchange rate and interest rate strategies.

However, integration is not working in every case. In some individual countries restrictive, inward-looking protectionist trade and investment regimes are not being dismantled with sufficient speed. Such policies hinder sub-regional integration.
In many respects the Andean Pact has dissolved into a series of bilateral agreements, largely due to a lack of political commitment and a history of widely divergent macro-economic policies. Elsewhere, the Central American Common Market remains a largely theoretical construct, with the exception of the progress being made in the northern tier countries in the trilateral accord. That agreement is leading the way to sub-regional integration in Central America.

Sub-Regional Integration

For the Caribbean and Central America, successful integration must rest upon a commitment to an outward-looking program, keyed to a goal of low external tariffs and elimination of non-tariff barriers coupled with reduced barriers to the free flow of capital in an environment conducive to investment -- both national and foreign.

The focus of Caribbean integration, however, has been largely inward-looking with a continued adherence to an import-substitution growth model. This policy pattern risks stagnation and isolation. Although the Organization of Eastern Caribbean States (OECS) is unique within Latin America and the Caribbean in its achievement of a monetary union, progress towards broader integration has been slow. Mobility of capital and labor are either tightly controlled or non-existent. Efforts geared to fostering a region-wide market served by regional firms have been halting. This sub-region is particularly challenged by broader movement to hemispheric integration due to the very small size of some national markets and their high standards of living, reflected in some of the highest per capita incomes in the hemisphere.

For the OECS, effective integration into the hemisphere will become increasingly urgent and critical to maintaining existing standards of living. Creative energy needs to be applied immediately by leadership in this region to position national economies on a more competitive basis. Failure to do so will see incomes erode and frustration grow.

Until recently, movement to integration in CARICOM has been hampered by a common external tariff (CET) of 40%. Although we welcome the agreement by CARICOM leaders to a phased reduction of the CET to 5-20 percent by January 1998, non-tariff barriers remain pervasive.

In Central America, I have already noted the progress being registered in the joint efforts of El Salvador, Guatemala, and Honduras. Although other countries in the region may be able to join this group with time, several remain far from willing to open their financial systems or economies to the rigors of competition.

The Role of External Support

The Enterprise for the Americas Initiative remains the defining framework for our economic and financial cooperation, support, and partnership with the countries of the Latin America and the Caribbean. The United States continues to stand ready to enter into bilateral official debt reduction agreements under the provisions of the EAI and, I am pleased to note, a number of additional countries are expected to become eligible for such benefits before year-end. On the trade front, we remain committed to the a hemisphere free trade zone, beginning with NAFTA.

The United States believes firmly that economic stabilization and regional integration needs to be actively supported by the multilateral institutions, specifically the International Monetary Fund, World Bank, and Inter-American Development Bank.

We have looked to the Inter-American Development Bank -- an institution controlled by the countries of Latin America and the Caribbean -- to play a major role in the Enterprise for the Americas Initiative. That institution is central to the region's economic recovery. It is playing a key role in the investment reform process through Investment Sector Loans and will soon be providing additional funds through the Multilateral Investment Fund. The MIF will have three separate facilities:

- a technical assistance facility to identify and implement policy changes needed to transform recipient economies;
- a human resources facility to train workers involved in the transition to more open investment regimes; and
- an enterprise development facility to invest in small business.

The MIF, which is now near its $1.5 billion funding target, has been structured so that non-member countries in the Caribbean can access its resources through the Caribbean Development Bank.

The United States believes the IDB's long-term role in the region needs to be enhanced. This belief was the basis for the U.S. proposal in September 1992 for the 8th Replenishment of the IDB, which called for a healthy increase in the resources available to

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the Bank. In that proposal we asked that fully 50% of the IDB's future lending be used to support economic opportunity, social sector development and governance objectives in all borrowing countries.

Conclusion

The economic progress of Latin America and the Caribbean continues to advance. It is attracting record levels of capital inflows, investor interest and renewed attention in voluntary capital markets. This progress has been underscored and reinforced by a new hemispheric partnership, a partnership characterized by new links joining and strengthening the economic and financial systems in the hemisphere.

At a meeting of eleven Latin American Finance Ministers with Treasury Secretary Brady last June, this new partnership was reconfirmed. In their joint statement, the Ministers emphasized the importance of our mutual interests in achieving stronger economies and stable democracies. They noted the importance of sustained economic recovery and adjustment and the need to broaden the benefits of growth to all levels of society. They also noted the crucial role played by open trade and investment regimes.

Nearly every country in the hemisphere is now engaged in a process of self-examination, restructuring and adjustment to meet the economic, social and political opportunities unfolding in the region. While the details and timing vary from country to country, the direction is clear.

In the case of the Caribbean Basin, national leaders face a rapidly changing trade and investment environment. The immediate need for reform and integration of markets implied by NAFTA demands sound economic management, increased reliance on market mechanisms, improved efficiency, a more hospitable climate for investment and greater regional cooperation and integration. Effective regional integration is particularly important if the countries in the region are to be competitive in the years ahead.

NAFTA is not the only challenge facing the Caribbean. One day Cuba will no longer be a dictatorship. I believe that it will one day be a democracy eager to rejoin the community of nations as a market economy. When this occurs -- and it most surely will -- the Caribbean will face new competition for private capital, development assistance, tourism, and export markets.

The potential for expanding markets and growth in the region is enough to sustain the region's economies in the face of NAFTA, a free Cuba, and a more open and competitive trading environment. But this growth cannot occur unless complacency and dependency is replaced by energetic leadership looking to the future.

Our mutual efforts to transform the hemisphere quickly and to secure greater benefits through cooperation and open markets is an unprecedented opportunity. We must have the courage to seize that opportunity now.

Doris Meissner and T. Alexander Aleinikoff

Target the Misery in Haiti

Surges of Haitian boat people bound for Florida on the heels of the inauguration would be the worst of all beginnings for the Clinton administration. Almost certainly we would see drownings on our shores and an unpracticed new team delivering an ineffectual performance.

Is this unhappy prospect inevitable? Not if the president-elect keeps to his pronouncements about the need for bold foreign policy leadership based on our beliefs in democracy and human rights. The case of Haiti is tailor-made.

For starters, the incoming administration's policy message must expand to focus squarely on the conditions in Haiti that spawn chaotic, dangerous boat journeys. Mr. Clinton's statements have properly spotlighted the importance of granting Haitians a fair interview to determine whether they qualify as refugees. However, this has not only been read by Haitians as an invitation to depart, it is also an insufficient—and ultimately self-defeating—response to migration pressures in Haiti.

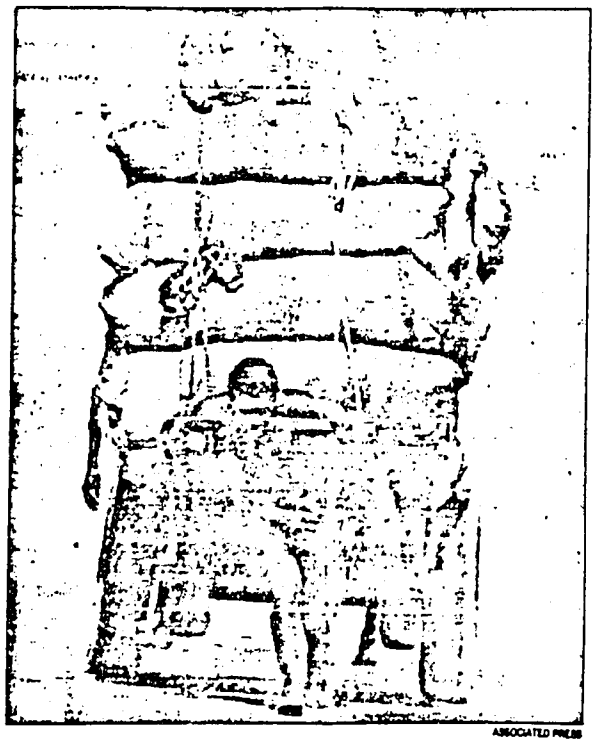
Haitians leave to escape endemic, widespread human rights abuses, a dictatorship that stole the country's first-ever free election and the worst poverty in the hemisphere. It is these conditions that must be the target of U.S. policy. Of the three, human rights are the most susceptible to early improvements that address the reasons people flee and are consistent with the ultimate goal of advancing democracy.

To avert an early humanitarian and political crisis, Clinton should publicly declare his support for democracy in Haiti and commit his administration to these actions:

■ Launch a vigorous, immediate attack on human rights abuses in Haiti. The Organization of American States monitoring effort must be significantly strengthened, particularly in the countryside, and United Nations participation should be pursued. U.S. officials should work collaboratively with the international human rights community to expose and denounce abuses. Refugee-screening offices should be opened outside Port au Prince, so those in immediate danger can apply for refugee admission to the United States from a number of places within Haiti.

■ Name the Latin American policy team quickly, and assign high priority to Haitian policy. Using U.S. power and influence to build democracy in a country lacking democratic institutions and traditions is a long-term, tenuous proposition. *En route*, there are thorny questions. Should the economic embargo be lifted or strengthened? Do we insist on President Jean-Bertrand Aristide's return or facilitate negotiations that could produce another outcome? Should the coup leaders be punished? Is the OAS the best broker? How should U.N. actions be brought to bear? New policy-makers must debate these matters and set a strategy for advancing the democracy agenda.

■ Lift the Bush order for summary return of Haitians as soon as fair processing can be ensured. Safety and humane treatment must be our objective for individual Haitians, as it is for all putative refugees. That requires interviews for all boat people and refugee resettlement for those who qualify, including those still being held at Guantanamo. Planning must be done quickly to avoid defending the Bush policy before the Supreme Court in February. Nonetheless, the new administration needs some time to organize a sensible procedure. It should declare its intent to lift Bush's summary return order once refugee processing within Haiti is expanded, when refugee processing centers in the Caribbean, possibly including Guantanamo, have been readied and when the U.N. High Commissioner for Refugees and other staff have been deployed to interview boat people and make refugee determinations.



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The combination of immediate attention to human rights, a sustained effort to build democracy and fair orderly processing is the best chance the new administration has to balance generosity with control in the face of a migration crisis and to diminish the need for boat departures over time.

In our post-Cold War world, it is internal weaknesses—instability, environmental degradation, overpopulation, poverty—that are emerging as serious threats to the security and well-being of powerful nations. This calls for confronting places like Haiti not simply as a problem of damage control but as a marker of new standards and initiatives for a new age.

Doris Meissner is a senior associate at the Carnegie Endowment for International Peace and former acting commissioner of the Immigration and Naturalization Service. T. Alexander Aleinikoff is a law professor at the University of Michigan.

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