PN-ABP-030

AFRICA
QUARTER 2, 1991

WASHINGTON ECONOMIC WATCH

A Digest of Development Policy Information

A Project of the Overseas Development Council

WASHINGTON ECONOMIC WATCH

A Digest of Development Policy Information

17 Massachusetts Ave. NW
Suite 501
Washington, DC 20036

(202)234-8701
fax (202)745-0067

July 8, 1991

Dear Reader:

The end of the Cold War continues to bring changes in U.S. economic policy toward the Third World. With this second edition of the 1991 series of the Washington Economic Watch, we are pleased to provide you with pertinent information on the major Washington policy debates of the past quarter.

The critical policy issues of the quarter include debate on the foreign assistance budget, the fast-track procedure for trade negotiations, and the evolving role of multilateral lending institutions. The deliberations over the 1992 foreign assistance budget have recently expanded with the introduction of several alternative post-Cold War budget proposals. In trade, the Uruguay Round of GATT negotiations and the U.S.-Mexico Free Trade Area talks were given new life with the extension of the fast-track negotiating mechanism. And, in finance, the role of the World Bank and the IMF in private sector development and a capital increase for the IFC were hotly debated. The WEW covers these as well as many other ongoing policy issues of concern to the U.S. and the Third World.

We would like to take this opportunity to remind you of the new reciprocal arrangement between the American University Library in Washington, DC and WEW subscribers. If you have not yet sent us a list of your institution's publications, please do so at your earliest possible convenience. With your help, we can create a unique and much needed exchange of information between the U.S. and the Third World.

Sincerely,

Richard E. Feinberg

Richard E. Feinberg
Executive Vice President
and Director of Studies

WASHINGTON ECONOMIC WATCH CONTACT LIST

1. Research Organizations and Other Non-Profits

American Enterprise Institute
1150 Seventeenth St. NW
Washington, DC 20036
202-342-5000

Atlantic Council of the U.S.
1616 H St. NW
Washington DC 20036
202-347-9353

The Brookings Institution
1775 Massachusetts Ave. NW
Washington, DC 20036
202-797-6000

Carnegie Endowment for International Peace
2400 N St. NW
Washington, DC 20037-1196
202-862-7900

The Cato Institute
224 Second St., SE
Washington, DC 20003
202-546-0200

Center on Budget and Policy Priorities
777 N.Capitol St. NE, Suite 705
Washington, DC 20002
202-544-0591

Center for International Policy
1755 Massachusetts Ave. NW
Washington, DC 20036
202-232-3317

Center for National Policy
317 Massachusetts Ave. NE
Washington, DC 20002
202-546-9300

Center for Strategic and International Studies
1800 K St. NW
Washington, DC 20006
202-887-0200

Committee for Economic Development
477 Madison Ave.
New York, NY 10022
212-688-2063

The Conference Board
845 Third Avenue
New York, NY 10022-6601
212-759-0900

Economic Policy Institute
1730 Rhode Island Ave. NW
Washington, DC 20036
202-775-8810

Environmental Defense Fund
1616 P St. NW
Washington, DC 20036
202-387-3500

Environmental and Energy Study Institute
122 C St. NW, Suite 700
Washington, DC 20001
202-628-1400

The Heritage Foundation
214 Massachusetts Ave. NE
Washington, DC 20002
202-546-4400

Indochina Project
318 4th St. NE, Second Floor
Washington, DC 20002
202-547-5075

Institute for International Economics
11 Dupont Circle, NW
Washington, DC 20036
202-328-0583

Institute for International Finance
2000 Pennsylvania Ave. NW
Washington, DC 20006
202-857-3600

Institute for Policy Studies
1601 Connecticut Ave. NW
Washington, DC 20009
202-234-9382

InterAction
1815 H St. NW 11th Floor
Washington, DC 20006
202-822-8429

Inter-American Dialogue
The Aspen Institute
1333 New Hampshire Ave. NW
Suite 1070
Washington, DC 20036
202-466-6410

Inter-Faith Action for Economic Justice
110 Maryland Ave. NE
Washington, DC 20002
202-543-2800

International Center for Research on Women
1717 Massachusetts Ave. NW
Suite 301
Washington, DC 20036
202-797-0007

International Food Policy Research Institute
1776 Massachusetts Ave. NW
Washington, DC 20036
202-862-5600

International Freedom Foundation
200 G Street
Suite 300
Washington, DC 20002
202-546-5788

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

Middle East Institute
1761 N St., NW
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
617-868-3900

National Planning Association
1424 Sixteenth St. NW Suite 700
Washington, DC 20036
202-265-7685

Panos Institute
1409 King St.
Alexandria, VA 22314
703-836-1302

Population Council
1 Dag Hammerskjold Plaza
New York, NY 10017
212-644-1300

Population Crisis Committee
1120 19th St. NW
Washington, DC 20036
202-659-1833

Population Reference Bureau
777 14th St. NW
Washington, DC 20005
202-639-8040

Rand Corporation
1700 Main St.
Santa Monica, CA 90406-2138
213-393-0411

Refugee Policy Group
1424 16th St. NW Suite 401
Washington, DC 20036
202-387-3015

Resources for the Future
1616 P St. NW
Washington, DC 20036
202-328-5000

SRI International
333 Ravenswood Ave.
Menlo Park, CA 94025
415-326-6200

United Nations Association of the USA
1010 Vermont Ave. NW
Suite 904
Washington, DC 20005
202-347-5004

U.S. Institute for Peace
1550 M St. NW
Washington, DC 20005
202-457-1700

The Washington Institute
1015 18th St. NW
Washington, DC 20036
202-293-7440

Washington Office on Latin America
110 Maryland Ave. NE
Washington, DC 20002
202-544-8045

Latin America Program
Woodrow Wilson International Center for Scholars
1000 Jefferson Dr. SW
Washington, DC 20560
202-357-2429

World Policy Institute
777 United Nations Plaza
New York, NY 10017
212-490-0010

World Resources Institute
1709 New York Ave. NW
Washington, DC 20006
202-638-6300

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

2. U.S. Governmental Organizations

African Development Foundation
1625 Massacusetts Ave., NW
Washington, DC 20036

Agency for International Development
Department of State Building
320 Twenty-first St., NW
Washington, DC 20523

Congressional Budget Office
House Office Bldg. Annex II
Second and D Streets, SW, Fourth Floor
Washington, DC 20515

Council of Economic Advisors
Old Executive Ofc. Bldg.
17th St. and Penn. Ave., NW
Washington, DC 20500

Department of Agriculture
14th St. and Independence Ave., SW
Washington, DC 20250

Department of Commerce
14th St. and Constitution Ave., NW
Washington, DC 20230

Department of Defense
The Pentagon
Washington, DC 20301

Department of Energy
Forrestal Building
1000 Independence Ave., SW
Washington, DC 20585

Department of Justice
Tenth Street and Constitution Ave., NW
Washington, DC 20530

Department of State
2201 C St. NW
Washington, DC 20520

X

Department of the Treasury
1500 Pennsylvania Ave. NW
Washington, DC 20220

Drug Enforcement Agency
C Street between 18th and 19th Streets, NW
Washington, DC 20240

Environmental Protection Agency
401 M St. SW
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
20th and Constitution Ave., NW
Washington, DC 20551

Federal Trade Commission
Sixth Street and Pennsylvania Ave., NW
Washington, DC 20580

General Accounting Office
441 G St. NW
Washington, DC 20548

Inter-American Foundation
1515 Wilson Blvd.
Rosslyn, VA 22209

International Trade Commission
500 E St. SW
Washington, DC 20436

Joint Economic Committee
SD-G01 Dirksen Senate Off. Bldg.
Washington, DC 20510

National Academy of Sciences
Bureau of Science and Technology in Development
2101 Constitution Ave.
Washington, DC 20418

Office of Management and Budget
Old Executive Ofc. Bldg.
17th St. & Penn. Ave., NW
Washington DC 20503

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

Office of Public Affairs
Executive Office of the President
1600 Pennsylvania Ave., NW
Washington, DC 20500

Office of Technological Assessment
600 Pennsylvania Ave., SE
Washington, DC 20003

Office of the United States Trade Representative
Winder Building, #600
Seventeenth St.,NW
Washington, DC 20506

Overseas Private Investment Corporation
1615 M St. NW, Fourth Floor
Washington, DC 20527

3. International Organizations

Inter-American Development Bank
1300 New York Ave. NW
Washington, DC 20577

International Monetary Fund
700 19th St. NW
Washington, DC 20431

Organization of American States
17th St. and Constitution Ave. NW
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

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 Suite
1220
Washington, DC 20036

Latin Finance
2121 Ponce de Leon Blvd.
Suite 1020
Coral Gables, FL 33134

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

TRADE

Lawrence, Robert Z. _An Examination of Major Factors Affecting U.S. International Competitiveness_, Statement before the Committee on Ways and Means, U.S. House of Representatives, June 6, 1991.

"International Trade Agreements: Fast Track Procedures," _Foreign Policy Bulletin_, May/June 1991.

Marchick, David. "Democrats Flubbed Fast-Track," _The Journal of Commerce_, June 25, 1991.

Stokes, Bruce. "Battling Jobs Scenarios," _National Journal_, May 11, 1991.

Davis, Phillip A. "Environmental Opposition Fading," _Congressional Quarterly_, May 18, 1991.

Hair, Jay D. "Nature Can Live With Free Trade," _The New York Times_, May 19, 1991.

Weintraub, Sidney. "Making Regionalism Work," _LatinFinance_, Number 25, March 1991.

Stokes Bruce, "Launching The Eastern Bloc," _National Journal_, April 20, 1991.

Bovard, James. "Feed the Soviets, Starve the Taxpayer," _The New York Times_, June 15, 1991.

Sullivan, Paige and Raimo Kaasik. "Trade Benefits for the Baltics," _The Journal of Commerce_, June 18, 1991.

Hamilton, Lee H. "The U.S. Should Use Its Leverage With China," _The Christian Science Monitor_, May 17, 1991.

Cohen, Richard. "One Nation That Should Not Be Favored in Any Way," _The Washington Post_, May 30, 1991.

Baker, Pauline H. "South Africa, When to Lift Sanctions," _The Washington Post_, June 18, 1991.

Nickel, Herman W. "Formula for Chaos," _The Washington Post_, June 24, 1991.

Moore, Julia A. "End Sanctions, or the Hate Will Never Die," _Los Angeles Times_, June 14, 1991.

Clawson, Patrick. "Sanctions Can't Topple Saddam," _The Washington Post_, June 23, 1991.

Boughton, James M. "Commodity and Manufactures Prices in the Long Run," International Monetary Fund Working Paper, IMF, May 1991. (Summary)

8

Statement of Robert Z. Lawrence*
Senior Fellow, The Brookings Institution
before the
Committee on Ways and Means
U.S. House of Representatives
June 6, 1991

An Examination of Major Factors Affecting
U.S. International Competitiveness

What is competitiveness? The first problem one confronts in testifying on U.S. competitiveness is deciding what "American competitiveness" means. Actually, we need to be precise both about what we mean by "American" and what we mean by "competitiveness."

In a world of multinational companies like IBM Japan and Honda USA, it is increasingly difficult to separate what is American from what is not. In my view the principal focus of U.S. policy should be geographic. Our concern should be for the competitiveness and well-being of U.S residents. Our policy should emphasize the competitiveness of the United States as a location for production, rather than the competitiveness of U.S.-owned firms, regardless of where they are located. Of course, this may require pursuing the interests of American multinationals, but firms located in the United States should have priority.

It is also not easy to define "competitiveness", for it is a word like "love" or "democracy" which has several meanings. The question, "Is America competitive?", has at least three interpretations. First, how does America compare? Second, how

*The responsibility for this statement is mine alone and does not reflect the views of the Brookings Institution, its officers, trustees, or other staff members.

9

well is the U.S. performing in international trade? And third, "Is the U.S. doing as well as it could?" In this testimony I will try to answer each of these questions in turn.

How does America compare? The U.S. position in the world today is best characterized as "first among equals," as judged by major indicators of economic performance. By the best measures we have, American living standards are higher and American workers more productive than those in other major economies. According to the Bureau of Labor Statistics, in 1989 for example, GDP per employed person in France, Germany and Japan were 85.9, 82.0 and 72.7 percent of those in the United States. Output per worker in U.S. manufacturing is likewise the world's highest.

What is striking, however, is how the relative position of the U.S. has changed. In 1960, for example, GDP employed person in France and Germany was less than fifty percent the U.S. level, while in Japan it was less than a quarter. But since then, productivity growth in the United States has been slower than productivity growth elsewhere. As a result, foreign living standards and productivity levels are converging to those of the U.S.

This convergence of other economies toward U.S. output levels has been the subject of much hand-wringing. But given that foreign economic development was the avowed objective of U.S. foreign policy, its success should hardly be taken as a sign of American failure. Some allege that the burden of military spending (imperial overstretch) has been the chief cause of America's relative decline. But in fact, this argument presumes, if the U.S. had not spent as much on defense, it would have used the money for technological improvements and domestic investment. It is more likely, however, that any dividend from reduced defense spending would have been spent in the same proportions as the rest of U.S. incomes have been spent -- that is, 94 percent would be consumed and only 6 percent invested.

Instead, the real explanation for America's slower productivity growth is a simple fact of life: it is easier to copy than to innovate. As the country at the technological frontier, Americans had to innovate to increase productivity growth. Foreigners, on the other hand, could increase productivity by adopting and copying U.S. practices.

Increasingly, however, foreigners have shifted from catching-up to leading. Although U.S. productivity in manufacturing remains the world's highest, in some industries (automobiles, electronics and technologies) levels in Japan have surpassed those in the United States. In part, this is also because foreign economies have been accumulating capital per worker at a more rapid pace than the United States has, and because the share of GNP spent on civilian research and development in economies such as Japan and Germany exceeds that of the United States. In the past, reflecting their technological and managerial advantages, U.S. firms found opportunities to set up manufacturing and marketing operations abroad. In the 1980s, foreign firms increasingly find their technological capabilities afford them profitable opportunities for direct foreign investment in the U.S.

It is important to recognize that the relative decline of the United States has differing implications for American power and for American living standards. The power of a nation flows from its relative economic capacity -- the economic performance of the United States compared with other nations, particularly its adversaries. In this respect, the power of the United States declines in a richer world economy. On the other hand, the welfare of a nation's citizens is largely a function of its absolute economic capacity; living standards are primarily based on a nation's productivity, which is promoted, not reduced when increased innovation abroad provides U.S. consumers access to better products and U.S. manufacturers more opportunities to emulate foreign products and processes. Indeed, while U.S. productivity grew more slowly than other developed economies over the years 1950-1973 when most of the convergence took place, these years were nonetheless, the most prosperous in our nation's history.

The growing equalization of technological capabilities also has important implications for U.S. performance. It implies that nations have become increasingly close substitutes as locations for production. This makes trade and investment flows much more sensitive to differences in all factors which influence costs, including wages and skills and differences in national tax and regulatory policies. In addition to implying greater competitive pressures on U.S. firms and U.S. policy, however, convergence also offers the U.S. new opportunities. We no longer have to carry the burden of global innovation alone. If our economy and our minds are open, we can now learn from others.

For a variety of reasons the environment for U.S. policy has become extremely complex. On the one hand, the growing international competitive pressures on U.S. firms, the need to respond to foreign industrial policies, the increased importance of commercial technology for national defense, and the need for increased collaboration among firms have all created demands for U.S. government aid and protection. On the other hand, the proliferation of corporate interpenetration and joint production among companies of differing national ownership has made it increasingly difficult for governments to know exactly which interventions do and which do not advance interests of its own firms, workers and citizens. This latter development is often less appreciated than the former.[1]

America's overall economic performance since 1973 compares poorly with its historical average. Not only has the growth in output per manhour been slower than other countries, and slower than it was between 1950 and 1973, but is is only half the rate of 2.2 percent recorded over the previous century.[2] Since Americans produce 86 percent of what we consume, this poor productivity performance has been reflected in an unusually slow increase in U.S. living standards and in stagnating real wages. Over this same period, the U.S. suffered numerous shocks from the world economy, including the emergence of a large trade deficit after 1981.

It is tempting to blame the sluggish growth in U.S. productivity and earnings on the changed international environment and argue that the unfair trade practices of others have reduced American productivity and living standards. But an examination of the data indicate that productivity growth has slumped mainly in sectors that do not engage in international trade. Actually, productivity growth in U.S. manufacturing (which usually directly competes with foreign firms) has accelerated in the 1980s and returned to its pre-1973 pace. Since most of the goods and services consumed by Americans are produced by Americans, as in the past,

1. For a more complete discussion, see Robert Z. Lawrence, "Innovation and Trade: Meeting the Foreign Challenge" in Henry J. Aaron, ed., Setting National Priorities: Policies for the Nineties (Brookings, 1990), pp. 145-84.

2. Angus Maddison, "Growth and Slowdown in Advanced Capitalist Economies," Journal of Economic Literature (June 1987), p. 683.

13

American's future standard of living will depend on gains in the economy as a whole. Services sector productivity in particular should not be neglected.

How well has America performed in international trade? It is tempting to use the trade balance as a measure of trade performance, but our trade deficit reflects the fact that Americans are spending more than they produce, rather than that our products have have become less attractive in world markets. The only way a country can consume more than it produces is to import the difference from abroad. The trade deficit indicates the amount the nation is borrowing from abroad. America is borrowing because of the behavior of both the government and the private sector. If the government increases its borrowing, either the private sector must be prepared to increase its lending or the country as a whole must borrow from abroad. In the 1980s, however, when the government increased its borrowing, the private sector actually saved less. Thus the rise in federal budget deficit was associated with an increase in overall national borrowing, i.e., with a larger trade deficit.

If the trade imbalance reflected increased borrowing to fund investment, we need not be concerned. Presumably the money would finance capital formation that would make U.S. workers more productive in the future. Unfortunately it has not. In 1990 the Gross Fixed Private Investment was only 13.6 percent of GNP versus 16 percent in 1980. Had we saved the same share of income in 1990 as we did in 1980 (i.e., 16.3 percent) we could have financed our investment and run a trade surplus of $148 billion!

What matters for national living standards, however, is the price of U.S. products required to maintain any given trade balance. Our overall trade balance is determined by our quantities of consumption and production. But the price which we must pay for a given trade balance is determined by our competitiveness. A loss of competitiveness implies that the prices of American goods must fall in world markets to finance imports. A decline in the terms of trade (a fall in the price of American exports relative to the price of imports) adversely affects the living standards of Americans, because they must give up more resources to obtain a given amount of imports. If the terms of trade must fall to maintain a constant trade balance, the United States suffers a loss in trade competitiveness.

Unfortunately, there is evidence that over the 1980s, the U.S. has indeed experienced such a loss of competitiveness. As can be seen in Figure 1, despite the fact that the dollar is now roughly as weak as it was in 1980, our trade balance remains at much lower levels than in 1980 (-.7 percent now versus +1.2 percent of GNP then). Thus it would now take an even weaker dollar to restore the trade balance to the level of 1980. In a recent study, I found that the dollar needed to be about ten percent lower than it was in 1980 to achieve the same trade balance.[3] Since imports are around 13 percent of domestic consumption, this translates into a loss of living standards of just over one tenth of a percent per year. So our trade competitiveness problem exists, but its impact on living standards should not be exaggerated. In terms of retarding living standards, our international competitiveness is only about a tenth of the problem presented by the decline in productivity growth generally.

---

3. See Robert Z. Lawrence, "U.S. Current Account Adjustment: An Appraisal," Brookings Papers on Economic Activity, 2:1990, pp. 343-92.

15

Are we doing the best we can? What policies should be followed to deal with America's changed global position and its relatively poor trade performance? Space permits me only a brief treatment here.

Productivity growth. The growth in American living standards has slowed because U.S. productivity growth has fallen. Although improvements in productivity may improve competitiveness and U.S. trade performance, their primary importance is as a source of gains in overall standards of living. They are beneficial regardless of whether or not the nation engages in trade. Moreover, they are of approximately equal value in industries that do and do not engage in trade. We should neither neglect nor emphasize manufacturing -- and indeed, since our productivity performance in services has been so poor recently, there may be more room for improvements in the service sectors than elsewhere.

Although much of the post-1973 slowdown in U.S. productivity growth remains a puzzle, existing studies do agree on a partial agenda of actions that the government could take to reverse the trend. It could encourage a higher rate of private capital formation; it could increase its own investments in the social infrastructure (for example, transportation); it could expand research and development outlays; and it could improve the quantity and quality of education. Government has traditionally played a role in all these areas, but that role costs money. To finance these efforts, Americans must be willing to reduce their current level of public or private consumption. In a country already faced with large deficits on its government budget and heavy overseas borrowing, greater spending in these areas will be very difficult to achieve.

None of the actions, moreover, will have large immediate effects on economic growth. They do not, as is sometimes suggested, provide a means for the United States to grow out of its second major economic problem, the budget deficit.

Increased savings. In the immediate future, the dominant issue for American economic policy is how to cut the growth of consumption, both to eliminate the need to borrow abroad and to provide the investment resources to improve U.S. living standards in the future. From a political perspective, slower consumption growth is a dismal prospect, and the extent to which political debate seeks to redirect public attention to the international arena and to blame the policies of other countries should not be a surprise. If the United States lowers its budget deficit, however, it will increase the national rate of saving, and market forces, supported by an easier monetary policy, will translate that saving into a lower trade deficit and a higher rate of domestic investment. Once it has reestablished a balance between its current government programs and the taxes to finance them, the country will be able to engage in a rational debate over the merits of spending more money to foster productivity growth.

Trade and innovation policy. The United States no longer falls neatly into the category of either leader or follower. In the past the U.S. strategy was clear. As the world's technological leader, the United States wanted free markets at home and open markets for its products abroad. As the free world's leader, it wanted to contain Soviet expansion with a strong military at home and prosperity abroad. But today U.S. policies reflect the growing pressures of its changed global status; the U.S. technological position has changed to "first among equals." The concern of the technological leader, to achieve unrestricted access to foreign markets, has been tempered by the concern of the follower, to nurture domestic firms. As American conflicts with the Soviet Union have become less threatening, the concern of the superpower, to contain Soviet aggression, has been tempered by concerns about commercial rivalries with allies and an eroding industrial base.

The challenge for U.S. policies in this new environment is to steer between two extremes. On the one hand, the United States can no longer take its commercial innovation for granted, nor can it ignore those foreign policies that damage its living standards. On the other hand, the United States must avoid nationalistic, protectionist intervention through sectoral industrial policies at home and managed trade abroad. U.S. policies should stimulate innovation and diffusion within the United States. They should also allow the United States to take full advantage of global markets through access to foreign markets, products, and technology.

Innovation. There is a theoretical case for government intervention to stimulate innovation. It rests on the excess of social over private rates of return. Empirical studies confirm that the difference is large and exists both for basic research and commercial R&D. The generally poor U.S. productivity performance over the past two decades strengthens the case for increased government support. Private markets may also prevent the optimal diffusion of technology. Thus policies to hasten technological diffusion should not be overlooked.

Historically, the United States relied on market forces to develop commercial technology. The emphasis was on preserving competition through antitrust policies rather than on providing incentives for innovation. Within this framework the government confined its financial support for innovation either to sectors with a clear public purpose, such as national defense, space, health, and basic research, or to activities in which commercial support seemed inadequate for social needs, such as synthetic fuels, breeder nuclear reactors, and the "Project Breakthrough" to improve methods for residential construction.

United States innovation policies must now respond to our changed international position. On the one hand, the United States remains the world's largest economic power. U.S. policies reverberate in other countries. Our policies at home should therefore be compatible with our demands on others.

The U.S. should have a general grants program to provide partial funding for pre-competitive, generic commercial research. It should also stimulate research through an enhanced permanent research and development credit. But extensive programs designed to promote firms or sectors should be avoided. There are no easy principles for selecting sectors to be favored and there are great dangers such programs will be captured by interests that will serve their own, rather than the nation's goals. Moreover, in a global economy, the links between product development and production are uncertain.

The U.S. should also improve mechanisms for diffusing technology. The most important is ensuring competition. Anti-trust laws can be relaxed to encourage collaborative ventures in basic and pre-competitive research. They should be vigorously applied, at the global level, however, to prevent unwarranted exercise of potential monopoly powers. Diffusion is also aided by speedy provision of standards, and programs to improve worker training and managerial competence.

Trade. Historically, the United States sought a liberal global trading order. Its policies aimed to open foreign markets not only for U.S. products but also for products of all nations. With U.S. leadership a series of multilateral negotiations under the General Agreement on Tariffs and Trade (GATT) diffused reductions in trade barriers through the principle of most favored nation treatment. If any GATT member granted another member a lower tariff, all GATT members were entitled to similar treatment.

The goal of an open multilateral trading system should continue be the principle U.S. trade policy objective and the GATT should continue to serve as the focal point of U.S. policy. It should be supplemented, however, by open regional arrangements such as the North American Free Trade Arrangement, the Enterprise for the America's Initiative and a new open Pacific Initiative. In all cases, these arrangements should invite countries to negotiate the removal of tariffs and other barriers to the free movement of goods, services and investment. The key is to that such trading arrangements be building blocks rather than stumbling blocks towards the ultimate goal of an integrated global economy.

The United States has seldom used trade policies to protect its high-technology products and it should continue this restraint. But as long as the United States provides foreigners with the ability to profit from sales here, it is justified in demanding similar access for its own firms and its own exports to markets abroad. Because scale economies are critical in the development of many high-technology products, a protected home market can give domestic firms an unfair advantage. A protected home market like Japan can also provide domestic firms with surplus profits they can use to accelerate their technological development.[4] The United

---

4. Especially for newer industries, capital markets are far from perfect so that access to large amounts of internally generated funds does provide an important advantage for further expansion and technological gains.

1E

States must insist that mature industrial economies not adopt infant industry approaches. This would involve several specific trade policies.

First, with respect to firms operating abroad, the United States should demand that all countries treat high-technology companies of all nations identically. If programs for R&D development are organized in the European Community, Japan, or the United States, foreign-owned firms should be allowed to participate. The United States should make participation by the firms of other countries in U.S. government-funded research programs and institutions contingent on the granting of "national treatment" to U.S. firms operating abroad -- i.e., they should be given equal treatment with domestic firms.

Second, if foreigners protect high-technology sectors with barriers against imports, the United States should impose tariffs on the sale of products developed that way. The key lies in putting foreign countries on notice during the development phase of such programs, rather than in waiting until U.S. importers have become dependent on such products as was the case with Japanese semi-conductors. Carrying out such a policy will require the use of actions under section 301 of the Trade Act of 1974 which are directed at targeted programs in their initial stages.

Two changes need to be made in U.S. anti-dumping policy. First of all, it needs to be retargeted. The current emphasis on preventing firms from selling below "full costs" is normally an unwarranted interference with normal business practices and needlessly costly to American consumers.[5] Emphasis should be shifted to preventing classical price discrimination -- that is, selling abroad at lower

5. There are exceptions, however; see the discussion below on anti-trust policy.

prices than are charged in the home market, which is universally recognized as an unfair trade practice. But second, the retargeted anti-dumping laws should be promptly and strictly enforced. A more severe penalty for discriminatory dumping should be applied.

The United States should not succumb to the temptation to negotiate a market share for its firms. This approach will not solve the essential problem which stems from the fact that the foreign market is not open. Indeed, it is likely to reinforce foreign monopoly powers. Managed trade arrangements to limit imports or promote exports should also be avoided. Generally these arrangements have unintended consequences are are often actually counterproductive.

Global anti-trust policies. Unlike the situation in the first three decades after the second world war, the United States is no longer the overwhelming source of technological advance and industrial innovation in the world. So long as we ourselves remain a vigorous economy the fact that we now have more nearly equal partners is a healthy, and in any event, inevitable development. But one consequence is that we cannot expect that the United States to be major player in every new industrial and technological specialty. And so, this country is likely to become dependent on foreign supplies for some important high-technology products.

In the United States, but also abroad, it will be tempting to subsidize domestic production on the grounds that dependence on foreign suppliers (and owners) renders the country vulnerable to foreign pressures, political and economic. Occasionally this argument will be compelling. But not all dependence is bad, while the policies which would seek to avoid all instances of dependence would be. If foreign suppliers are geographically diverse and compete vigorously, countries have little to fear from dependence on foreign ownership or supplies. Or, to put it more precisely, both in the United States and abroad, the problem of the relationship between foreign suppliers should be viewed from the standpoint of anti-trust policy.

Where foreign takeovers threaten undue concentration of the global market, these should be stopped. Similarly, anti-trust authorities must be vigilant if the United States relies on a few foreign suppliers for a vital input. Anti-trust policies should be used to ensure the rapid diffusion of foreign products to the United States. If, for example, a small number of foreign firms in control of the market for DRAM semi-conductors were to engage in monopolistic practices such as denying access to American users or engaging in price fixing, U.S. anti-trust policies should be invoked. Those damaged by these practices should be entitled to the normal treble-damages compensation.

This is also the context in which we should view foreign suppliers who sell in the United States at prices well below costs. If the world industry is reasonably competitive we should not use our anti-dumping laws to deprive American buyers of low prices. But if it is a foreign monopoly or cartel doing the selling, driving out U.S. producers in the process, then we should treat it just as we might predatory practices in the United Sates that threatened a monopoly outcome.

Like any set of anti-trust policies, carrying these recommendations out in practice will involve many sticky questions and much argument over how the principles apply in particular cases. Moreover there will always be a temptation to be much more aggressive in applying the anti-trust approach against foreign firms than against domestic firms. Nevertheless, formulating specific U.S. trade policies on the basis of such principles offers the best hope of walking the appropriate line between seeking the advantages of free trade and protecting the U.S. economy against real -- as contrasted with trumped-up -- dangers from unfair foreign trade practices.

Toward deeper integration. In the early postwar period tariffs and quotas obstructed trade, and capital movements were severely restricted. When economic interdependence was limited, trade policy needed to deal only with policies, such as tariffs and quotas, that directly affected trade in goods.

Economic interdependence has now expanded so much that major differences and inconsistencies among government policies in much broader areas can no longer be readily tolerated. As border barriers have been eliminated, national differences in such areas as anti-trust, regulation, tax, and technology policy can now seriously distort trade and investment flows. Critics are correct, therefore, when they argue the GATT must extend its purview beyond tariffs and quotas. Indeed, the agenda of the current GATT negotiations which includes areas such as services, agriculture, intellectual property rights, trade-related investment measures, and subsidies, indicates that the majority of GATT members feel the need for improvements in the global rules on these issues. Improved mechanisms for surveillance and dispute settlement are also needed.

24

Over the medium term, U.S. trade policy should strive for an open global trading system governed by a common set of rules. This regime should be implemented through a vastly strengthened and extended GATT apparatus.

Once the GATT negotiations are concluded and the mechanisms for creating a single internal European market are achieved in 1992, the next step should be a multilateral effort to achieve a single OECD market for goods, services and capital by the year 2010. The approach should use the example of the initiative for Europe 92. The European governments decided they needed to complete the internal European market by removing all remaining obstacles to the free movement of goods, labor and capital within the Community by 1992. In a 1985 White Paper they laid out the 300 measures required to achieve this goal. The OECD should similarly be given the task of formulating measures to create an integrated market for goods, services and capital.

Of course, it would be impossible and undesirable to obtain identical practices across all nations. But this should not be necessary. Indeed some competition among regulatory regimes could actually be beneficial. The difficult task will be to determine those issues on which harmonization will be essential, and those in which principles such as national treatment and mutual recognition of technical standards will suffice.

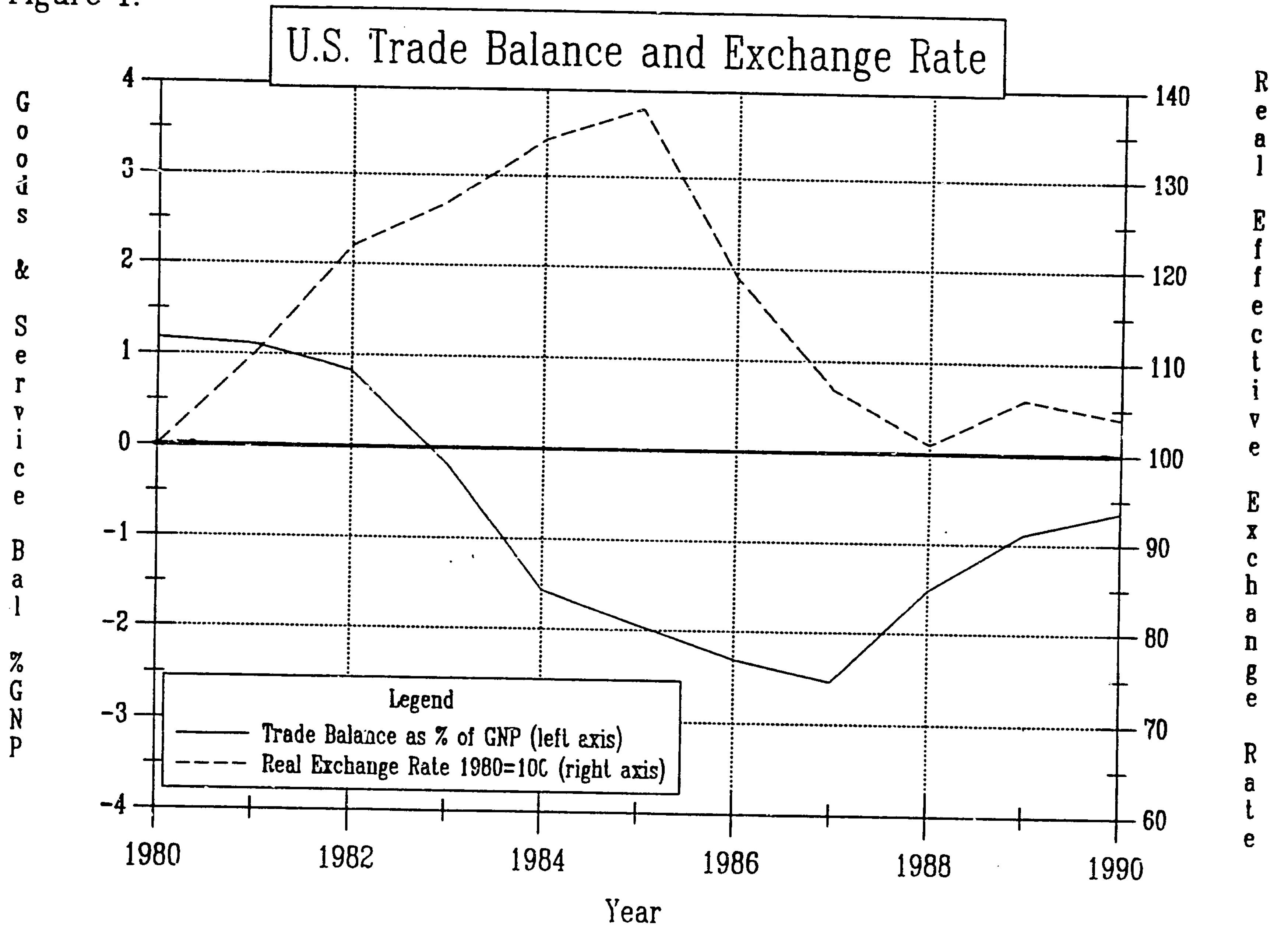
Investment. The United States remains the world's largest direct foreign investor, but America has also become home to a large number of foreign-owned companies. Moreover, multinational companies operate in so many places and international alliances between U.S. and foreign-owned companies have become so numerous that determining the national origin of firms,

25

products and technologies is becoming increasingly difficult. Our policies should not discriminate against foreign-owned firms in the U.S. and should aim at national treatment for U.S. firms abroad.

U.S. policies should take advantage of some superior foreign technologies. Their diffusion to the U.S. should be encouraged, not through local content programs but through policies which make the U.S. an attractive location for investment. American dependence on imported products and foreign takeovers in the U.S. should be viewed, not through the prism of economic nationalism, but through considerations of anti-trust.

Figure 1:



U.S. Trade Balance and Exchange Rate
Goods & Service Bal %GNP
Real Effective Exchange Rate
4
3
2
1
0
-1
-2
-3
-4
140
130
120
110
100
90
80
70
60
1980
1982
1984
1986
1988
1990
Year
Legend
Trade Balance as % of GNP (left axis)
Real Exchange Rate 1980=100 (right axis)

International Trade Agreements: Fast Track Procedures

Foreword to a report to Congress submitted by President Bush, March 1, 1991.

The Fast Track and Why It Is Essential

For the better part of this century, Congress and the executive have recognized that the negotiation and implementation of trade agreements require special cooperation between the two branches. In the aftermath of the record high rates of the Smoot-Hawley Tariff Act of 1930 and the Depression that they helped fuel, both Congress and the executive came to realize that only by working closely together in the exercise of their constitutional responsibilities could the two branches effectively bring down foreign barriers to our trade and open opportunities for U.S. products and services in the international marketplace.

This new partnership was reflected in the Reciprocal Trade Agreements Act of 1934, which gave the President authority not only to conclude tariff-cutting agreements but also to implement them by proclamation without the need for subsequent legislation.

During the following years, when the principal barriers to trade were tariffs, this arrangement proved highly successful and was responsible for the tariff reductions that promoted post-World War II economic growth, particularly in successive rounds of multilateral tariff-cutting negotiations.

As countries began to rely less on tariff protection and more on non-tariff trade barriers, the scope of trade negotiations broadened, and the "fast track" procedures were created by Congress as the necessary complement to this broader trade agenda.

Fast track procedures for approval of trade agreements were included by Congress in trade legislation in 1974, 1979, and again in the Omnibus Trade and Competitiveness Act of 1988 (1988 Act). While giving Congress the assurance of meaningful participation throughout the negotiating process, fast track also provides two guarantees essential to the successful negotiation of trade agreements:

- A vote on implementing legislation within a fixed period of time; and
- No amendments to that legislation.

These procedures reflect an understanding that trade agreements, in which results in one area are often linked to results in others, are particularly vulnerable to multiple amendments that, while possibly small in themselves, could unravel entire agreements. Whether the balance of benefits contained in any trade agreement is in the overall interest of the United States can only be determined by looking at the whole package.

These procedures reflect an understanding that trade agreements, in which results in one area are often linked to results in others, are particularly vulnerable to multiple amendments that, while possibly small in themselves, could unravel entire agreements.

Through the fast track, Congress has given the President the same bargaining power possessed by his counterparts: the ability to assure his negotiating partners that the agreement reached internationally would be the agreement voted on at home. Without fast track, the President cannot give his negotiating partners that assurance. Without that assurance, foreign governments are reluctant to negotiate with the United States and will not make the tough concessions necessary to reach agreements the United States would be willing to sign. No negotiating partner will give its bottom line knowing that the bargain could be reopened.

On the basis of fast track procedures, the United States has negotiated and implemented three remarkable trade agreements, each of which was approved by an overwhelming majority in both Houses of Congress. These agreements—the results of the Tokyo Round of GATT [General Agreement on Tariffs and Trade] negotiations in 1979, the free-trade agreement (FTA) with Israel in 1985, and the FTA with Canada in 1988—have reduced barriers to trade and provided a powerful engine for economic growth in the United States and worldwide.

The United States has much to gain through trade agreements that open markets and provide rules for free and fair trade. Maintaining the fast track will preserve our ability to continue efforts to liberalize trade and open markets through the GATT, through other multilateral agreements, and through bilateral agreements.

Extension of Fast Track Continues a Cooperative Relationship

Fast track procedures preserve Congress' role during the negotiation, approval, and implementation of trade agreements. To ensure congressional and private sector input, the fast track statute contains extensive notification and consultation requirements. At each step along the way, from initiation through implementation, Congress is an active partner.

To use the fast track for any agreement, bilateral or multilateral, the President must notify Congress 90 calendar days before signature. By the time the President gives his 90-day notification, our many private sector advisory committees must report their views on the agreement both to Congress and the President. For bilateral agreements, Congress must be given advance notice of the negotiations; during the following 60 legislative working days, either the Senate Finance or House Ways and Means Committee can vote to deny fast track treatment.

Once an agreement is reached, Congress and the Administration work in close consultation to formulate implementing legislation. The process has involved the full participation of all committees of jurisdiction, and not only those committees traditionally consulted in setting trade negotiating objectives. If the agreement and its implementing legislation are still not acceptable, they can be rejected by majority vote of either house. In fact, as a result of the extensive consultations with Congress and the private

28

sector, the agreements that have been implemented under fast track procedures enjoyed widespread support when they were presented to Congress.

We find ourselves today engaged in bilateral and multilateral trade initiatives that hold unprecedented promise for the advancement of U.S. economic objectives. With such initiatives in the balance, now is not the time to dissolve a partnership that has endured for almost sixty years.

Continuing Fast Track Is Essential to Securing Economic Gains

In incorporating the fast track in the 1988 Act, Congress expressly contemplated that an extension of the provision beyond June 1991 might be necessary and appropriate in order for the President to pursue effectively the trade policy objectives set out in the law.

The continued availability of fast track procedures over the next two years—during which we expect to complete the Uruguay Round of multilateral negotiations, negotiate a North American Free Trade Agreement with Mexico and Canada, and pursue the trade objectives of the Enterprise for the Americas Initiative—will enable our negotiators to bring to Congress for its consideration trade agreements that will enhance the ability of the United States to compete internationally. Supporting fast track now will allow these important negotiations to go forward without in any way detracting from Congress' ability to assess each agreement on its merits when presented for approval.

The Uruguay Round. These complex negotiations with 107 other nations (many of which are not fully integrated into the multilateral trading system) offer rich opportunities to break down trade barriers and expand the scope of international trade rules.

- Since their inception in 1986, the Uruguay Round negotiations have been conducted in 15 areas. Our objectives include more open markets, internationally agreed rules in areas not previously covered by multilateral agreements (services, investment, intellectual property rights), and institutional improvements in the GATT. The negotiations have been difficult, and important issues remain, but there has been significant progress overall toward our objectives. That progress should not be abandoned.
- The United States had hoped to conclude the Uruguay Round last December at a ministerial level meeting in Brussels. However, the status of the negotiations on several subjects at that time did not warrant conclusion—particularly on agriculture. The unwillingness of the European Community (EC), as well as Japan and Korea, to accept a framework for agricultural reform impeded progress in the negotiations in all areas.

We are encouraged by a recent statement of GATT Director-General Arthur Dunkel that all participants have now agreed to negotiate specific binding commitments in each of the key areas of agricultural reform, thus clearing the way for the resumption of negotiations. However, important differences in agriculture and other areas remain. Much hard bargaining lies ahead.

The United States refused to accept a deficient Uruguay Round package in Brussels. Our high standards have not changed. Although ultimate success in the Uruguay Round cannot be guaranteed, we believe the United States should continue negotiations because a successful Round is overwhelmingly in our long-term economic interests.

North American FTA. We have a historic opportunity to achieve a North American Free Trade Agreement (NAFTA) with Canada and Mexico. The Mexican government has been pursuing a dramatic opening of its trading regime and has introduced market oriented domestic reforms that benefit both Mexico and the United States. Building on those reforms and on the existing FTA we have with Canada, we can create a NAFTA that encompasses some 360 million people with almost $6 trillion in output. A comprehensive NAFTA will create growth and better jobs in all three countries, and will make us more competitive in the global marketplace.

Extension of fast track will be essential for these negotiations, which are expected to begin in late Spring.

Enterprise for the Americas Initiative. An extension of fast track will also enable the United States to take steps in the next two years toward fulfillment of the trade objectives of the Enterprise for the Americas Initiative (EAI), announced in June 1990. Although it is likely that few Latin American nations will be in a position to enter into FTA negotiations with the United States before June 1993, the United States must continue to be able to respond to the increasing pace of economic liberalization in the region.

The United States has an enormous stake in the future of the global trading system. Exports have become a vital source of strength to the U.S. economy. In 1990, the nearly 8.5 percent growth in U.S. exports accounted for 88% of U.S. GNP [gross national product] growth. Since 1986, expanded exports have accounted for more than 40 percent of the growth in U.S. GNP.

In order to sustain the expansion of exports and consequent growth, we must continue our efforts to open world markets. We must maintain our active leadership role. Without an extension of fast track, those efforts and that role are placed in jeopardy.

Preserving fast track procedures—and the partnership between Congress and the executive branch which fast track represents—will keep on course our joint efforts to liberalize trade and open markets through the initiatives described above and through other multilateral and bilateral agreements. No country stands to gain more from those efforts than the United States.

As we approach the beginning of a new century, we should not hesitate to pursue the opportunities for economic growth and prosperity presented by successful trade negotiations. In order to turn those opportunities into realities, Congress and the executive must continue to work together in the manner envisioned by the fast track.

President's letter to Congressional Leaders on Fast Track Authority Extension and the North American Free Trade Agreement, May 1, 1991 [2]

Through the better part of this century, successive Congresses and Administrations—Republican and Democratic—have worked to open markets and expand American exports. This partnership has resulted in unparalleled growth in world trade and huge economic benefits for the United States. Opening foreign markets means economic growth and jobs for all Americans.

Historically, the fast track procedures established by the Congress have served us well. On March 1, I requested an extension of fast track so that we could continue to realize increased economic growth and the other benefits of expanded trade. The fast track in no way limits the ability of Congress to review any agreement negotiated, including the Uruguay Round or a North American Free Trade Agreement (NAFTA). If Congress is not satisfied, it retains the unqualified right to reject whatever is negotiated. But refusing to extend the fast track would end negotiations before they have even begun and relinquish a critical opportunity for future economic growth.

Initiatives to open markets will enhance the global competitiveness of the United States and create new opportunities for American workers, American exports, and American economic growth. The Uruguay Round offers a vital opportunity to eliminate barriers to our goods, investment, services, and ideas. A NAFTA offers an historic opportunity to bring together the energies and talents of three great nations, already bound by strong ties of family, business, and culture. Prime Minister Mulroney and President Salinas are both leaders of great vision. They believe, as do I, that a NAFTA would enhance the well-being of our peoples. They are ready to move forward with us in this unprecedented enterprise.

Responding to Congressional Concerns

In seeking to expand our economic growth, I am committed to achieving a balance that recognizes the need to preserve the environment, protect worker safety, and facilitate adjustment. In your letter of March 7, you conveyed a number of important Congressional concerns about free trade with Mexico. At my direction, Ambassador [Carla] Hills and my Economic Policy Council have undertaken an intensive review of our NAFTA objectives and strategy to ensure thorough consideration of the economic, labor, and environmental issues raised by you and your colleagues. The Administration's response is presented in the attached report. Let me emphasize the following:

First, you have my personal commitment to close bipartisan cooperation in the negotiations and beyond. And you have my personal assurance that we will take the time necessary to conclude agreements in which both the Congress and the Administration can take pride.

Second, while economic studies show that a free trade agreement would create jobs and promote growth in the United States, I know there is concern about adjustment in some sectors. These concerns will be addressed through provisions in the NAFTA designed to ease the transition for import-sensitive industries. In addition, my Administration is committed to working with the Congress to ensure that there is adequate assistance and effective retraining for dislocated workers.

Third, based on my discussions with President Salinas, I am convinced that he is firmly committed to strengthened environmental protection, and that there is strong support for this objective among the Mexican people. Because economic growth can and should be supported by enhanced environmental protection, we will develop and implement an expanded program of environmental cooperation in parallel with the free trade talks.

Fourth, President Salinas has also made it clear to me that his objective in pursuing free trade is to better the lives of Mexican working people. Mexico has strong laws regulating labor standards and worker rights. Beyond what Mexico is already doing, we will work through new initiatives to expand U.S.-Mexico labor cooperation.

Thus, our efforts toward economic integration will be complemented by expanded programs of cooperation on labor and the environment. The catalyst for these efforts is the promise of economic growth that a NAFTA can provide, and the key to these efforts is the extension of unencumbered fast track procedures.

There are great challenges ahead. The world is changing dramatically, as nations move toward democracy and free markets. The United States must continue to open new markets and lead in technological innovation, confident that America can and will prevail in this new and emerging world. By working together, we can negotiate good trade agreements that assure a strong and healthy America as we prepare to meet the challenges of the next century.

Summary of Report Responding to Concerns Raised by Congressional Leaders About a North American Free Trade Agreement, May 1, 1991 [3]

On September 25, 1990, the President notified the Congress of his decision to proceed with free trade negotiations with Mexico. After consultations with Prime Minister Mulroney and President Salinas, the President notified Congress on February 5, 1991, of his decision to include Canada, and so to work towards a North American Free Trade Agreement (NAFTA).

Today, the President responded to a variety of concerns raised last month in letters from Chairmen Bentsen and Rostenkowski and from Majority Leader Gephardt about the effect a NAFTA would have on the economy, on labor, and on the environment. The response, which sets forth detailed action plans for addressing these concerns, as well as views on the economic impact of a NAFTA, is summarized below.

1. A NAFTA Would Benefit the U.S. Economy.

From 1986 to 1990, as Mexico reduced import barriers, our exports more than doubled—from $12.4 billion to $28.4 billion—generating 264,000 additional U.S. jobs. Under a NAFTA, we can do even better. Mexico still has higher trade barriers than the United States. Mexico's average duty is 10 percent compared to 4 percent in the United States. Significant nontariff barriers remain. We, therefore, have much to gain from the elimination of these barriers.

All three major economic analyses done to date corroborate that the United States will benefit from a NAFTA in exports, output, and employment.

We will benefit from Mexican growth: for each dollar Mexico spends on imports, 70 cents is spent on U.S. goods; for each dollar of GNP growth, 15 cents is spent on U.S. goods.

Further, the resulting economic integration will strengthen the ability of the United States to compete with Japan and the EC.

2. A NAFTA Would Include Transition and Safeguard Provisions.

Transition Measures: In order to avoid dislocations to industries and workers producing goods that are import-sensitive, tariffs and nontariff barriers on such products should be eliminated in small increments over a time period sufficient to ensure orderly adjustment.

In determining import sensitivity, we will rely heavily on advice of the International Trade Commission, the Congress, and the private sector.

We will be prepared to consider transition periods beyond those in the U.S.-Canada FTA.

Effective Safeguard Provisions: Even where reductions in tariffs and other trade barriers are staged over a lengthy period, there may be isolated cases in which injurious increases in imports could occur. To prevent injury from such increases, we will seek to include in the agreement a procedure allowing temporary reimposition of duties and other restrictions.

This mechanism should be designed to respond quickly, especially in cases of sudden import increases.

Special "snap-back" provisions should be included to address the unique problems faced by producers of perishable products.

Strict Rules of Origin: We will negotiate rules of origin to ensure that the benefits of a NAFTA do not flow to mere passthrough operations exporting third country products to the U.S. with only minimal assembly in Mexico.

Rules of origin will impose clear, tough, and predictable standards to the benefit of North American products.

We will seek to strengthen the required North American content for assembled automotive products.

We will consult closely with the private sector and the Congress in designing these rules.

3. The Administration Is Committed to Effective Retraining and Worker Adjustment Programs.

Since trade barriers on sensitive products should be decreased over a long timeframe, we do not expect immediate or substantial job dislocations.

Nevertheless, beyond including adjustment provisions in the NAFTA itself, there is a need to assist dislocated workers who may have adjustment difficulties.

The administration is committed to working with Congress to ensure a worker adjustment program that is adequately funded and that provides effective services to workers who may lose their jobs as a result of an agreement with Mexico.

Whether provided through the improvement or expansion of an existing program or through the creation of a new program, worker adjustment measures should be targeted to provide dislocated workers with comprehensive services in a timely fashion.

4. Labor Mobility and Immigration Laws Are Not on the Table.

We have agreed with Mexico that labor mobility and our immigration laws are not on the table in NAFTA talks, with the possible exception of a narrow provision facilitating temporary entry of certain professionals and managers.

5. Mexico's Laws Provide Comprehensive Rights and Standards for Workers.

Protections afforded by Mexican labor law and practice are stronger than generally known.

Mexico's laws provide comprehensive rights and standards for workers in all sectors, including the maquiladoras.

Mexico has ratified 73 International Labor Organization conventions on workers rights, including those on occupational safety and health.

Mexico has a minimum working age of 14 and mandates special protections and shorter working hours for those between the ages of 14 and 16.

A substantially higher proportion of the Mexican workforce is unionized than is the U.S. workforce.

While enforcement problems have resulted largely from a lack of resources, a NAFTA would both raise living standards and create resources for enforcing existing laws.

6. There Will Be Increased U.S.-Mexico Cooperation on Labor Matters.

Memorandum of Understanding: The Secretary of Labor and her counterpart from Mexico are prepared to sign a Memorandum of Understanding providing for cooperation and joint action on a number of labor issues which could be implemented in parallel with our FTA negotiations. These include health and safety measures; work conditions, including labor standards and enforcement; labor conflicts; labor statistics; and other areas of concern to the United States and Mexico.

Specific Projects: U.S. and Mexican officials have agreed on joint projects to address specific concerns in the labor sector. Initial projects include: occupational health and safety, child labor, and labor statistics.

7. Mexico is Committed to Strengthened Environmental Protection.

As President Salinas has made clear, Mexico has no interest in becoming a pollution haven for U.S. companies. Mexico's comprehensive environmental law of 1988, which is based on U.S. law and experience, is a solid foundation for tackling its environmental problems. All new investments are being held to these higher legal standards, and an environmental impact assessment is required to show how they will comply.

Enforcement has in the past been a key problem, but Mexico's record has been improving dramatically. Since 1989, Mexico has ordered more than 980 temporary and 82 permanent shutdowns of industrial facilities for environmental violations, and the budget of SEDUE (Mexico's EPA) has increased almost eightfold.

8. A Number of Environmental Issues Would Be Addressed in the NAFTA.

Protection of Health and Safety: We will ensure that our right to safeguard the environment is preserved in the NAFTA.

We will maintain the right to exclude any products that do not meet our health or safety requirements, and we will continue to enforce those requirements.

We will maintain our right to impose stringent pesticide, energy conservation, toxic waste, and health and safety standards.

We will maintain our rights, consistent with other international obligations, to limit trade in products controlled by international treaties (such as treaties on endangered species or protection of the ozone layer).

Enhancement and Enforcement of Standards: We will seek a commitment to work together with Mexico to enhance environmental, health, and safety standards regarding products, and to promote their enforcement.

We will provide for full public and scientific scrutiny of any changes to standards before they are implemented.

We will provide for consultations on enhancing enforcement capability, inspection training, monitoring, and verification.

9. Expanded U.S.-Mexico Environmental Cooperation Will Be Pursued in Parallel With NAFTA Negotiations.

In parallel to the FTA negotiations, we intend to pursue an ambitious program of cooperation on a wide range of environmental matters.

We will design and implement an integrated border environmental plan to address air and water pollution, hazardous wastes, chemical spills, pesticides, and enforcement.

During the design phase of the border plan, there will be an opportunity for public comment and hearings; during implementation, there will be periodic comprehensive reviews.

We will consult on national environmental standards and regulations, and will provide an opportunity for the public to submit data on alleged noncompliance.

We will discuss expanded cooperative enforcement activities, such as coordinated targeting of environmental violators.

We will establish a program of technical cooperation and training, which will include facilitating sharing of technology for pollution abatement.

10. Environmental Experts Will Be Invited To Participate in the Policy-Making Process.

We will broaden public participation in the formulation and implementation of trade policy to ensure that efforts to liberalize trade are consistent with sound environmental practices.

We will appoint individuals to selected trade policy advisory committees who can contribute both an environmental perspective and substantive expertise.

In consultation with interested members of the public, we will complete a review of U.S.-Mexico environmental issues, with particular emphasis on possible environmental effects of the NAFTA, to enable U.S. officials to consider the results during ETA negotiations and other bilateral efforts.

---

1 Department of State Dispatch, March 4, 1991.

2 Text from Weekly Compilation of Presidential Documents of May 3, 1991. Identical letters were sent to Lloyd Bentsen, Chairman of the Senate Finance Committee; Richard A. Gephardt, House Majority Leader; and Dan Rostenkowski, Chairman of the House Ways and Means Committee.

3 White House Fact Sheet. Text from Weekly Compilation of Presidential Documents of May 3, 1991.

32

Democrats Flubbed Fast-Track

By DAVID MARCHICK

Democrats in Congress never miss an opportunity to miss an opportunity. They squandered one last month with their overwhelming vote against expedited trade negotiating rights for President Bush. So-called fast-track authority, which the president nevertheless won from the full House and Senate, is essential to complete a free trade agreement with Mexico and to conclude world trade talks under the General Agreement on Tariffs and Trade.

Voting against fast-track authority reinforces the public's perception that Democrats are inexperienced in international affairs and too closely tied to special interests, two characteristics that have kept them out of the White House.

Early in the debate, many Democrats linked their votes to commitments from the president to mitigate such legitimate trade-related concerns as job losses, environmental pollution and health and safety standards. After winning critical concessions from the president in May, some key Democrat leaders, including Rep. Dick Gephardt — no dove on trade — backed free trade and fast-track authority. At this point most Democrats might have declared victory and endorsed fast-track. But they didn't.

In the House, more than two-thirds of the Democrats voted against fast-track. Even though Mr. Gephardt and Ways and Means Committee Chairman Dan Rostenkowski voted for fast-track, 17 of the 22 Democratic committee chairman voted against it. The same was true in the Senate, where a majority of Democrats opposed free trade. These votes followed several anti-fast-track resolutions in Democratic national and state party organizations. Alternatively, only 22 House Republicans broke with the president, nine of whom represent districts with large textile industries, a likely loser in the Mexico and GATT agreements.

Interest groups on both sides of the issue worked at a frenetic pace. Big-business lobbyists swarmed Capitol Hill, and the Mexican government hired blue-chip public relations and law firms. Trade Representative Carla Hills visited Sen. Lloyd Bentsen's office so much that he threatened, jokingly, to charge her rent. And the Hispanic community, a Democratic stronghold, endorsed expanded trade with Mexico.

On the other side, defeating fast-track authority was organized labor's top priority. Some key industries, including autos, glass and textiles, warned of hundreds of thousands of jobs moving south of the border. Environmentalists were also initially opposed, although some later supported fast-track after winning commitments from the administration.

What led to the overwhelmingly negative Democratic vote?

Mainly pressure from labor groups, which went to Capitol Hill early and often. Beyond that, Democrats were reluctant to cede negotiating control to the administration and waive their right to amend a final trade agreement.

Many Democrats also represent districts with textile, auto and produce industries; they were hard pressed to buck those who voted them into office. And finally, once it was clear the president would win his negotiating authority, many Democrats predisposed to support free trade voted against fast-track so as not to alienate their labor friends unnecessarily.

Even though free trade with Mexico primarily concerns organized interest groups and Washington operators — in one poll, only 26% of registered voters had an opinion about an agreement with Mexico — this vote may have long-term political implications at home and abroad.

Labor and environmentalists will remain solidly Democratic. Even though environmentalists won some concessions from the Republican administration, it was only because of effectively applied Democratic pressure by Sen. Bentsen and Reps. Rostenkowski and Gephardt.

Opposing fast-track will hurt the Democrats' strong standing among Hispanics, 77% of whom think a free trade agreement with Mexico would benefit them. With state and federal redistricting in 1992, up to seven new Hispanic districts in the Southwest and growing economic power, Hispanics wield increasing power.

The vote also reinforces the business community's suspicions of Democrats. In recent years Democrats have successfully raised trade and competitiveness issues throughout the country, only to miss the mark on this critical vote.

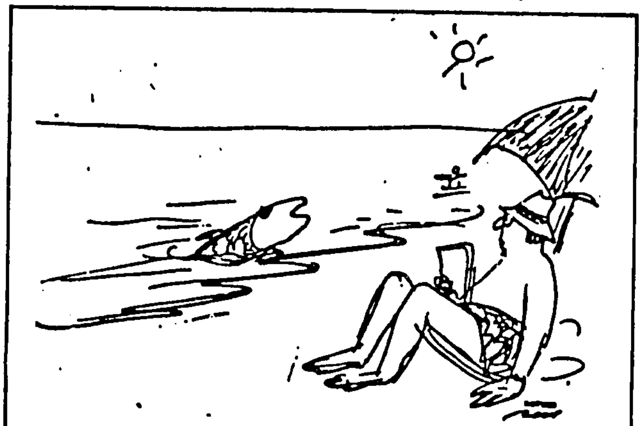
Thus, the Democrats not only failed to accommodate one of their traditional constituencies, they also didn't branch out to those that will be essential to win the White House.

Consequences abroad may be profound as well. Many Latin Americans realize that Democrats Franklin D. Roosevelt and John F. Kennedy, respectively, initiated the "Good Neighbor Policy" and the "Alliance For Progress." But now a Republican president may have seized the traditionally Democratic agenda of cooperation with Latin America through the free trade initiative with Mexico and his "Enterprise for the Americas" program.

When the trade negotiators finish their work, the Democrats will have one final opportunity to salvage their standing with Hispanics and with other voters. President Bush needs congressional approval to put the trade agreement into effect. At that time, congressional Democrats could vote for the accord but simultaneously provide worker training for those who lose their jobs as a result. The Democratic party could then be on record as pro-free trade and pro-labor.

Make no mistake about it: International trade doesn't win or lose elections. In 1988, only 5% of voters polled cited trade as the major deciding factor in their choice. But occasionally, as in this case, trade becomes a critical issue for members of Congress. As exports become more important to the U.S. economy, both parties must stake out a forward-looking position on trade.

Yet Democrats are still searching for a workable alternative to ideological free trade and have yet to articulate a coherent trade policy. Following their current path, they will probably have until 1996 to work it out.



"Where the hell's the media? I just swam the Atlantic Ocean."

David Marchick is a policy analyst at the Center for Strategic and International Studies in Washington.

BATTLING JOBS SCENARIOS

BY BRUCE STOKES

Controversy continues to swirl around the likely economic impact of a U.S.-Mexican free-trade agreement (FTA). President Bush, in a May 1 letter to Democratic congressional leaders, reiterated Administration assertions that "a free-trade agreement would create jobs and promote growth in the United States." FTA opponents maintain that their analyses show the pact could cost the American economy hundreds of thousands of jobs during the next decade.

With the competing scenarios relying as they do on controversial assumptions, the jobs debate is mired in econometrics. But politicians can't wait for economists to make up their minds. As Congress takes up Administration fast-track negotiating authority for the Mexico deal, the numbers debate is shifting toward shaping the negotiations to maximize the economic benefit for the United States.

"You have the chance to do the deal right," said Robert B. Cohen, an adjunct fellow at the Economic Strategy Institute, who concludes in a study that the United States could gain 225,000 jobs by 1999 thanks to the FTA if Mexico is not used as an export platform into America.

The Administration is drawing on studies by the International Trade Commission (ITC), the consulting firm of KPMG Peat Marwick and Clopper Almon, a University of Maryland economist. Almon is the most optimistic, predicting the creation of up to 44,500 new jobs. The ITC report found little or no effect on employment levels in the United States and a real increase in incomes for all workers. Peat Marwick says real income will increase.

Administration officials steadfastly deny the existence of internally generated spreadsheets showing substantial FTA-related job losses. *(See NJ, 3/23/91, p. 690.)* "We have been unable to unearth any document fitting [this] description," Commerce undersecretary J. Michael Farren wrote *National Journal.* Other government sources, however, continue to insist that such data exist.

FTA critics, such as the union-financed Economic Policy Institute (EPI), complain that Administration studies unrealistically assume that there will be no net shift in investment from the United States. An EPI scenario, assuming a $44 billion shift in capital from the United States to Mexico, results in the loss of 550,000 jobs.

The Administration retorts that if investment shifts of this magnitude were going to take place, they would already have happened. Moreover, Peat Marwick contends that though some investment may shift south of the border, other U.S. investors may consolidate production in the United States once they are no longer forced by Mexican law to produce in Mexico. Finally, though Administration economists privately admit that some investment may shift to Mexico, they say EPI exaggerates the shift.

As crucial as this unresolved dispute is, the FTA debate is already shifting toward how to structure the seemingly inevitable negotiation.

The Economic Strategy Institute proposes negotiating objectives tailored to maximize U.S. economic benefits. Among these goals are at least a 75 per cent North American content for goods gaining FTA benefits and a requirement that Japanese or European automakers in Mexico match any export of autos to the United States with a similar level of exports to other markets.

Such proposals may well turn up as congressionally imposed negotiating objectives for the FTA talks. The Administration would be likely to balk at such strictures, but it has already opened the door by agreeing to consider rules of origin higher than the 50 per cent required for autos in the 1988 U.S.-Canadian Free-Trade Agreement. Though Mexico would probably fear that such provisions would limit foreign investment there, minimizing the FTA's advantages, the loudest howls are likely to come from Tokyo and Brussels, which would see the FTA fulfilling their worst discriminatory nightmares.

So in the end, controversial numbers are likely to drive the U.S.-Mexican free-trade debate for some time to come. ■

34

Environmental Opposition Fading

Democratic Sen. Dennis DeConcini sees his home state of Arizona as a conspicuous example of the paucity of Mexican environmental protection: A hepatitis outbreak in Nogales was caused by untreated sewage flowing north from its sister town across the border.

DeConcini

Wyden

But DeConcini, who has sponsored legislation (S 503) to establish a U.S.-Mexico Border Environmental Protection Fund, nonetheless plans to vote for congressional fast-track procedures that President Bush says are needed if the administration is to negotiate a free-trade agreement with Mexico. The fast track bars Congress from amending trade pacts submitted for its approval.

"I think the Mexicans are willing to make a commitment to the environment," DeConcini said last week, adding that he believed the administration will no longer hand Mexico "a blank check" that does not link environment and trade.

His is an attitude that is becoming more prevalent both in Congress and among the environmental lobby, as Congress moves toward a final vote on the fast track. *(Story, p. 1256)*

"It seems as if support for a resolution of disapproval of fast-track procedures has dwindled in Congress," acknowledged Stewart Hudson, a lobbyist for the National Wildlife Federation, a large environmental organization that had spearheaded opposition to fast track. The group is now in the process of revising its position.

The Natural Resources Defense Council (NRDC), another influential environmental lobby, about a month ago dropped its opposition to the fast track, according to international program assistant Glenn T. Prickett.

For the NRDC, the administration's May 1 "action plan," which addressed environmental and labor issues, was "a positive first step." *(Weekly Report, p. 1121)*

"There's been quite a shift in attitudes," Prickett said. "We're seeing a new willingness at the U.S. Trade Representative and the Environmental Protection Agency to take on these issues, and I think it's clear the [Mexican government] is taking environmental issues seriously."

As recently as a month ago, newspaper articles and congressional hearings were filled with testimony about the danger to the environment posed by a Mexico pact.

But confronted with an administration suddenly willing to take their concerns seriously, a Mexican government that has aggressively raised its profile on environmental enforcement, and the sobering realization that much of the damage already has been done, environmentalists have largely dropped their opposition to the fast track.

There still are some who oppose the Bush proposals on environmental grounds, such as Rep. Ron Wyden, D-Ore. "We've seen a lot of noble sounding language — and it can be useful. But on enforcement, it's been a wish and a hope," he says.

And Sen. Tim Wirth, D-Colo. criticized the administration's action plan as lacking "key details and firm commitments." But Wirth added that "a free-trade agreement can be a clean trade agreement."

Environmental groups have voiced a number concerns about a U.S.-Mexico agreement. U.S. standards for pesticides and cleanliness in handling food are generally stricter than Mexico's, said Mary Kelly, director of the Texas Center for Policy Studies in Austin. Mexico has complained that such standards are a restraint on trade, she said.

In other trade areas, Mexico has challenged as unfair trade practice U.S. regulations that ban imported tuna caught in nets that also can trap dolphins, says David E. Ortman, a representative of the Friends of the Earth.

Finally, the worst example of lax commitment to environmental protection, at least in the eyes of politicians in border towns, is the network of more than 1,900 maquiladora plants — foreign-owned automotive and other assembly plants that have sprung up since the 1960s just on the other side of the U.S. border.

There is so much untreated waste from Tijuana, Mexico, for example, that the United States has agreed to finance and build a wastewater treatment plant there to keep the pollution from spreading into San Diego Bay.

Dick Kamp, director of the Arizona-based Border Ecology Project, says that elsewhere along the border the maquiladoras and their attendant unplanned development have seriously contaminated the air around Juarez/El Paso, Texas, poisoned the ground water in Nogales, and are the sites of frequent explosions and hazardous waste spills. Overall, according to the group, 95 percent of the maquiladoras have not accounted for their hazardous waste disposal as required by Mexican law.

However, recent steps by the administration and the Mexican government to combat this negative image seem to have had some effect.

According to the Mexican Embassy in Washington, the Mexican environmental agency, SEDUE, has seen its budget increase more than sevenfold to $38.6 million this year. SEDUE has closed 28 border businesses this year for environmental infractions. And President Carlos Salinas de Gortari took the unprecedented step of shutting down Mexico's largest oil refinery in March at a cost of 5,000 jobs because of the air pollution it generated.

Though pleased that the administration action plan gives them more input, environmentalists are seeking some changes, such as effective monitoring and enforcement mechanisms and a plan to use some of the benefits of free trade to pay for environmental protection.

On May 10, the Environmental Defense Fund, the National Wildlife Federation, the National Audubon Society and the NRDC said that if some changes were made to the plan, "our organizations would be able to support continued fast-track authority."

—Phillip A. Davis

NEW YORK TIME May 19, 1991

Nature Can Live With Free Trade

By Jay D. Hair

WASHINGTON

President Bush's commitment linking the environment and free trade has made it possible for environmentalists to support putting the negotiations on the U.S.-Mexico pact on the "fast track." The National Wildlife Federation can thus confidently call for Capitol Hill's endorsement of this process, which would prohibit amendments to the trade agreement and force Congress to accept or reject the accord in its entirety.

While Mr. Bush's position is not all that many environmentalists might want, the ideal should not be the enemy of the good. His word is his marker. The job ahead is to forge environmentally sound free-trade agreements, beginning with Mexico. We should not obstruct a path that can lead to significant international benefits.

When a handful of environmental groups first stepped into the free-trade discussion, they were greeted with condescending incredulousness by financial experts who viewed the talks as belonging to a closed club devoted exclusively to commercial considerations. That presumption — that environmentalism and economics don't mix — has been punctured.

International trade is increasingly the basic way our planet's natural resources are allocated. The rules of trade profoundly influence whether these resources will be protected or degraded. The same rules determine whether pollution will be prevented or allowed to spread, harming all life on earth.

Free trade agreements are scripts from which we can read a future of sustainable development or accelerated environmental deterioriation. If we get the script wrong, then the stage is set for costly and avoidable mistakes. From now on, free trade pacts are inherently statements of environmental policy.

Mr. Bush has adopted this concept. His embrace is tentative, but that is less important than the precedent he has set. He has made the commitment that for the first time in free trade history, an environmental review will be part of the negotiations. This is a crucial step. Certainly, further strides will be necessary.

> Bush's word on the Mexico pact should satisfy environmentalists.

Mr. Bush has offered a framework within which the hard details of meshing environmental and free trade concerns can be worked out. It should be accepted as such, with a clear understanding that the structure is far from complete.

In its talks with Mexico, the United States should negotiate the enforcement of environmental standards and the adoption of a "polluter pays" principle for investment that results from the agreement. Discussion of these issues, from an environmental perspective, implies a good-faith commitment that all the talk will produce action.

At the same time, environmentalists must not evade the logic of free trade. The means of addressing environmental concerns are directly tied to economic development. If environmental progress is not to remain solely the property of affluent nations, developing nations must have their fair shot at progress. Free trade incorporating sound environmental principles enhances that prospect of advancement.

Advocates argue that the underlying argument for free trade is that it will improve business conditions. Trade is intended to spur progress, not dismantle it. In this light, the President's commitment to protect U.S. environmental standards from attack as non-tariff barriers to free trade must govern the negotiations with Mexico.

President Bush has made two additional pledges. One is to include environmental representation on his advisory committee on trade policy and negotiations. The other is to consult closely with Congress throughout the negotiations for a free-trade agreement; this offer to maintain the dialogue should be taken seriously by all involved.

The President has pledged to deal effectively with the environmental aspects of a free trade agreement. So it is fair to take him at his word — and to hold him to it.

His commitment should be reciprocated by Congress; it should grant fast-track authority to begin the free trade negotiations with Mexico in earnest. □

Jay D. Hair is president of the National Wildlife Federation.

26

The Enterprise for the Americas Initiative could either build hemispheric trade bloc by bloc or promote multiple cases of bilateral confusion, warns a leading academic authority on U.S.-Latin American trade relations

Making Regionalism Work

by Sidney Weintraub

A decade ago, Latin Americans would have greeted President George Bush's Enterprise for the Americas Initiative with suspicion, perhaps even derision, as just another neocolonial U.S. maneuver to keep countries from developing. Yet the reception was favorable, even enthusiastic.

North America—and conceivably the entire Western Hemisphere—is moving decisively toward regionalism. The first fruit of this new regionalism is the Canadian-U.S. free trade area. The second is likely to be a North American free trade, including Mexico. The Bush initiative for free trade "from Anchorage to Tierra del Fuego" carries this regional logic one giant step further. The question is whether this new regionalism can be reconciled with multilateralism and the need to revive the General Agreement on Tariffs and Trade.

In the June 27 speech announcing the initiative, Bush said that the United States "stands ready to enter into free trade agreements with other markets in Latin America and the Caribbean, particularly with groups of countries that have associated for purposes of trade liberalization." This language opens the United States to a series of free trade agreements with individual countries—a nightmarish prospect.

In the U.S. vision of hemispheric free trade, a Mexico-U.S. free trade agreement comes first. Congressional approval for a U.S.-Mexican FTA will come, assuming that it does, only by the summer of 1991. A free trade accord will then take another year or two. And Mexico's economic integration must be digested before the U.S. embraces the concept of a broader regional free trade zone.

A series of individual country free trade agreements could set up a nightmare of special interests

New Thinking

Most of Latin America is just starting to promote exports and lower import barriers, and rear-guard actions against precipitate liberalization are quite fierce. Old concerns about the loss of sovereignty become especially potent when the free trade embrace comes from the United States.

The 1982 debt crisis precipitated the breakdown of extreme import substitution and export pessimism in the region. During the 1970s, Latin American and Caribbean real GDP growth averaged about 5% a year, not much lower than developing Asian countries. In the 1980s, GDP grew by just 1-2% a year, and actually declined in per capita terms. By contrast, real GDP growth in developing Asian countries accelerated during the 1980s.

This tragic or "lost" decade cleared many minds in the region. It became evident to the non-ideological observer that the Asian growth policy was delivering higher incomes, with less inequality, than the Latin American and Caribbean model.

The shift to export promotion—and its corollary of more open import markets to reduce exporters' input costs—now dominates philosophical discussions in Latin America. Years of vested interests in protected markets are not easily wiped away by intellectual argumentation. But the process of trade liberalization is now clearly under way and the export pessimism that dominated Latin American thinking after World War II has been largely jettisoned. With the economic case for rejecting the U.S. initiative gone, what remains is underlying political mistrust of the United States.

Free trade is more likely to take permanent root in Latin America and the Caribbean if it does not take the form of individual agreements with the United States. A wiser U.S. policy would encourage revitaliza-

continued on page 51

Regionalism
continued from page 49

tion of sub-regional free trade groupings and then offer to negotiate free trade with them. Assuming that there will be a North American free trade area, the negotiations could then be between groupings: a free trade area in North America negotiating with sub-regional Latin American and Caribbean blocs.

A series of individual country free trade agreements--yesterday Canada, today Mexico, tomorrow Chile, and after that who knows which country—would set up a nightmare of special interests. The proposal's structure could splinter the hemisphere by creating a complex system subject to much fraud, lack of supervision and strong political animosities. In the name of economic integration, the end result would almost certainly be trade confusion and political conflict.

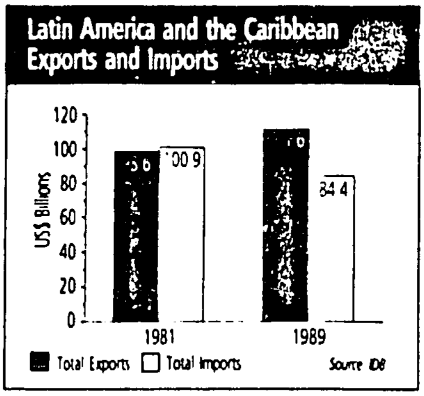
This kind of bilateralism would be a throwback to the early 1920s, before the United States abandoned its then-traditional policy of conditional most-favored-nation treatment. Under this system, U.S. trade partners "earned" MFN privileges for a particular product only if they made a specific trade concession. The policy was changed because it generated interminable and insoluble conflicts inimical to the interests of a great power with vast trading relationships.

The same problems would arise from a series of individual FTAs under which each negotiating partner would "earn" free trade by concessions suitable to its situation.

Group-to-group negotiations, however, would promote many positive developments: less bilateral treaties, increased Latin American and Caribbean economic integration, and bigger markets.

Inner Circles

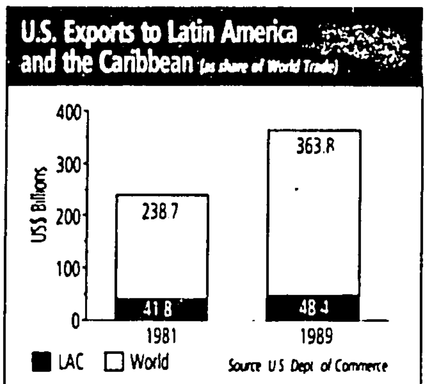
The Europeans embarked on precisely this model of group-to-group negotiations some three decades ago. In the free trade agreement between the EC and the European Free Trade Association, the EC countries make up an inner circle. These countries are prepared to take on deeper obligations than are the



outer circle of countries, those of the EFTA. Tomorrow, there may be another outer circle of former communist countries, such as Hungary and Czechoslovakia.

In the Western Hemisphere, the inner circle would be the three North American countries. If their free trade prospers, they are likely to assume other economic commitments that are more comprehensive than would be possible with Caribbean, Central American, and most South American countries. These countries could then be outer groupings, but still enjoy free trade among themselves and with North America.

If the United States abandons



its country-by-country free trade strategy in favor of group talks, sub-regional trade would be encouraged. Because Latin American and Caribbean countries are now lowering import barriers, the conditions for sub-regional free trade groups are more propitious than they have been at any time since World War II.

For the Latin American and Caribbean region as a whole, the dominant trading partner is the United States. More than 40% of Latin American and Caribbean trade is with the United States, over twice the percentage for any other country or group of countries. During the 1980s, the European Community's share of Latin America's trade remained constant at about 20%; the Japanese share remained steady at 5-6%; and intra-regional trade declined to 14-15%. The proportion of trade with the United States, by contrast, went up 10 percentage points in the past decade.

Trade dependence varies. Commerce with the United States represents more than 80% of total foreign trade for the Dominican Republic and the Bahamas; between 60% and 80% for Mexico, Haiti, and Trinidad and Tobago; between 40% and 60% for most Central American countries, Venezuela, Ecuador, Panama, Jamaica, and Barbados; 20-40% for Brazil, Chile, Colombia, and Peru; and less than 20% for Argentina, Uruguay, Bolivia, and Paraguay.

While the United States is the major player in international trade with Latin American and Caribbean countries, U.S. exports to the entire region other than Mexico were only $24 billion in 1989, about the same level as to Mexico alone. During the 1980s, the proportion of U.S. exports going to the Latin American and Caribbean region declined; they were more than 17% in 1981 and only 13% in 1989.

This decline in the Latin American and Caribbean share of total U.S. exports can be explained by the region's economic downturn. Average import volumes in these countries grew 6.5% a year during the 1970s, but were largely stagnant during the 1980s. As with real GDP growth, the contrast with developing Asian countries is quite stark; during the 1980s, import volume growth in Asian countries held steady or surpassed the near-9% mark of the 1970s.

The United States was in a poor economic neighborhood during the 1980s. The Bush initiative recognizes, however, that the Western Hemisphere is an area of substantial U.S. interest. In the past, this interest has kept out non-hemispheric powers (the Monroe Doctrine) and alien political philosophies (Central America and Cuba). Some of these motivations remain,

continued on page 53

Regionalism
continued from page 51

but the Bush initiative shows an economic interest as well. U.S. policy makers must understand that political hegemony can be costly whereas fostering more affluent neighbors can be profitable. Japan learned this lesson well once forced to do so after its defeat in WW II.

Building Blocs

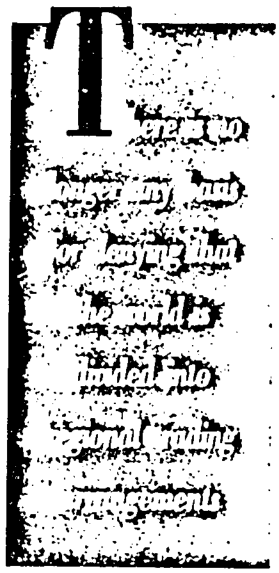
With the addition of Mexico to a North American preferential trade grouping—assuming this comes to pass—there is no longer any basis for denying that the world is divided into regional trading arrangements. The "blocs" are somewhat closed—this is largely true of the EC's common agricultural policy, and may be in many other areas if EC-'92 brings on a spate of restrictions in the name of reciprocity—but transparent import barriers in the main trading areas are generally low.

The word bloc has a rationale in Europe and North America in that the trading arrangements are preferential. Japan does not have overt preferences with its trading partners in Asia, but links between Japanese investors in these countries and intra-firm or intra-*keiretsu* trade ties make a "yen bloc" a practical reality.

Regionalism was a natural outgrowth of the U.S.-Canadian trading relationship. The two countries have reasonably similar cultural backgrounds (if Quebec is excluded), traditions of democracy, comparable per capita incomes, and an industrial structure that is largely integrated. More than half of Canada's manufactured exports to the United States are intra-firm in nature. The FTA was a way of formalizing a *de facto* integration that was already substantial.

The Mexican-U.S. case is more complex. There are great cultural differences and about a ten to one ratio in per capita incomes. However, there are similarities with the Canadian case. Industrial integration is deep and intra-firm trade in the manufacturing sector is comparable to that between the United States and Canada. Once Mexico removed most import licensing requirements and reduced its average tariff to less than 10%, Mexico had to secure access to the U.S. market. Further import liberalization over time is no longer a traumatic issue, because the majority of the work has already been done.

The Mexican trade relationship with the United States is similar to that of Canada in that each country sends about two-thirds of its total exports to the United States and an even higher proportion of its manufactured exports. Each country's manufactured exports to the United States are in the same broad sectors, dominated by automobile trade. Each country feared increased protectionism, particularly through non-tariff measure.



Mexico's decision to seek free trade with the United States is historic. Economic considerations now dominate political resentments, at least for the Salinas administration. While Mexico may continue to seek cultural nourishment from its Latin American connection, the country must look north for its economic sustenance. Mexican trade with its Latin American partners represents barely 3% of its total trade, a share that has declined over the past decade.

When the United States and Mexico began contemplating free trade, Canada's first reaction was resentment that its own free trade agreement with the United States would be compromised. Eventually, as President Bush's letter informed Congress, Canada decided to participate in the U.S.-Mexico talks.

Canada could not ignore the extension of U.S. regional strategy to Mexico. And Canada cannot stand aside if the U.S. policy moves all the way to Tierra del Fuego. Canada will be drawn in, both to protect its interest in the U.S. market and then to take advantage of potential opportunities in Latin America and the Caribbean.

The U.S. initiative came at a most propitious time. Latin America has just gone through a devastating decade. The orthodoxy of the past 50 years is being abandoned and real steps are being taken to open economies. External debt problems and repetitive renegotiations have cut off the supply of commercial bank credit. Foreign capital—which should be attracted by the promise of freer access to a hemispheric market—is clearly needed to promote development.

The Bush proposal itself was made almost offhandedly, in a speech that was little publicized by the White House and, consequently, barely noticed in the U.S. press. But it prompted immediate attention in Latin America and the Caribbean. The proposal is now generating a spate of hemispheric meetings, seminars, and counter-proposals—plus bilateral negotiations for framework agreements of the type that preceded the Mexico-U.S. free trade initiative.

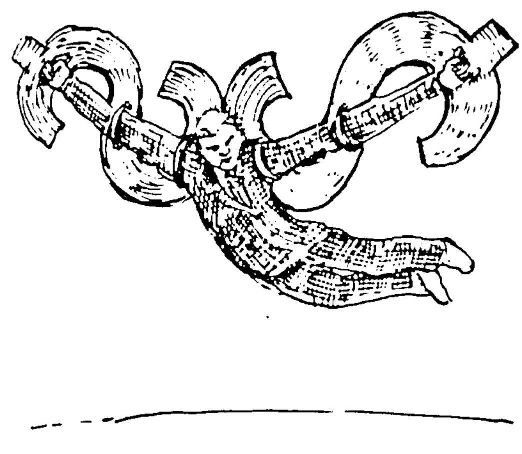
The disadvantages of regionalism are well known: Most importantly, it discriminates against countries not party to the agreement. But regionalism does have one important advantage over multilateral negotiations: Countries make more sweeping concessions in this limited framework than in global negotiations. All EC members accepted each other's regulations. The arbitration provisions for dispute settlement of the U.S.-Canadian FTA could not have been negotiated in the GATT, at least not in the first instance.

Trade throughout the Western Hemisphere could similarly benefit as regionalism is pursued as an alternative to bilateralism. Most Latin American and Caribbean countries are simply not large enough to make sense as free trade partners for the United States. But as part of larger groupings, free trade would have more meaning for the United States, and, ultimately, for its Western Hemisphere neighbors as well.

■ *Sidney Weintraub is the Dean Rusk Professor of International Affairs at the Lyndon B. Johnson School of Public Affairs at the University of Texas.*

BRUCE STOKES

LAUNCHING THE EASTERN BLOC



Janusz Kapusta/INX

The fanfare that greeted the April 15 inauguration of the European Bank for Reconstruction and Development (EBRD), a London-based multilateral financial institution created to ease Eastern Europe's transition to a market economy, threatens to obscure a lesson the governments of Latin America learned the hard way in the 1970s: Credit, such as that to be offered by the bank, is a dangerous and ultimately inadequate fuel for economic growth. Trade is a much better source of financial resources for impoverished economies because it offers far greater potential for sustainable growth.

If Eastern Europe is to breathe new life into its economies in the next few years, it will have to raise capital the old-fashioned way: It must earn it. And the European Community (EC), as Eastern Europe's neighbor and largest trading partner after the Soviet Union, is the region's logical market.

"The Community has a direct interest in helping [East European] reforms succeed," said James Rollo, director of the international economics program at the Royal Institute of International Affairs in London. But, in the EC's current negotiations with Czechoslovakia, Hungary and Poland to grant those nations special association trade status, he said: "The Community is being at least halfhearted in its commitment to Eastern Europe. We've raised expectations, and we are on the verge of deflating them."

Washington can ill afford to be a disinterested bystander as Brussels strikes commercial deals with Budapest, Prague and Warsaw. Western Europe's failure to truly open its market to the steel, textiles and agricultural products Eastern Europe has available to sell could prove to be folly. In a shortsighted effort to protect its producers, the Community may doom economic reform in Eastern Europe, eventually necessitating massive new transfusions of Western capital. Moreover, it may engender political and social unrest, reopening the door to authoritarian governments and new regional meddling by the Soviets.

To deepen East-West European economic interdependence and to reinforce the emergence of capitalism and democracy in the East, the European Commission, the EC's executive branch, was authorized in December 1990 to negotiate association agreements with Czechoslovakia, Hungary and Poland.

An EC association agreement allows preferential access to EC markets but falls short of full membership in the Community's common market. Such an arrangement is expected to improve survival prospects for the state-owned firms now being privatized in Eastern Europe and encourage new private investment, to modernize the Czechoslovak, Hungarian and Polish economies. EC officials also hope that East Bloc economic revitalization will forestall massive migration from the region.

But the Community's offer to the East is woefully inadequate, according to European economists who have been following the talks. Brussels says it is willing to eliminate tariffs on textile imports from Eastern Europe during the next 10 years. The EC has offered to lift restrictions on steel imports in five years and suggests it will consider unspecified concessions on agricultural imports.

This is of little solace to Eastern European producers struggling to survive. Steel, farm commodities and clothing are the foundation upon which Eastern Europe must rebuild its economy. Farming accounts for about a sixth of Hungary's gross domestic product, according to World Bank data. And textiles account for a sixth of the value-added in Poland's manufacturing sector.

Moreover, Brussels insists on continued strict application of its antidumping statutes, to ensure that hidden state subsidies, a legacy of Eastern Europe's socialist past, don't give Czechoslovak, Hungarian and Polish imports an unfair competitive advantage. The EC wants safeguards to protect industries that might be adversely affected by products coming from the East. And it demands a minimum level of East European content in goods coming from the region, to guard against Japan's using Eastern Europe as an export platform.

Free access of Eastern European products to EC markets will undoubtedly create hardships. But the cost of the Community's failing to increase imports may be even higher. "Rapid and special action is necessary if the collapse in [East European] export trade is not to be calamitous," Rollo warned.

Rollo proposes phasing out EC steel and textile quotas during the next two to three years and suggests immediately opening EC markets to some Eastern European livestock, fruits and vegetables while the Community completes its reassessment of its Common Agricultural Policy. He recommends making such market access contingent on evidence of progress toward regional democracy and economic reform, such as enactment of new laws governing fair competition.

Washington could do much to encourage the Community to make its markets more accessible. The current Uruguay Round of multilateral trade talks are bogged down in finger pointing between Americans and Europeans over farm subsidies. The Bush Administration may have a greater chance of getting the negotiations back on track by arguing Eastern Europe's case rather than its own.

Early next year, U.S. import restraints on EC steel are up for renewal. Washington could trade off greater access to the American market in return for the Community's accepting more imports of Eastern European steel. Similarly, the Multifiber Arrangement, an international accord regulating world textile and apparel trade, must be extended pending the completion of the current Uruguay Round. Such an extension provides an opportunity for the United States to trade off greater access to its market for Third World producers in return for market openings in Western Europe for Eastern European products.

U.S. steel or textile producers will balk, but the alternative, regional instability and potentially higher military budgets if Eastern Europe's economy falters, makes such tradeoffs a bargain for the American economy. ■

Feed the Soviets, Starve the Taxpayer

By James Bovard

WASHINGTON

With this week's announcement of another export credit package for the Soviet Union, the Federal Government is once again trying to solve U.S. farm problems by throwing money at foreign governments. Unfortunately, Washington's farm export policy is becoming a black hole that is senselessly pulling in more and more tax dollars while providing minimal benefit to farmers.

U.S. grain exports are now routinely Pyrrhic victories. The Agriculture Department recently paid an export subsidy of $1.41 a bushel on wheat sold to Norway for $1.50 a bushel. Thanks to the department's generosity, American wheat is now far cheaper in Oslo than in Chicago.

And by paying a 94 percent export subsidy on wheat, the Agriculture Department displaced unsubsidized exports of U.S. grain sorghum to Norway. The Feed Grains Council complains that subsidized wheat exports are increasingly undercutting unsubsidized exports of corn and other feed grains.

The Export Enhancement Program, the largest U.S. export subsidy program, has spent more than $2 billion to boost wheat exports. An Agriculture Department study concluded that 9 of every 10 bushels of wheat exported through the program would have been exported anyhow. So instead of exporting for a profit, the U.S. sold for a loss. Robert Paarlberg, a Harvard economist, notes, "It would have been almost a dollar a bushel cheaper simply to buy surplus wheat on the free market and then destroy it, rather than to give it away" under the export program.

The Agriculture Department is also burning tax dollars to export eggs to Hong Kong, barley malt to Venezuela, rice to Turkey and frozen chickens to Saudi Arabia. A department study found that poultry export subsidies not only cost taxpayers more than $50 million — but also drove up retail poultry prices in the U.S. by almost $1.5 billion.

On March 1, the department announced a major expansion of dairy export subsidies. The Government is paying farmers 96 cents a pound for butter — and selling butter to foreigners for roughly 60 cents a pound. At a time when many Americans cannot afford to buy milk, we will spend more than $50 million to dump 140,000 tons of U.S. dry milk on world markets at fire-sale prices.

Americans won't get rich by giving away food to foreigners.

Members of the Congressional farm lobby appear to believe that taxpayers are obliged to bankroll any foreign government willing to receive U.S. farm products.

Representative Dan Glickman of Kansas complained that Mr. Bush's initial refusal to grant more credits was the "equivalent of a grain embargo" against the Soviets. This makes as much sense as my complaining of a Mercedes embargo because the German Government will not give me the money to buy a fancy imported car.

Farm-state Congressmen are happy that giving export credits to the Soviets, by fueling demand for American wheat, is driving up U.S. wheat prices. This may be great for politicians. But the higher U.S. prices become, the less competitive American wheat will be on world markets. The more export subsidies Washington provides, the more difficult it becomes to export any grain without a subsidy.

If legislators truly want to boost farm exports, they should abolish Federal farm programs. This year the Agriculture Department will pay farmers to leave more than 60 million acres of land idle — thereby sharply decreasing output and productivity. Federal price supports drive U.S. crop prices above world prices, crippling our competitiveness.

We cannot become rich by giving food to foreigners. Farm export subsidies have disrupted international markets, squandered billions of dollars and bushwhacked some American farmers. The sooner the crazy-quilt collection of export subsidies is abolished, the more prosperous the nation will be.

James Bovard is the author of "The Farm Fiasco" and the forthcoming "The Fair Trade Fraud."

THE JOURNAL OF COMMERCE, Tuesday, June 18, 1991

Trade Benefits for the Baltics

By PAIGE SULLIVAN
and RAIMO KAASIK

After approving a $1 billion loan to Moscow for agricultural purchases, President Bush plans to put before Congress the U.S.-Soviet trade agreement that was signed at the last summit in Washington one year ago. The trade agreement, which could reach Congress by the end of June, would extend to the Soviet Union most-favored-nation status. This would allow Soviet imports the same low-tariff treatment accorded most other U.S. trading partners.

Soviet leaders view MFN status as critical to economic recovery in their beleaguered country. But while Moscow puts on its vulnerable face for the West, it is simultaneously trying to throttle economic recovery in the Baltic states.

The Bush administration has completely passed over Moscow's acceleration of economic warfare tactics against Lithuania, Latvia and Estonia. Among these tactics, by far one of the most unfair has been the Soviet threat to deny the Baltic states (and three other republics that refuse to sign a new Union Treaty with Moscow – Moldavia, Georgia and Armenia) the benefits of future foreign credits and trade agreements, including most-favored-nation status from the United States. In effect, the Kremlin is planning to exploit its future MFN status as a potentially lethal economic weapon.

Moscow's continued policy of all-out economic warfare with the Balts became obvious during the events this year surrounding the April "9 plus 1" agreement. At this meeting between Soviet President Mikhail Gorbachev and the leaders of nine of the Soviet Union's 15 republics, there was a clear understanding that any government electing not to participate in the Union Treaty (which so far remains an ambiguous document) would be excluded from the Soviet "common market."

Such a vague-sounding and ominous threat could portend disaster for those states that still are economically dependent on the Soviet Union, but struggling to come to an agreement with Moscow on an equal footing.

Soviet leaders are pointing with one hand to the recent passage of the freedom of emigration bill, which removes one last hurdle (as stipulated by the 1974 Jackson-Vanik Amendment) to MFN status for the Soviet Union. Meanwhile, with the other hand, they are slamming the door to U.S. economic assistance in the faces of the real democratic movements of the collapsing Russian empire.

In light of this cynical Soviet ploy, the time has come for the United States to divorce economics from politics in U.S.-Baltic relations. The United States should reextend independent MFN status to all three Baltic states.

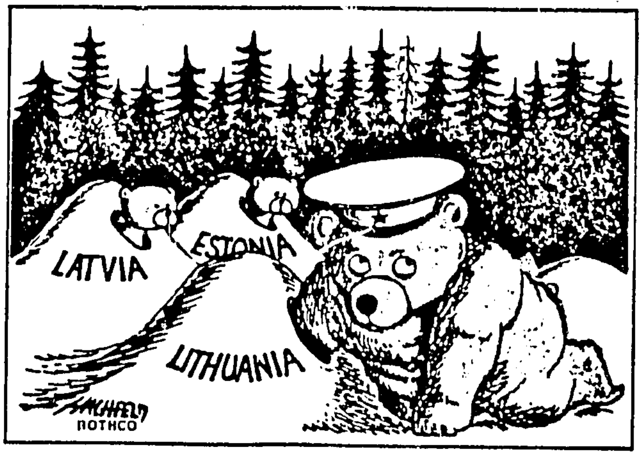
According to Article 4 of the Trade Act of 1974, the United States is legally empowered to sign a trade agreement with any government – not only with politically sovereign nations – that control their foreign trade policy. Under such an agreement, it is normal procedure to extend MFN status.

The only real obstacle to the graduation of the Baltic republics to MFN status is political – namely, the Bush administration's desire not to cross Mr. Gorbachev. But can this political concern be truly justified when our own policy ultimately boomerangs against our long-term goal, which is the democratization and economic transformation of the Soviet Union?

During the period of Baltic independence (1920-1940), all three states entered into trade agreements with the United States. These provided for unconditional MFN treatment for Baltic exports to the United States. But after Estonia, Latvia and Lithuania were forcibly incorporated into the Soviet Union, MFN status was terminated for all of them.

The question of renewing MFN for the Baltics remained moot until November 1989, when Soviet President Mikhail Gorbachev signed a law granting economic autonomy to each of the Baltic states. This Declaration of Baltic Economic Autonomy gave each state financial and commercial independence both internally and in dealings with foreign countries.

Furthermore, the law allowed the Baltic governments to negotiate a reinstatement of their prior trade status with any state they might choose. As a result, the "door" to MFN status for the Baltics was first opened by the Soviet government itself.



Since then, Estonia, Latvia and Lithuania have consistently moved forward in the independent administration of their economic affairs. In fact, the Baltic governments have taken the lead in initiating market-oriented reforms. All three are actively experimenting with pricing and subsidies reforms, the conversion of state-run enterprises into private entities, the formation and encouragement of small business and the restructuring of state tax systems.

The legislatures are encouraging joint ventures with Western partners and promoting crucial hard-currency-earning exports to the West. The presidents and prime ministers of these states are sounding out the chances of obtaining observer or the equivalent in international economic organizations such as the General Agreement on Tariffs and Trade, the World Bank and the International Monetary Fund.

Clearly, in light of the current degree of Baltic economic autonomy, Estonia, Latvia and Lithuania meet the statutory requirements for preferential trade treatment from the United States.

Granting independent MFN status to Estonia, Latvia and Lithuania would not be tantamount to an official U.S. recognition of the independence of the Baltic states. Nevertheless, MFN status would attract hard currency into these states, which in turn they could withhold from Moscow and use as leverage for negotiating a "fair deal" with the Kremlin.

The stronger the Baltic republics become financially and commercially, the less they will be forced to submit to Soviet political blackmail on account of economic dependence. They will then be in a better position to sign equitable treaties with the Soviet Union, but on their own terms.

Paige Sullivan is a research associate at the Center for Strategic and International Studies in Washington. Raimo Kaasik is an attorney in San Diego, Calif.

12

The US Should Use Its Leverage With China

By Lee H. Hamilton

UNITED States relations with China have deteriorated since the 1989 crackdown on pro-democracy protestors. We face tough decisions on China policy during the coming months.

In response to the crackdown, the US, Europe, and Japan suspended trade programs and military cooperation. Multilateral loans were blocked. China's leaders subsequently eased some repression and resumed limited economic reform. They also supported the Persian Gulf coalition. Many countries lifted some sanctions.

Four factors will influence China's future: the scope of reform, the leadership transition, the shift of power to the provinces, and the end of the cold war. China's key internal issue is economic reform. But reform threatens stability. China's aging leadership wants to reap the short-term economic benefits of reform and trade, without the long-term political consequences.

New leaders might be able to accelerate reform. A power struggle between hard-liners and reformers over whom will next rule China has reached a critical point.

China will also be influenced by the shift in power to the provinces. This trend was set in motion during the 1980s, when Beijing permitted provinces to retain a share of tax revenues and make their own foreign trade and investment deals. Provinces now sometimes defy central government economic directives.

The end of the cold war has important consequences for China's relations with the West. The decline of the Soviet threat has reduced China's value as a strategic ally. As a result, Western countries are taking firmer positions with China on issues of concern.

Inside China, we would like to see economic reform and peaceful evolution toward democracy. In its foreign relations, we want China to support stability in Asia and other regions. Reform and security cooperation will suffer if we disengage. They will also suffer if we do not press our concerns more strongly.

What are these concerns? First, Americans are troubled by the denial of many basic political rights in China and Tibet. Second, China appears to be using sales of unconventional weapons and technologies to acquire money and influence. Third, our trade deficit with China – $10 billion in 1990 – is in part the result of unfair trading practices.

VIEWS FROM CAPITOL HILL

Trade is the most pressing issue. President Bush must decide by June 3 whether to renew most favored nation (MFN) trading privileges for China. China needs trade to obtain technology and foreign exchange crucial for its development. Congressional displeasure with Chinese trade and arms policies has increased the chances that MFN will be revoked this year.

Revoking MFN would strongly convey our opposition to China's policies. But US-China relations could nose-dive. Suspending MFN also could retard rather than promote reform. Economic interaction is a key source of exposure to Western values.

For these reasons, revoking MFN could be counterproductive. We might want to hold this step in reserve while we exert other pressures on China. President Bush has cited China for illegally copying US pharmaceuticals, software, and chemicals. We can retaliate if China does not end these practices.

If China fails to make progress on human rights and arms transfers, we could reimpose sanctions lifted last year. We could also restrict high-technology sales.

On human rights, we need to be more forceful. Bush's decision to meet last month with Tibet's exiled spiritual leader, the Dalai Lama, sent a strong signal of US opposition to Chinese policies in Tibet.

To enhance the longer-term prospects for reform and democracy, we should try to increase contacts with reformist elements, especially in the military. On weapons proliferation, we should investigate reports of the transfer of missile technology to Pakistan and Syria and nuclear technology to Pakistan and Algeria.

A hostile relationship would not be in our interest, because we want China's cooperation on security and trade. If we disengage economically, we may also undermine long-term reform prospects. The end of the cold war enables us to press our concerns more strongly, though. We have economic leverage and should use it.

■ *Rep. Lee H. Hamilton (D) of Indiana is a member of the House Foreign Affairs Committee.*

THE WASHINGTON POST May 30, 1991

Richard Cohen

One Nation That Should Not Be Favored in Any Way

Ever since becoming president, George Bush has shown a certain tropism toward China, ignoring its human rights abuses until forced by Congress to take notice. Now the president wants to give China the best break possible on trade, saying his is the moral course. Tell that to the families of the victims of Tiananmen Square.

The president reiterated what amounts to his China policy in a commencement address at Yale University. Some of what he said was both sophisticated and reasonable. He warned against American "self-righteousness," which is indeed a national characteristic, and said he was trying "to chart a moral course through a world of lesser evils." Yes, indeed. But what about greater evils?

Surely, China fits nicely into the latter category. Its prison system holds about 20 million people, many of them incarcerated for political reasons. The Chinese gulag, much like the Soviet one of old, is a vast industrial empire. It makes some of the goods exported to the West—everything from children's clothing to wine—even giving some of the slave labor camps factory-sounding names. Except for Guangdong Province, where a private and semi-private economy thrives, its national economy remains rigidly centralized—precisely what the "most favored nation" law says should not be favored in any way.

What's worse is that there's a "trust me" quality to the president's address—a promise that he, the old China hand, would be able to strike the perfect balance between the carrot and the stick. But the president has earned no such trust when it comes to China. Instead, he has proven himself to be devious and secretive in his relations with Beijing, treating it far less harshly (even when it comes to trade) than he has the Soviet Union.

After the June 1989 Tiananmen Square massacre, for instance, the administration promised that the United States would suspend all "political-level" exchanges with China. Yet within a month, Bush secretly dispatched national security adviser Brent Scowcroft to Beijing—a trip that was kept secret from congressional leaders and was only acknowledged after CNN reported it in December.

When Congress threatened, after Tiananmen, to extend the visas of Chinese students in the United States by legislation, Bush protested and said he would do it by executive order. Not only did he not do so, but the White House denied that the promise had ever been made. It was only when Sen. Connie Mack (R-Fla.) produced a letter from the president containing the words "executive order" that the White House did what it said it would do all along.

In deciding how and under what circumstances to aid China and the Soviet Union, the president has no easy choices. But the Soviet Union is led by Mikhail Gorbachev, a hesitant reformer, but a reformer nonetheless. No less a critic than Boris Yeltsin has attested to Gorbachev's intentions. Gorbachev, he wrote, "could have gone on like Brezhnev or Chernenko did before him. . . . He could have draped himself with orders and medals. . . . Yet Gorbachev chose to go another way"—the very difficult task of democratization.

No such words have ever been written about China's aging leaders. There is no guarantee that they will respond to either the carrot or the stick. Nevertheless, it would not be wise to totally isolate China. Trading is inherently a liberalizing process, since when goods are exchanged, so too are ideas. It's for that reason that historically the most tolerant cities have been ports—New York and San Francisco in this country, Shanghai in China. The fax that places a factory order can send a political message as well.

But Bush is tone-deaf when it comes to the pitch of human rights. As a former director of the CIA, he seems to have left the agency but taken its ethic with him. All he can see is what advances the political interests of the United States, human rights (even trade) being peripheral. China's willingness to forgo the veto on several key U.N. votes before and during the Persian Gulf War enabled Bush to get his resolutions through the Security Council. Thus, not those 20 million souls in the Chinese gulag, seems to be uppermost in Bush's mind.

China, a country where Bush fashions himself to be an expert (he was chief liaison officer), brings out the Poppy-knows-best instincts in the president. He will brook no congressional interference. But on a score of issues, ranging from human rights to nuclear nonproliferation, China remains a rogue state, totally undeserving of "most favored nation" status. That's a carrot Bush should make China earn. If there are such things as "lesser evils," one of them, certainly, is to do nothing about greater ones.

Pauline H. Baker

South Africa: When to Lift Sanctions

Administration officials have indicated that President Bush intends to relax sanctions against South Africa when the five conditions set forth in the 1986 Comprehensive Anti-Apartheid Act are fulfilled. Now that Pretoria has completed the repeal of apartheid legislation, the lifting of sanctions could be imminent.

South African President F. W. de Klerk started to beat a hasty retreat from apartheid 3½ years after sanctions were enacted in the United States in 1986. His decision to release Nelson Mandela and unban the anti-apartheid opposition in February 1990 was the South African equivalent of the collapse of the Berlin Wall. Roughly six months later, however, after Mandela's African National Congress agreed to a cease-fire last August, de Klerk began to shift gears. The model statesman who made sweeping reforms in consultation with black leaders became a calculating politician who took halting, provocative and unilateral steps with dangerous repercussions.

This deviation in de Klerk's behavior ought to give Bush pause as he approaches the question of sanctions now. The issue is not whether to lift sanctions—most of the world is already moving in that direction—but rather when and how. Bush must not squander the credibility Washington has carefully cultivated with all sides in the conflict, set back the course of negotiations or revive the bitter controversy over South Africa in our own domestic politics.

De Klerk has made Bush's job harder by altering the character of his reform program over the past 10 months, adding qualifications and loopholes that are breeding distrust. His land reform program denied restitution for land forcibly taken from blacks while protecting land currently owned by whites. He reduced, but did not revoke, powers of preventive detention. He stretched out the repatriation of exiles, blocked the United Nations refugee office from helping resettlement and quibbled over the release of political prisoners, many of whom are still languishing in prison.

De Klerk's limp posture on township violence, which has resulted in 2,000 deaths over the past year, has dismayed even his own admirers. De Klerk has refused to launch a credible investigation, discipline the police, relieve ministers responsible for security portfolios from their posts, prosecute confessed hit-squad assassins, impose a nationwide ban on the public display of all weapons or dismantle the single-sex hostels for migrant laborers, the ghettos within ghettos from which come many of the attacks on innocent bystanders. Instead, Pretoria staged a paratroop drop on Soweto, treating the black townships as if they were foreign territory.

De Klerk's backsliding does not diminish the importance of the larger breakthroughs, but it does suggest that he is not making a clean break with the past. Sensing the vulnerability of the anti-apartheid opposition, which is having a hard time establishing itself as a viable and cohesive voice after four decades of repression, de Klerk wants to retain the upper hand, even if it means that blood will flow in the streets. His actions are heightening tensions within the ANC as it approaches its party congress in early July, a meeting that will be a critical test of Mandela's leadership.

Bush cannot lift sanctions at this time without appearing to approve of these ominous signs of drift. He should recognize the progress made thus far but at the same time encourage de Klerk to get back on the track of honest and purposeful reform.

Specifically, Bush should link the lifting of sanctions to the onset of full-scale constitutional negotiations, the only way that it can be demonstrated beyond doubt that Pretoria is fulfilling a "good faith" commitment to enter negotiations with truly representative members of the black majority. This is the fifth condition in the American sanctions law, and de Klerk, despite his repeal of apartheid laws, has now placed his compliance in doubt. Negotiations could begin in a matter of months with the convening of a multi-party conference, an idea that has been agreed to in principle by the three main parties—the government, the ANC and Inkatha.

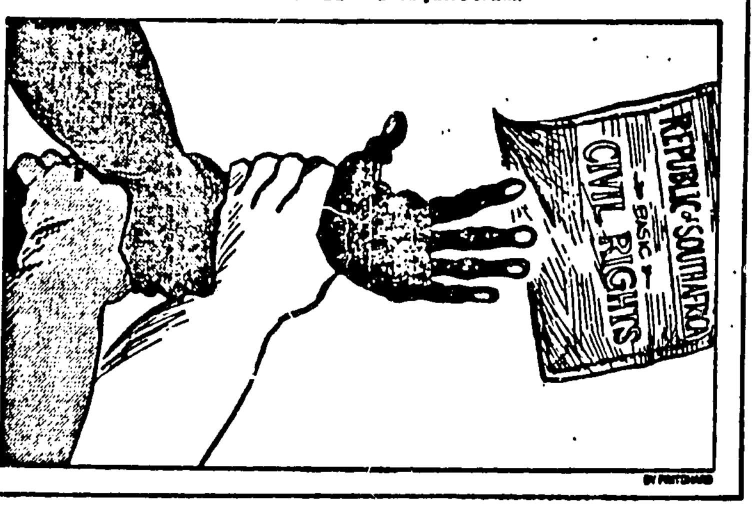
Bush should announce his policy in response to de Klerk's latest move. If the White House determines that four out of the necessary five conditions are fulfilled, Bush should indicate that sanctions will terminate when the multi-party conference or a comparable forum is held. Satisfying the final condition, precisely defined, would allow all economic restrictions to be lifted.

This policy commits the United States to a phased course of action designed to advance the negotiating process. For the South African players, it offers clarity and certainty, with no surprise or room for reinterpretation. It gives Mandela the breathing space to prepare his supporters for the change, and it provides de Klerk the incentive to get back on a path of speedy reform.

Each of the next stages in the negotiation process should trigger further economic support. When a representative mechanism to achieve popular legitimacy for the process is established, such as a constituent assembly or an interim government, then the restriction on loans by the International Monetary Fund should be lifted. Implementation of the final constitutional agreement should stimulate a Western aid package for the whole of southern Africa, a region in which other prolonged conflicts are also drawing to a close.

Too much is at stake for Bush to base the sanctions decision on narrow legal arguments that do not carry out the spirit of the law, take account of the larger political context or assess the ultimate consequences in South Africa. If Bush acts prematurely, then the fires of racial antagonism could get dangerously out of control and expand rapidly, as they did during the Reagan years, and leap into his own political backyard.

The writer is a senior associate at the Carnegie Endowment for International Peace and director of the South African Breakfast Forum.



Herman W. Nickel

Formula for Chaos

Continued sanctions will make post-apartheid South Africa ungovernable.

Pauline Baker's plea to President Bush to put off lifting the Comprehensive Anti-Apartheid Act of 1986 ["South Africa: When to Lift Sanctions" op-ed, June 18] demonstrates the lengths to which the sanctions movement will go to move the goalposts in order to stay in business.

By twisting the facts to impugn the good faith of F. W. de Klerk's commitment to negotiate a new democratic order, she builds a case that adds up to bad law and worse policy.

By signaling to Pretoria that solemn undertakings by both the legislative and

Taking Exception

executive branches of the U.S. government are subject to constant reinterpretation—and are thus meaningless—the effect of her advice would be to undermine U.S. credibility and influence on the de Klerk government during the critical negotiations ahead.

By sending the African National Congress and its ally, the South African Communist Party, the message that Washington has become their "useful idiot," the effect would be to make them more intransigent just when more flexibility is called for.

Perhaps most damaging, by leaving in place artificial obstacles to the recovery of South Africa's economy, Baker's recommendations would further reduce the chances for a successful transition to a democratic "New South Africa." If there is one thing ANC and government economists can agree on, it is that unless the South African economy resumes growth very soon (after 15 years of stagnation) that transition is doomed. Without a resumption of vigorous growth, there is little chance that any constitutional compromise will withstand the wave of instant expectations of an angry, ever-growing underclass of undereducated, unemployed young blacks. To them, liberation has as much economic as political meaning.

While South African business has been remarkably resourceful in replacing export markets closed by sanctions, the denial of access to the IMF and the negative effect on normal bank lending have made it impossible for Pretoria to pursue growth-oriented economic policies. The longer this situation drags on, the more likely it becomes that measures taken in the name of fighting apartheid will make post-apartheid South Africa ungovernable.

When will it finally sink in that the real victim of continued economic sanctions is not the present South African government, but the one that succeeds it? (Not to mention the rest of the region, which depends on the South African economy for its own recovery.)

In fact, the pressure on President de Klerk to negotiate a new democratic constitution for South Africa does not come from sanctions, but from his political imperative to have the new constitution in place before his present term expires, which will be in early 1995 at the very latest. De Klerk cannot hope to reach this target unless the ANC agrees, and that requires good will and good faith on everyone's part.

A prime reason for de Klerk's remarkable success in keeping his National Party caucus so solidly behind his radical reform course is their awareness that its right wing rival, the Conservative Party, no

> ***Pauline Baker defines "good faith" as de Klerk's willingness to do exactly as the ANC says.***

longer stands a chance once a non-racial franchise comes into effect. To imply that it is de Klerk who has been dragging his feet on the convening of a multiparty conference is to turn the truth on its head. It is the ANC that has been adding new preconditions. No one has been keener to get the talks started than de Klerk.

It was precisely this entry into negotiations by all the parties that the 1986 sanctions law sought to encourage. Once the U.S. Embassy certifies that the South African government has released "all persons persecuted for their political beliefs" (as distinct from acts of violence), de Klerk will have met all the five objective conditions of the law, after which, under section 311 (a), the act automatically terminates.

Sanctions campaigners are thus faced with the awkward task of coming up with new legal constructions to keep the law alive. The one Baker comes up with is as ingenious as it is disingenuous. Not only does the law require the South African government to enter into negotiations, she argues, it must do so in "good faith." Giving the concept of negotiations a novel meaning, she then proceeds to define "good faith" in terms of de Klerk's willingness to do exactly as the ANC says.

This applies to various new preconditions with which the ANC has dragged out the start of multiparty talks, including some the ANC later dropped, like the firing of the ministers of Defense and Law and Order. She also puts the onus for the continuing bloody turf fights between the ANC and Inkatha on de Klerk's "limp" reaction, but she signals how negatively she would react to sterner measures by expressing her indignation over a ham-handed paratrooper exercise in Soweto.

But even if de Klerk satisfied these preconditions, Baker would keep the sanctions in place on the theory that only the actual course of negotiations, not their start, can test de Klerk's bona fides. Once again, compliance with ANC demands is the test.

Specifically, she would lift the most consequential sanction—denial of access to the IMF—only after de Klerk has agreed that his cabinet step aside in favor of an interim government and that the job of drafting a constitution be moved from the multiparty conference to an elected constituent assembly. There the ANC and its allies hope to impose their views by their superior numbers rather than first having to establish a consensus on essentials in a multiparty conference.

In as ethnically and racially divided a society as South Africa, such a simplistic majoritarian approach is a certain prescription for continued conflict. Nevertheless, as recently as June 16, Nelson Mandela vowed that the ANC would not compromise on these demands and threatened de Klerk with "mass action" if de Klerk does not comply. It would appear that, under pressure from radicals, Mandela now agrees with his wife, Winnie's, dictum that there can only be negotiations about the transfer of power, not the sharing of power.

For the United States to sign on to this agenda would be a disaster. It would fan the very fires of racial antagonism in South Africa that Baker warns against. It would violate not only the plain language of the Anti-Apartheid law but its spirit—which was to push not only the South African government but also the ANC toward negotiation and compromise.

The writer was U.S. ambassador to South Africa from 1982 to 1986.

116

End Sanctions, or the Hate Will Never Die

■ **Iraq: The deprivation hurts mostly women and children, and, in the long run, America.**

By JULIA A. MOORE and ROBERT B. LIVINGSTON

George Bush might learn from his Republican predecessor, Herbert Hoover, to convert collateral damage of war to strengthening peace. In 1951, based on his lifelong experience with international conflicts, Hoover wrote: "America, with its skill in organization and the valor of its sons, could win great wars. But it could not make lasting peace. I was convinced that we must . . . lend ourselves to measures preventing war, maintaining peace and healing the wounds of war."

While relatively few Americans lost their lives in the Gulf War, Iraqi casualties were horrendous. By recent estimates, 80,000 soldiers were killed and tens of thousands were wounded, mostly youthful draftees. About 60,000 civilians were killed and roughly as many wounded, preponderantly women, infants and children. Children are dying in droves because of contaminated water supplies, ruined sewage systems, damaged health facilities and continuing lack of electricity. Another important cause is malnutrition.

Iraq is on starvation rations, estimated by Western observers to be about 1,000 calories per person per day. According to a recent Harvard survey, 55,000 more Iraqi children died in the first four months of 1991 than in the same period a year ago, and if sanctions are not lifted, 170,000 more children will perish from preventable causes before the end of this year.

Hoover was familiar with the human consequences of war: "It is impossible for one who has never seen real famine to picture it—the pallid faces, the unsmiling eyes, the thin, anemic and bloated children; the dead pall over towns where the children no longer play; the dull, listless movements and dumb grief of women."

Following World War I, Hoover wrote: "Although the food blockade may have played a part in the defeat of Germany, every enemy soldier, every munitions worker, every farmer, every government official and his family had food. The rest of the people, mostly women, children and elderly were left with less and less." Hoover organized delivery of food and clothing to people throughout occupied Belgium and northern France, despite initial German and Allied opposition.

"Love of children is a biological trait common to all races. It therefore seemed to me that around this devotion there could be built a renaissance of unity and of hope among their distracted elders. I hoped that in this evidence of someone's concern for their children there might be a lessening of the consuming hates that burned in the

'It is impossible for one who has never seen real famine to picture it—the pallid faces, the unsmiling eyes, the thin, anemic and bloated children.'

—Herbert Hoover

hearts of women because their own children or millions of the children of their nation had come to this condition."

Of course, the problems in Iraq can be blamed on Saddam Hussein. Where history will fix the blame is less important now that millions of children are at risk for their lives because of deplorable conditions that could be remedied quickly by discontinuing sanctions.

"Maintenance of the blockade on food during four months from the Armistice until March [1919] was a crime in statesmanship and against civilization as a whole," Hoover wrote. "Nations can take philosophically the hardships of war; when the fighting is over they begin to buy the past as part of the fighting. But when they lay down their arms and surrender, and then find that the worst instrument of attack upon them is maintained—then hate never dies."

Maintaining sanctions is not going to unseat Hussein until effectively the entire civilian nation succumbs. Until life-support systems are restored, physical and psychological consequences will continue to punish women and children. Iraq has assets in this country frozen by sanctions, which also preclude selling oil that could provide for restoration of nutrition, health care and infrastructure. Even though food and medicine are not contravened, sanctions allow Iraq and its Arab neighbors to perceive Americans as heartless. As Hoover observed after World War I, "The Germans have never ceased to use the continuation of the food blockade to poison the minds of their people and the world."

Iraq imported 70% of its foodstuff before the war and now needs 10,000 tons of cereals daily. Comparatively little food is getting through. For instance, 128 tons of powdered milk sent by German physicians needed by Iraqi children was delayed for fatal weeks awaiting clearance into Iraq.

As Hoover wrote: "No matter how deeply we may feel at the present moment, we must live with these people in the future. Our vision must stretch over the next hundred years and we must write now into history such acts as will stand creditably in the minds of our grandchildren."

Julia A. Moore is executive director and Dr. Robert B. Livingston is president-elect of Physicians for Social Responsibility.

Patrick Clawson

Sanctions Can't Topple Saddam

Current administration policy toward Iraq is doomed to failure. That policy relies on sanctions to overthrow the current Iraqi regime. As President Bush proclaimed on May 20, "We don't want to lift these sanctions as long as Saddam Hussein is in power."

There are only three possible outcomes for this policy, one unlikely and two unfortunate. The first possibility, for which the administration hopes, is that the sanctions will lead to Saddam's overthrow in a Baathi putsch or in a military coup that does in the Baath itself. Neither is likely; the Baathi elite does not care very much about the welfare of the Iraqi people, and its own welfare—still plush by most standards—is connected to the Saddamite center. The professional army is divided and cowed by Saddam's security goons.

The second possibility is that sanctions could be sustained indefinitely. Before the regime would fall from the pain, however, sanctions would, within a year, cause at least 1,000 Iraqi deaths a day. Sanctions prevent Iraq from earning money to pay for food and medical imports, and they deny Iraq full access to its foreign bank accounts. While Iraq can import some supplies with funds it has hidden away, that cannot provide basic goods in the needed quantities. Reports that Baghdad stores are full are misleading in two ways: The situation is much worse for the three-fourths of Iraqis in the Shiite south and Kurdish north, and the Baghdad stores are full only because prices are so high that customers cannot afford to buy much.

If the typical government employee spent his entire salary on food, he could buy one pound of meat per day. The quality of the Iraqi diet is deteriorating below the level needed to sustain life over the long run. The population is getting weaker, which contributes to mounting public health problems. Perhaps there are no epidemics yet—evidence from outside Baghdad is sketchy—but more people are succumbing to diseases they could have survived had they been in better general health.

The daily death toll will increase sharply either this summer, when hot weather contributes to disease, or this winter, as food supplies run low. For the United States to enforce sanctions that cause deaths on a large scale would be a disastrous misdirection of its might. Public opinion in the United States and throughout the world, one suspects, would be revolted.

The third possibility is that sanctions would erode over time, either with U.S. approval or without. Neither world nor U.S. public opinion wants to see Iraqis starve in large numbers. At some point, the sanctions will be undercut one way or another: Countries like Jordan will openly cheat, the United Nation sanctions committee—in which the United States has no veto—will erode the sanctions, or America and other industrial countries will be forced to mount a rescue operation similar to that done for the Kurds. Any of these outcomes will look like a climb-down by the United States and contribute to the perception that Washington is inconstant.

Meanwhile, as we wait for sanctions to doom Saddam, U.S. policy surrenders the moral high ground to the Butcher of Baghdad, allowing him to pose as the protector of Iraq's poor and hungry.

The sanctions regime should be changed to expose Saddam's lack of interest in the welfare of Iraqi. The United States must sponsor changes now before worse changes are forced on it. The current sanctions should be stood on their head in two ways:

First, the West should require rather than forbid Iraqi oil exports. The U.N. secretary general has proposed five sensible alternatives to keep money from such exports out of Iraq's hands until the Security Council decides to release the funds. With this oil money, reparations payments could begin immediatedly rather than forcing Kuwait and other claimants to wait years to collect on bills for damages.

The oil exports could also fund humanitarian needs. It is obscene that U.S. taxpayers are paying $566 million for Kurdish relief when Baghdad gets off scot free. Furthermore, the money that accumulates in this account would form a multibillion-dollar "carrot" that could be waved under the noses of those who might be contemplating a coup against Saddam: Throw him out, and the money is yours.

Second, the West should require, rather than merely "permit," Iraqi food imports. Under the procedures set forth in Security Council Resolution 666, the U.N. would determine what food Iraq needs and then distribute the food itself in cooperation with the Red Cross or other appropriate humanitarian agencies.

It is not safe to permit Saddam to have the necessary money while trusting he will spend the funds on food, because his priority expenditure would be on arms. Iraqis need to know that the world community cares about their welfare while their leader is prepared to starve them in order to feed his war machine. In addition, the presence of foreign relief workers throughout Iraq would give the world early warning of any genocide Saddam may be planning against Kurds and Shiites.

The reformulated sanctions are unlikely to lead to Saddam's overthrow, but neither are sanctions in their current form. The administration understood in 1990 that sanctions without force would not work; that principle is no less true today. The only way that the United States can get rid of Saddam is to send U.S. troops into Baghdad. Perhaps it was a mistake not to do just that in early March but, be that as it may, the option is closed. There is no support in the United States, in the Middle East or in the world for sending U.S. troops back into Iraq to overthrow Saddam.

What sanctions can do is to keep Iraq weak and isolated so long as Saddam is in power, which may for quite a while. The point, however, is to design the sanctions in such a way that they injure the guilty—Saddam and the Baath—and not the innocent—the Iraqi people and the image of the United States. As things stand, this is not the case.

The writer is a resident scholar at the Foreign Policy Research Institute in Philadelphia. He is the author of "How Vulnerable Is Iraq's Economy?"

INTERNATIONAL MONETARY FUND

Research Department

Commodity and Manufactures Prices in the Long Run

Prepared by James M. Boughton *

May 1991

Summary

Primary commodity prices have been depressed since the mid-1980s, with severe consequences for countries that depend heavily on commodity export revenues. The causes of this problem are manifold. At the global level, the depreciation of the U.S. dollar tended to raise the dollar prices of manufactured goods but probably not those of primary commodities. The debt crisis may have contributed to the problem by increasing the pressure on developing countries to raise exports. At the micro level, there have been many developments with adverse effects on the markets for specific commodities. These factors have included health and environmental concerns, the weakening of international marketing arrangements, bumper crops, and cyclical increases in metals supplies.

Rather than attempting to quantify the relative importance of these various disturbances, this paper examines recent developments in the context of longer-run movements in commodity prices. Based on data for the prices of primary commodities and manufactured goods in international trade since the middle of the nineteenth century, it is shown that there has been a stable negative trend in the relative price of commodities amounting to around 1/3 of one percent per annum, or about 40 percent over the past 120 years. The economic importance of this trend is difficult to assess, because of the impossibility of accurately measuring quality changes over such a long period. What seems more disturbing is that there has been a secular tendency for commodity prices to become more volatile, with adverse consequences for consuming as well as producing countries. This tendency first appeared around the time of the first World War, but it has become much more marked since the early 1970s.

The relative price of commodities in 1990 is estimated to be at the lowest level ever recorded: some 60 percent below the level that would have prevailed in the absence of the negative trend and major disturbances to market conditions. Taking the negative trend into account, it appears that the recent decline is not quite unprecedented. There have been three times in this century that the relative commodities price has fallen more than thirty percent below trend: in the aftermath of World War I, after which commodity prices rapidly recovered in the boom period of the 1920s; at the onset of the Great Depression, after which commodity prices remained relatively low until the end of the Second World War; and now. History thus seems to suggest that strong growth in industrial countries is required for a recovery in commodity prices. The estimates in this paper, however, must dampen even that degree of optimism, because the recent decline is not attributable to slow growth and is largely outside the realm of previous experience.

49

FINANCE

Brady, Nicholas F. Statement before the Development Committee of The World Bank and The International Monetary Fund, Treasury News, April 30, 1991.

"Development Committee Cites Poverty Reduction as Priority for International Community," World Bank News, Vol. X, No.18, May 2, 1991.

Mulford, David C. Under Secretary of the Treasury for International Affairs. Statement before the Subcommittee on Banking, Finance and Urban Affairs, U.S. House of Representatives, June 12, 1991.

"Strengthening the World Bank Group's Support for Private Sector Development," World Bank News, May 2, 1991.

Fishlow, Albert. "Deficits, Debt Management, and International Debt." Statement before The Senate Finance Subcommittee, June 12, 1991.

Riess, Armin-Detlef. "Zambia is First Country to Benefit from Rights Approach," IMF Survey, May 27, 1991.

Gandillot, Thierry and Dominique Nora. "A Cry for Capital," World Press Review, June, 1991. (Taken from "Le Nouvel Observateur" of Paris).

Khanna, Vikram. "Global Capital Markets Might Behave Differently in the 1990s, Says BIS Study," IMF Survey, June 24, 1991.

Hoxter, Curtis J. "Mr. Attali's Grand Vision," The Journal of Commerce, May 21, 1991.

Kleiman, Gary N. "Healthy Banks for the East," The Journal of Commerce, May 31, 1991.

Agnevli, Bijan B., Mohsin S. Khan and Peter J. Montiel. "Exchange Rate Policy in Developing Countries: Some Analytical Issues," International Monetary Fund, March 1991. (Summary and Conclusion)

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

STATEMENT OF
SECRETARY OF THE TREASURY
NICHOLAS F. BRADY
AT THE MORNING SESSION
OF THE DEVELOPMENT COMMITTEE
OF THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND
WASHINGTON, D.C.
APRIL 30, 1991

INTRODUCTION

Mr. Chairman, fellow Governors and distinguished guests: It is a pleasure for me to welcome the Development Committee to Washington for its spring session.

I wish especially to welcome Chilean Finance Minister Foxley as the new Chairman and express my appreciation to Yves Fortin for his distinguished service as Secretary to the Committee for the last three and a half years.

In addition, let me give my personal thanks to World Bank President Barber Conable for five years of distinguished service. It has been my pleasure to have known him and worked with him in his many years of leadership in the U.S. Congress as well as at the Bank.

FOREIGN INVESTMENT

I welcome the Committee's decision to revisit the vital topic of the role of foreign investment in the development process. The world has changed significantly in recent years, as indicated by the momentous events in Central and Eastern Europe, as well as the sweeping reforms underway in Latin America. The Bank and the majority of its member nations have begun to recognize the key role of the local private sector in development. Fortunately there is now also growing awareness of the beneficial role which foreign direct investment can play. Foreign investment can serve as a partner to the local private sector, generating jobs and providing a dynamic effect on an expanding local economy. It can help underwrite successful privatization, as well as provide long term technology transfer and access to export markets.

NB-1248

51

The Bank must help developing countries adopt appropriate institutional and policy reforms that would attract foreign direct investment, and encourage the return of flight capital. In particular, it needs to develop further an investment sector lending program which can be instrumental in encouraging the required reforms to support directly the private sector. These efforts are especially important for the severely indebted nations. A discussion of this issue is particularly timely in light of the proposed IFC capital increase.

IFC CAPITAL INCREASE

The United States fully appreciates the vital and unique role of the IFC within the overall World Bank Group. The IFC has a solid record in providing capital for worthy projects and investments throughout the developing world. We believe that the IFC should build on this record of many years and strengthen and broaden its role in the 1990s. For this to be done the IFC will need additional capital. We are prepared to support a capital increase in the appropriate circumstances. For additional capital to be most effective, however, we believe actions are needed in three broad areas:

First, measures to enhance the focus, operations, and priorities of the IFC itself.

Second, measures to strengthen communication and collaboration between the IFC and the rest of the World Bank Group.

Finally, measures to strengthen the focus of the World Bank on the private sector so that the IFC is not operating in isolation, but is part of a comprehensive World Bank effort in support of private sector development.

We look forward to a comprehensive action plan to provide a clear framework for the Bank's evolution towards the private sector in the years ahead.

POVERTY ALLEVIATION

We commend the Bank for the increasing attention it is giving to poverty alleviation. The U.S. believes strongly that poverty considerations are integral to development and should be a top priority for all countries. Assessments of whether a country's policies and programs are consistent with the reduction of poverty should be prepared for each borrowing nation, and updated regularly. A country's commitment to poverty alleviation is critical and should be taken into account in the allocation of Bank resources.

DEBT

The debt situation of several developing countries is improving through a combination of reform efforts, commercial bank packages which include debt and debt service reduction as well as new financing, and continued support from official creditors.

By offering support for commercial bank debt and debt service reduction, the international debt strategy has allowed debtor country officials to turn their attention to the key issues of reforming and liberalizing their economies at home. In a number of cases -- Mexico, Chile, and Venezuela -- these efforts are reaping tangible results -- economic growth, return of flight capital, new investment flows, and access to spontaneous foreign financing. This signal of a return to creditworthiness is especially gratifying.

Official creditors are continuing to provide strong support for debtor nations. For Poland and Egypt, we have supported exceptional action due to their extraordinary situations. For heavily indebted, low income countries, the Paris Club is reviewing the implementation of existing options under Toronto Terms, as well as possible additional measures to assist these countries.

As a part of our commitment to assist the poorest countries on a bilateral basis, the United States has agreed to forgive approximately $1.1 billion in debt owed by Sub-Saharan African countries. We also expect to begin implementing new authority this year to reduce food assistance obligations of least developed countries.

ENVIRONMENT

The U.S. is pleased to participate in the meeting of the Global Environment Facility that will take place later this week. Over the three year life of the facility, we intend to provide up to $150 million in parallel financing through our Agency for International Development.

We see the facility as an experimental pilot program. It should test new approaches and techniques, fund projects which would otherwise go unfunded, and fold the lessons learned into mainstream development operations.

Our first priority will be to address outstanding issues of organization and governance. The process should be open and transparent, and provide opportunities for an exchange of views with the scientific and technical community and NGOs. The U.S. is prepared to review projects to ensure that the work program is balanced, and that the projects provide global benefits and lessons that can be incorporated into the ongoing and regular

53

lending programs of the Bank. It is essential to establish the credibility of the facility through the selection of "good" projects. We must therefore resist the temptation to move too quickly until a proper foundation for operations has been laid.

URUGUAY TRADE ROUND

I would also like to mention the important subject of international trade. Maintenance of a vibrant multilateral trading system characterized by free and open markets will provide a sound basis upon which developing countries can improve their economic prospects. A successful Uruguay Round of multilateral trade negotiations is necessary to strengthen the trading system and improve market access for developing countries.

Developing countries which have integrated themselves into the global trading system and have begun or accelerated trade liberalizing programs can greatly assist their own economic prospects and maximize their gains from the trade negotiations. It is in the economic interest of all trading nations to work toward a successful Uruguay Round. Indeed, each of our nations has the responsibility to ensure that the negotiations produce broad ranging and sustainable results as quickly as possible. Until we achieve such a conclusion to the Round, we must consider our work, regrettably, unfinished.

CONCLUSION

It is clear that there are a number of important issues facing us in the near future. I am sure the work of this Committee under the able leadership of Chairman Foxley will meet these challenges. Thank you.

WORLD BANK NEWS
Vol. X No. 18 May 2, 1991

Development Committee Cites Poverty Reduction as Priority for International Community

Reducing the incidence of poverty in developing countries is the "highest priority for the world development community," a committee that advises the World Bank and the International Monetary Fund stated on April 30 in Washington.

According to a communique issued by the Development Committee, achieving this goal "would be facilitated by good governance in all countries, recognizing that their sovereignty must be respected."

The Development Committee consists of 22 members, generally ministers of finance. The committee advises and reports to the Boards of Governors of the World Bank and the International Monetary Fund (IMF) on all aspects of transferring resources to developing countries.

The committee expressed support for a poverty-reduction strategy described in the World Bank's "World Development Report 1990." Members of the committee indicated a special need for countries with a high level of poverty to make the most efficient use of existing resources and to mobilize additional domestic savings and public revenues for poverty reduction purposes while increasing the poor's access to these resources. "Adequate external resources, mainly of a concessional nature, are necessary to complement the efforts at poverty reduction in these low-income countries," the communique stated. Countries should also look at how public spending programs--including those for the military--affect poverty.

The committee asserted that foreign direct investment plays an important role in development and called on host countries to create a "climate of confidence" for investors. The World Bank and the IMF, the committee said, should continue to strengthen their efforts to promote an environment favorable to a higher contribution by the private sector to development and increase the flows of foreign direct investment to developing countries. Noting the World Bank President's plan to strengthen the institution's role in the private sector, the committee stated that the International Finance Corporation "should have adequate resources to meet the growing demand for its services during the 1990s in a financially prudent and regionally balanced manner."

IFC is the World Bank affiliate that supports the growth of the private sector.

The committee called on host countries to create a "climate of confidence" for investors.

The committee also:

- urged the World Bank and the IMF to continue assessing the financial requirements of countries affected by the Gulf crisis;
- called on governments to examine how trade barriers affect development efforts;
- encouraged continued efforts to relieve the debt burdens of many countries; and
- welcomed the establishment of the Global Environment Facility, co-sponsored by the World Bank, the United Nations Development Programme, and the United Nations Environment Programme.

The Development Committee is formally known as the Joint Ministerial Committee of the Bank and the Fund on the Transfer of Real Resources to Developing Countries. ■

55

STATEMENT OF THE HONORABLE
DAVID C. MULFORD
UNDER SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL DEVELOPMENT, FINANCE, TRADE
AND MONETARY POLICY
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES
JUNE 12, 1991

International Finance Corporation

I am also pleased to testify today on the proposed Capital Increase for the International Finance Corporation (IFC). IFC management and member countries have been negotiating a Capital Increase for over a year. All documents pertaining to the Capital Increase have been circulated, and a joint World Bank/IFC Board is scheduled to discuss the Increase on June 20.

As you know, the IFC is the component of the World Bank Group which most directly serves our key policy goal of promoting private sector development. The IFC was established in 1956 to support private sector led economic growth in its developing member countries by making direct equity and debt investments in private companies, mobilizing funds from other sources, and providing important advisory services to developing country governments and corporations. Unlike the World Bank and IDA, the IFC lends directly to the private sector. The IFC is in strong financial shape, and enjoys an "AAA" credit rating. The U.S. is the largest single shareholder, owning about one quarter of the IFC's capital.

Recent IFC Projects

I would like to mention briefly some current IFC projects, as they help illustrate how the IFC pursues its private sector development mandate.

-- In Czechoslovakia, IFC has been retained by that nation's largest heavy industrial group to provide advice on its privatization strategy.

-- In Poland, IFC has recently established the Polish Business Advisory Service, in cooperation with the European Bank for Reconstruction and Development (EBRD). PBAS will provide technical assistance and support for Polish entrepreneurs and small businesses.

-- The IFC is actively discussing privatization opportunities with Mexico, Argentina, Bolivia, Brazil, Ecuador, and Uruguay. Currently, the IFC is assisting in the privatization of the Chilean telephone company.

-- IFC's strategy in Asia focuses on assisting companies to access international capital markets, as well as developing internal capital markets.

-- In Africa, in addition to individual investment projects, the IFC finances small enterprises directly through its African Enterprise Fund, provides technical assistance through the African Project Development Facility, and is addressing management needs by increasing training activities of the African Management Services Company.

U.S. Goals

The world has changed significantly in recent years, as shown by the momentous events in Eastern Europe and the sweeping reforms now underway in many nations in Latin America. It is now understood in most of the world that real economic, social, and even political progress requires the development of strong local private sectors. Accordingly, we are seeking to strengthen both the IFC and the World Bank so that these institutions will take the lead in assisting this historic transformation.

The U.S. believes that for an IFC Capital Increase to be effective it must be part of an accelerated effort by the entire World Bank Group to support private sector development. We believe that the Bank Group can increase its support for the private sector while maintaining the Bank Group's emphasis on growth and development, poverty alleviation, and the environment.

To accomplish this objective there is a very important practical problem which must be resolved successfully. The IFC needs to implement a stronger and more active policy to promote privatization in countries moving towards market economies. However, this effort will not be successful if the World Bank does not actively support the same objective. A large state enterprise in a developing country or in Eastern Europe which can borrow from the World Bank with the support of a government guarantee will not easily give up that important source of capital by privatizing and cutting itself off from future World Bank loans. How both institutions face and resolve this transitional problem will be an important determinant of the speed and success of privatization.

As Secretary Brady told the Joint World Bank/IMF Development Committee on April 30, 1991, actions in three broad areas are needed as a part of an IFC Capital Increase:

-- First, measures to strengthen IFC's project selection and overall operations.

-- Second, measures to strengthen communications and collaboration between the IFC and the rest of the World Bank Group.

-- Finally, measures to strengthen the private sector focus of the World Bank, so that the IFC is not operating in isolation, but is part of a comprehensive World Bank effort in support of private sector development.

Although the IFC Capital Increase will not be finalized until the Bank and IFC Boards and then IFC Governors approve the Increase, the U.S. has been pursuing a number of major objectives in the negotiations and expects that all our policy objectives will be met.

With respect to the IFC, we believe that the IFC should make privatization a top priority and become a strong advocate for privatization with developing countries. There is clearly a great need for expanded work in this area. We also believe that the IFC should collaborate more closely with the rest of the Bank Group in promoting needed policy reforms in borrowing countries and pay more attention to the Bank's policy reform goals when selecting its own projects. This means that IFC project selection should reinforce economic reforms supported by the World Bank and the IFC should avoid projects in countries where overall macroeconomic policies are clearly unsound. The IFC also should avoid lending into highly protected sectors when there is little prospect for liberalizing trade in those sectors.

In connection with the efforts to improve communication and collaboration between the Bank and the IFC, we believe that there should be a clearer definition of the respective roles of both institutions, especially in such areas as privatization and lending to financial intermediaries. A World Bank Group Private Sector Development (PSD) Committee under the Chairmanship of the Bank's President has been set up to coordinate the implementation of private sector development work within the Bank and between the IFC, MIGA and the Bank. To be successful, this new effort will require the constant close cooperation of key policy, operational, research, and personnel offices within each of the institutions. The Bank and IFC will collaborate in carrying out Private Sector Assessments (PSAs), which will be used to formulate country assistance strategies and will incorporate private sector development priorities. We understand that the Bank is in the process of identifying the first 20 countries for assessments.

We believe that the Bank should increase its own support for private sector development, in addition to what the IFC is doing. This would include developing country policy reforms -- legal, regulatory and institutional -- in support of an efficient private sector, more support for privatizations, and implementation of more projects through private rather than public channels.

We also believe that Bank management and the Executive Board should study the issue of amending the IBRD's charter. The IBRD's charter requires a government guarantee for any Bank loan to a private entity. Although no policy decisions have been made, there could be cases where it would be useful if the IBRD could lend directly to the private sector without government guarantees. Unless the charter is changed, current practice could be a disincentive to privatization. As I mentioned earlier, former state-owned enterprises which have been privatized are no longer eligible for IBRD loans unless the government extends guarantees. Some countries have constitutional prohibitions against such guarantees.

Status of Negotiations

We believe the negotiations for an IFC Capital Increase are moving towards a successful conclusion, with what we hope will be agreement on a Capital Increase and related IFC and World Bank policy reforms. We, along with most other major shareholders generally favor the proposal for an IFC Capital Increase. The IFC Capital Increase and Strengthening the World Bank Group Effort on Private Sector Development will be discussed by the World Bank and IFC Executive Boards on Thursday, June 20. It is our hope that the Boards will agree at that session to send the Capital Increase proposal to member governments for their approval. Approval of a Capital Increase will require an affirmative vote of the IFC's Board of Governors by a three-fourths majority of the total voting power.

The U.S. would be prepared to support a Capital Increase, provided that our major policy reform goals for both the IFC and World Bank are achieved. The U.S. currently holds about 25 percent of IFC capital. It has been our objective to maintain our current share in an agreed Capital Increase. However, the actual amount of the U.S. share will be dependent on the ultimate size of the Increase.

Conclusion on the IFC Capital Increase

We expect the IFC within a coordinated World Bank Group effort to play an especially important role in the 1990s, due to its expertise in privatization, capital markets development, and foreign investment. The IFC will place special emphasis on Eastern Europe (in cooperation with the EBRD), expand its activities in Latin America, and seek to maximize its activities in Sub-Saharan Africa and Asia.

Madam Chair, in the final analysis, the justification for our supporting an IFC Capital Increase bears repeating: that it is essential for the IFC and World Bank to work together to ensure the success of the difficult transition away from state controlled economies to free markets. This will require strong and coordinated support from both the IFC and the World Bank. We look forward to the IFC and the Bank stepping forward to meet this challenge. Thank you.

Strengthening the World Bank Group's Support for Private Sector Development

The following is an excerpt of a statement made by World Bank President Barber Conable at a press briefing in Washington April 26.

The World Bank Group's central objective is to reduce poverty and promote growth. You will recall this was the focus of our "World Development Report 1990." This theme will be reemphasized in this year's WDR which will stress the importance of a balanced relationship between government and the market in promoting development.

Thus, it is very timely that the agenda for the Development Committee meeting includes the private sector and, in particular, the International Finance Corporation capital increase. The continuing promotion of private sector activity--in developing countries and in economic relations between these countries and the industrial world--remains a key item on the World Bank Group's agenda.

In recent years, it has become increasingly evident that private initiative and competitive markets play a critical role in fostering dynamic economic growth, development and poverty alleviation. Governments throughout the world have come to recognize that the most efficient allocation and use of resources is achieved through the marketplace.

The World Bank Group--World Bank, IFC and Multilateral Investment Guarantee Agency--has consistently emphasized the importance of the private sector in development strategies. We help governments create an enabling environment for the private sector to develop and prosper. We help expand competition. We help governments create more space for private initiative.

60

As the environment for private initiatives improves, it is vital that the private sector respond to available opportunities. As a risk-taking partner, IFC can encourage and assist companies to undertake sound investments that will produce economic benefits. It can mobilize funds from market sources and provide valued advice on all aspects of private sector development.

Private initiative and competitive markets play a critical role in fostering dynamic economic growth, development and poverty alleviation.

Given the rapid expansion of the private sector's role in development, and the growth in interest by our member governments, the Bank Group is continuing to adapt its instruments and policies to provide effective support for private sector development. Coordination of activities needs to be strengthened within the World Bank Group to maximize our overall effectiveness, drawing on the unique strength of each of our three institutions. Accordingly, we have recently taken some specific actions internally to bring about greater effectiveness.

I have reconstituted and strengthened a Private Sector Development Committee made up of senior managers of the Bank, IFC and MIGA to assist me--and, in due course, my successor--in providing policy guidelines, and in coordinating the work of the three institutions.

Staff guidelines have been prepared to clarify roles and further improve coordination between the Bank and IFC in all phases of our private sector work, from the formulation of broad country strategies to the design of specific operations.

The Bank, IFC and MIGA will jointly prepare private sector development strategies that will be reflected in individual country assistance programs, and will jointly conduct private sector assessments in selected countries.

Further, staffing within the Bank's Technical and Country Departments will be reviewed to ensure that they have the requisite skills to formulate and implement private sector development strategies.

With these actions, the World Bank Group can now push ahead in its support of private sector development in a more effective fashion.

IFC's role in this effort is crucial. IFC has grown remarkably in recent years. It has greatly diversified the range of services it provides and the roster of its clients. IFC's capacity to continue to expand its lending and investment activities is, however, constrained by lack of resources. A substantial increase in the IFC capital base is needed now.

As the environment for private initiatives improves, it is vital that the private sector respond to available opportunities.

As you know, discussions on a capital increase have been taking place for many months. There is widespread, solid support in our Board for the IFC and for a capital increase. We are close to an agreement. Only the United States has not yet joined in this consensus. I hope we will now see progress on this issue. And I hope that the Development Committee will endorse our proposal to increase IFC's capital to enable us to expand IFC's activities in the next fiscal year.

61

Statement of Albert Fishlow

Senate Finance Subcommittee
on Deficits, Debt Management and International Debt

June 12, 1991

It is now almost a decade since the Latin American debt crisis first became manifest. The subsequent adjustment has taken a significant toll in foregone economic growth for the people of the region: per capita production now stands 10 per cent below 1980 levels; and per capita income, factoring in the 20 percent decline in the regional terms of trade, lower still. And there is evidence to suggest in many countries that the principal burden of the lost decade of the 1980s has fallen upon the poor.

Gradually, public policy of the industrialized countries and multilateral financial institutions has shifted from an immediate concern with the fragility of the international financial system and the exposure of bank lenders to a recognition of the need to focus upon renewing economic development. The Baker Plan in 1985 envisaged larger financial flows, both from official sources and commercial banks, to ease the large financial transfers required by debt service. This policy failed for two reasons. First, the required private flows were not forthcoming; second, medium term uncertainties created by the sheer size of the debt overhang made the Baker policy of growing into an expanded debt progressively more difficult.

More than two years ago, partially in recognition of the more precarious position of official lenders who were being placed in the position of underwriting interest repayments to commercial creditors, the Brady Plan was launched. It recognized the need for debt reduction, both as a means of improving cash flow as well as avoiding disincentive consequences of the debt overhang. Such new style agreements have now been negotiated with Costa Rica, Mexico, Uruguay and Venezuela, while Chile has opted in favor of rescheduling with new money, including a return to the voluntary capital market.

But while it is now fashionable to put the debt problem behind, it is well to remember that many countries of the region remain in arrears to an estimated total of some $30 billion; that several are delinquent in payments to the multilateral institutions; and that the Latin American debt of well over $400 billion remains much higher relative to exports than it did in 1981 and 1982.

What are the lessons to be learned from this experience?

First, public policy of the United States and other industrialized countries, and of the multilateral institutions, makes a difference. Brady style agreements, without simply diverting benefits from debtors to creditors, were possible only in the context of significant pressure in behalf of debtor countries. Otherwise, the free rider problem would have encouraged individual banks to hold out in favor of more beneficial terms. Private profit maximization in isolation does not correspond to the best social outcome. Conversely, countries that have tried to go it alone and impose unilateral debt relief, were largely unsuccessful, including at various times, Argentina, Brazil and Peru. Even where

63

countries were able to avoid immediate payment, the extra cash flow was reduced in its favorable effects both by poor domestic policy and the attendant uncertainty of its sustainability. Bank negotiating positions thus remain relatively strong; there can be no solution without active private participation.

Second, debt relief has generally been limited in its magnitude. In the cases of Mexico, Uruguay and Venezuela the improvement in cash flow has been of an order of about 10 per cent of cash flow, but higher for Costa Rica. The reason is that typically only a portion of total debt is reduced, and not at deep discounts. That does not mean that such arrangements were not desirable -their calculated rates of return are favorable- but rather that debt relief cannot be counted on in isolation to make a big difference. The overall content of domestic policy, and external variability in import and export prices and interest rates, count for much more. Note that Mexico and Venezuela gained more incremental foreign exchange from the rise in oil prices than from debt relief. All countries in the region are still in fragile circumstances, and will need years of sustained growth to emerge strengthened.

Third, debt policy thus far has failed to contribute to successful stabilization and adjustment in Argentina and Brazil. It is argued, and persuasively, in view of massive inflation, a succession of failed domestic macroeconomic plans and diminished confidence in domestic policies, that debt relief must await more durable evidence of these governments' commitment to reform.

Otherwise any increase of external resources will be diluted in wasteful public deficits and capital flight. But this sequencing is too simplistic and also potentially too costly: the objective is not to maximize austerity but to induce durable structural change within the context of democratic politics.

There is an opportunity, and a need, for integrating structural reform -including privatization and trade liberalization, most prominently-, macroeconomic stabilization and debt relief to achieve favorable results in Argentina and Brazil, and in other lagging Latin American countries. In both these larger countries there is an ample effort underway. Inadequate implementation can be given a boost by external support rather than a more cautious policy of wait and see that can contribute to erosion of private sector support.

Mexico and Chile provide lessons, but perhaps others than are conventially drawn in favor of domestic reform first, and eventual external accommodation second. Earlier endorsement of the de la Madrid reform policies might have been helpful rather than deleterious; there could be no doubt of his commitment, as continued and amplified by President Salinas. Yet Mexican economic growth was hampered by excessively high real domestic interest rates and handicapped by potential foreign exchange limitations. Because there are now much more favorable Mexican economic prospects does not mean that the way chosen was the best. In parallel fashion, Chile's current democratic politics and growing economy should not simply rationalize Pinochet's dictatorship and underline how essential the earlier reforms were. Rather, optimistic Chilean forecasts demonstrate how, given an advantageous economic starting point, democracy can work.

Helping to create these economic conditions where the inheritance has been less favorable is what external policy should be about. It is encouraging to see United States leadership in helping Honduras and most recently Peru make up their arrears to the multilateral financial institutions as a prelude to renewed eligibility for official finance. But a more aggressive stance on private debt relief could also prove productive and help to provide immediate assistance to reform efforts elsewhere. For smaller countries, like those of Central America and the Caribbean, moreover, official debt owed to the United States represents a significant sum. Active implementation of the promise of relief inherent in the Enterprise for the Americas can afford assistance.

Fourth, financing needed economic growth in the region in the 1990s must remain a concern. Inevitably the vast bulk of the resources must be supplied domestically. But rebuilding obsolescent public infra-structure and private capital will require an external contribution. There is wide recognition in Latin America that private investment must play a significant part in transferring not only savings but also technology. Attitudes about foreign investment, and earlier restrictions, have shown important modification.

Renewed economic growth will attract back to some countries, most notably Mexico, capital that earlier left. The estimated $100 billion held outside countries of the region constitutes a major pool. But one must also not exaggerate expectations: some will stay abroad as part of a desired diversification of asset holdings just as we see with other countries, and cautious owners of deposits may be the last to commit. Accumulated flight capital cannot be held up as a rationale for doing nothing on the grounds that the resources exist. But, equally, evidence of persistent renewed capital flight is a signal that domestic policy is not working.

The 1990s promise to be a decade of increased pressure on available savings as industrialized countries progressively recover, the needs of Eastern Europe and the Soviet Union are taken into account and one factors in restored economic growth in Latin America. In such circumstances, interest rates will remain relatively high, penalizing countries of the region for their past indebtedness and making external resources the more necessary. Paradoxically, since debt reduction has been only modest, and further renegotiation is now rendered more difficult, the "success" of the Brady Plan will quite possibly require a new Baker Plan, but one dimensioned over a medium term.

In order to sustain growth rates of the order of 5 per cent, Latin America will need to increase both its rate of investment as well as its imports of capital goods. While both domestic savings and exports can be expected to play the largest role in financing these increments, a residual requirement of external finance will be needed. Even under present circumstances, arrearages are being accumulated. Rough calculations would suggest a shortfall of the order of $25 billion annually as growth accelerated.

The successful placement of the Chilean issue and return to the market in modest scale of Mexico and Venezuela, enhanced by the higher oil price, while encouraging, and the recovery of private investment, do not suggest that a totally private response will be adequate to meet it. Covering the gap would fall to longer term official flows that should be programmed now; in their absence, growth potential will be diminished.

Private equity and official debt should again become the principal vehicles for external finance for countries of the region in the 1990's, as they were earlier. The Enterprise for the Americas emphasizes trade and not aid. It should also emphasize finance and not aid if the promise of rapid economic development in the 1990s is to become a reality.

This hearing occurs at a time when much attention is upon industrial country response to the request of the Soviet Union for large economic assistance to undergird its transformation into a market economy and its conversion to democratic politics. It would be more than ironic, after a decade of costly sacrifice for the Latin American countries, if the needs of our hemispheric neighbors were given short shrift by these other priorities. Almost all countries in the region have already moved far along in economic and political transformation. And what they require is not massive assistance but fuller extension of debt reduction and assured access to finance. The claims of eastern Europe and the Soviet

Union are important for our vital interests, but they need not be exclusive of also vital concerns for economic development and political democracy in Latin America.

NATIONAL ECONOMIES

Zambia Is First Country To Benefit from Rights Approach

With its recent approval of the first "rights accumulation program"—for Zambia—the IMF has broken new ground in applying its strategy to deal with countries that have protracted arrears to the IMF.

On April 17, 1991, the IMF's Executive Board commended the Zambian Government, endorsed Zambia's three-year economic and financial program, and approved the accumulation of "rights" for up to a maximum of SDR 837 million, which was the level of Zambia's arrears to the IMF as of July 1, 1990, the outset of the IMF-monitored program for 1990.

Upon successful implementation of the rights accumulation program, prior clearance of its arrears to the IMF, and approval of a successor arrangement by the IMF, Zambia will be eligible to "encash" the accumulated rights under the successor arrangement. The following article provides a brief chronicle of the various and, in important ways, divergent approaches to economic adjustment that Zambia undertook in the 1980s. Subsequently, this article highlights economic policies and performance under the IMF-monitored program for 1990 and summarizes the economic policies that form part of the rights program for 1991.

Adjustment in the 1980s

During the first half of the 1980s, Zambia embarked on three IMF-supported adjustment programs aimed at creating a more stable financial environment and diversifying the economy away from copper. However, the implementation of economic and financial policies proved difficult because of unexpectedly weak conditions in the world copper market, shortfalls in donor assistance, and a lack of political and social consensus. As a result, none of these programs met with lasting success.

In 1985–87, with the support of the IMF and the World Bank, Zambia undertook an adjustment program based on a rapid transition to market pricing and tight demand-management policies. In particular, it called for market determination of nearly all prices–including auction mechanisms for setting the exchange rate and treasury bill rates.

In the event, monetary and fiscal policies went off track relatively early in the course of the program, contributing to a pronounced acceleration in inflation.

After gradually backing away from several structural reform measures, Zambia finally abandoned the program in May 1987 and embarked, in the context of its "New Economic Recovery Program," on a major reorientation of economic policies toward heavy reliance on administrative controls. To combat inflation, the authorities reintroduced price control, replaced the foreign exchange auction system with an administrative allocation of foreign exchange at an appreciated fixed exchange rate, and reduced interest rates to substantially below market-clearing levels. In addition, they suspended payments to the IMF and World Bank. As a result of the latter decision, overdue obligations to the IMF rose to SDR 367 million by the end of 1987.

During the first half of the 1980s, Zambia embarked on three IMF-supported adjustment programs aimed at financial stability

The adverse economic impact of the shift in policies was initially disguised by an increase in economic activity arising from favorable weather conditions and high copper prices. By late 1988, however, Zambia was facing chronic shortages of foreign exchange and essential imported inputs, a proliferation of black market activities, severe difficulties in servicing external debt obligations, a rapidly deteriorating fiscal position, and—despite price controls—accelerating inflation. It was against this background that, at the end of 1988 and in early 1989, the Government initiated certain remedial actions that signaled its intention of moving away from controls and toward a market-oriented approach to economic policy.

10

Zambia's transition to a more market-oriented policy stance had gained momentum by mid-1989, when the IMF and the World Bank assisted the authorities in formulating a policy framework paper for 1989–93 whose underlying strategy again aimed at stabilizing and diversifying the economy while protecting more vulnerable groups from the impact of adjustment. Specific policy measures were laid out in the economic and financial program for 1990. Based on Zambia's renewed determination to reorient its policies, the international donor community provided external resources to support the country's adjustment efforts, after which the IMF endorsed Zambia's program in July 1990.

A copper mine in Zambia: facing the prospect of declining prices in the near term and a sharp contraction in production around the end of the decade.

The 1990 Program

The 1990 program emphasized the necessity of establishing a low-inflation environment so that the economy could be revitalized through the implementation of market-oriented structural policies, including measures to bring about market-related interest and exchange rates, price decontrol, and public enterprise reform, and to promote the private sector's participation in the economy.

The implementation of structural policies proceeded in line with program objectives. To strengthen price incentives for non-copper exports and to pave the way for the elimination of administrative foreign exchange allocations for imports, the Government introduced a dual foreign exchange market in February 1990.

Under this arrangement, all foreign exchange earnings, except those from copper exports, could be sold at a more depreciated "second window" exchange rate. Automatic access to foreign exchange under an open general license (OGL) system at the second window rate was expanded progressively during 1990. As a consequence, at the end of the year, only copper industry transactions and payments for oil, fertilizer, and some services continued to be channeled through the first window.

Impressive strides were made toward market-determined pricing and marketing of maize, maize products, and fertilizer. Producer prices for maize and ceilings for maize meal and fertilizer prices were adjusted substantially. Moreover, farmers were permitted to sell maize directly to millers and private traders rather than only to the cooperative unions, which had previously enjoyed a monopoly in maize marketing.

The implementation of macroeconomic policies was mixed. During the first half of 1990, Zambia made satisfactory progress in meeting its stabilization goals. All of the key fiscal targets were met, and the annual rate of growth of broad money was reduced considerably.

During the second half of the year, however, the implementation of macroeconomic policies was disappointing and performance fell short of target. The monetary program was severely undermined by slippages in fiscal policies that were mainly caused by an unexpectedly large wage settlement for civil servants and difficulties in controlling budgetary expenditure.

The monetary implications of weak fiscal policies were exacerbated by larger-than-expected central bank lending to the cooperatives and certain public enterprises. In addition to excess monetary growth, inflationary pressures were compounded by the cost-push effects of the increase in international oil prices and large wage settlements. As a result, the consumer price index rose by about 105 percent in 1990 compared with a targeted increase of 50 percent.

Rights Accumulation Program

The program for 1991, which is set in the context of the medium-term strategy laid out in an updated policy framework paper for 1991–93, was formulated against the prospect of a decline in copper prices in the near term and a sharp contraction in copper

71

production around the end of the decade. The program targets a 3 percent increase in real GDP, a reduction in the rate of inflation to 40 percent, a decline in the fiscal deficit to about 1 percent of GDP, and a slowdown in money supply growth to 25 percent. If Zambia meets a set of quarterly quantitative and structural performance criteria, it will be eligible to accumulate rights up to the equivalent of SDR 270 million during the 1991 program.

Structural and sectoral policies in 1991 are geared to continuing the transition to an economic system guided by market forces and to strengthening the operations of public enterprises. The liberalization of the exchange and trade systems is expected to proceed expeditiously. The two exchange markets were unified in April 1991, and the unified rate for the kwacha is to be adjusted regularly to balance demand and supply.

With the aim of further improving the economic performance of the agricultural sector, the Government will phase out remaining controls on maize and fertilizer pricing and will take additional steps to strengthen the private sector's participation in agricultural production and marketing. The Government will also start implementing the privatization program that was announced in 1990 by selling outright, or at least transferring majority ownership in, all public enterprises with the exception of public utilities and other strategic industries.

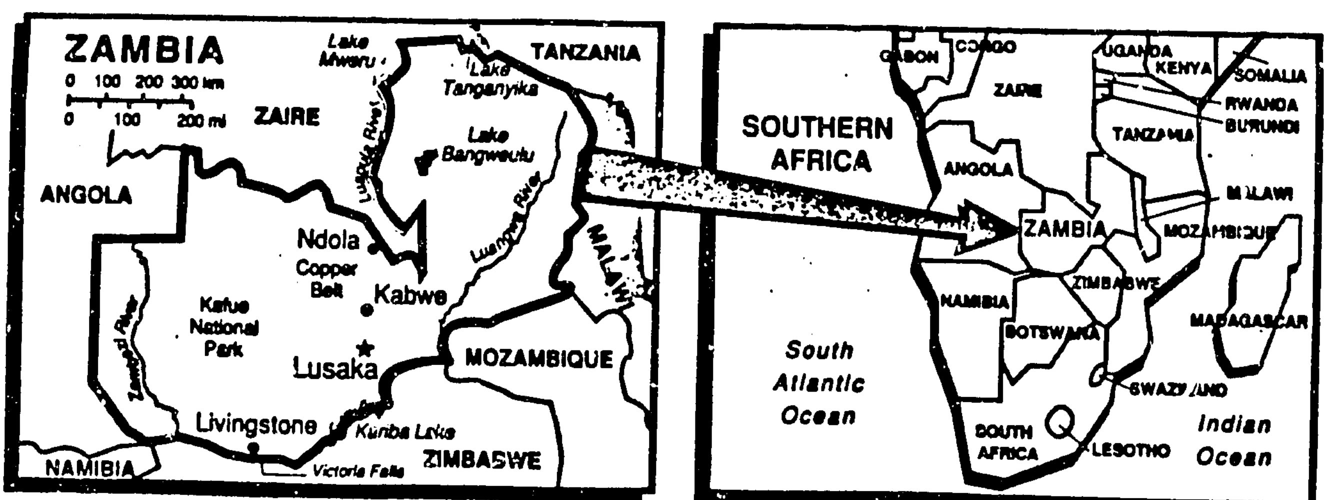
To enhance the efficiency and financial viability of enterprises that remain in public ownership, the weakest public enterprises' cost structure, international competitiveness, and use of foreign exchange resources will be examined.

Given the insufficient results in terms of macroeconomic stabilization in 1990, the Government intends to make up for lost ground in 1991. To achieve the targeted inflation rate, the Zambian authorities consider it essential to stabilize real money demand and contain the growth in money supply. In the past, the inflationary process was in part driven by an accelerated decline in money demand as a result of increasingly negative real in-

Zambia: A Profile

Zambia is the most urbanized country in sub-Saharan Africa, with about one half of the population living in urban areas. Its population is estimated at 8 million in 1990 and is growing at over 3.5 percent a year. Per capita GDP is estimated at $383 in 1990.

The Zambian economy is heavily dependent on copper. In 1990, copper accounted for 85 percent of total exports, contributed about 10 percent to GDP, and represented an important source of budgetary revenue. The vulnerability of the economy to developments in the international copper market was evident during the 1970s and most of the 1980s, when a protracted decline in metal prices, in conjunction with a contraction in copper output, contributed to a fall of one third in per capita GDP. Zambia is also rich in agricultural and forestry resources, but this potential has not yet been fully exploited. Except for the agricultural and banking sectors, economic activity is dominated by public enterprises.



The Rights Approach

The rights approach is part of a three-pronged cooperative strategy for eliminating overdue financial obligations to the IMF, which comprises prevention, deterrence, and intensified collaboration. The rights approach was formulated in early 1990 and was endorsed by the Interim Committee of the Board of Governors of the IMF in May 1990.

In the context of intensified collaboration, the rights approach provides for a member with protracted arrears to the IMF in December 1989 to earn rights based on its performance under an IMF-monitored adjustment program. The accumulated rights can then be encashed as the first disbursement under a successor IMF-supported program financed from the IMF's general resources or, for eligible countries such as Zambia, partially from the concessional structural adjustment facility and enhanced structural adjustment facility resources, or a blend of the two.

terest rates. Consequently, the Bank of Zambia aims to establish positive real interest rates so as to ensure the success of the monetary program.

With respect to containing the growth in money supply, it is crucial that the Government's recourse to bank borrowing be limited. Accordingly, a comprehensive package of measures has been put together to reduce the fiscal deficit. Tax reform measures or increases in rates and fees have been announced in every major category of non-copper revenue.

On the expenditure side, the focus is on cutting the real level of noninterest expenditure and on strengthening budgetary monitoring and control procedures. For example, follwing the very large wage settlements that were awarded in mid-1990 as part of a two-year labor contract, no increase in personal emoluments is programmed for 1991.

Macroeconomic stabilization and structural reform offer improved living standards by increasing employment and income generation. However, to cushion the impact of economic adjustment on the most vulnerable groups, the Government has launched a Social Action Program with a view to improving the availability of social services and employment opportunities for the poor.

The external financing needed to cover Zambia's import requirements and debt-service obligations, to clear arrears to the World Bank, and to reduce arrears to the IMF to SDR 837 million has been mobilized through exceptional efforts by Zambia's donors and multilateral lending institutions. Paris Club creditors agreed in July 1990 to reschedule, on Toronto terms, principal and interest falling due between July 1990 and the end of December 1991 as well as arrears outstanding at the beginning of the consolidation period. Debt relief or refinancing on terms comparable to those of the Paris Club has also been requested from, and is envisaged to be granted by, other nonmultilateral creditors.

Consultative Group donors disbursed about $300 million in 1990 as part of the IMF-monitored program and have signaled their intention to disburse some $650 million in 1991, and the World Bank is expected to release about $414 million in program and project loans.

Exceptional efforts have also been made by all parties concerned to enable Zambia to regularize its position with multilateral creditors. To help Zambia clear all arrears to the World Bank and to reduce those to the IMF to the level prevailing on July 1, 1990, a number of Zambia's donors agreed to further front-load their external assistance, and Zambia accepted a temporary drawdown of its reserves. The World Bank has indicated that it will be able to increase its assistance for the year as a whole. These actions permitted Zambia to clear in March some $294 million in arrears to the World Bank and would also permit arrears to the IMF to be reduced to the targeted level.

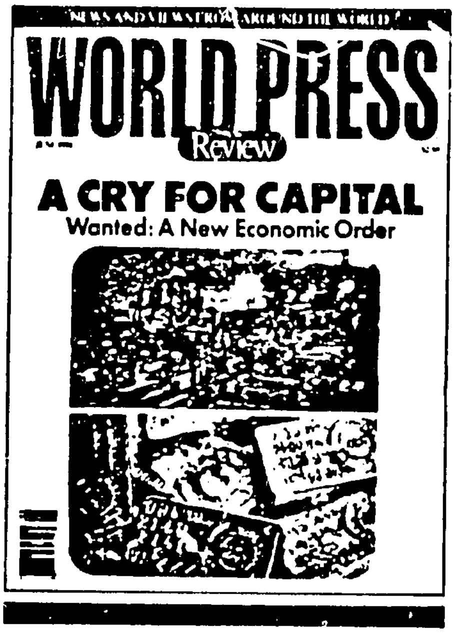
The success of this strategy requires major efforts from all. Zambia needs to maintain the strongest commitment to its economic reform effort, while the donor community must do its utmost to ensure that pledges made to cover Zambia's financing needs for 1991 are fully disbursed. Looking beyond 1991, Zambia, its donors, the IMF, and the other multilateral institutions will need to continue their cooperative efforts in order to place Zambia on a path of durable growth and external viability. The IMF's rights approach, together with the assistance of the Consultative Group, will remain a means to help encourage further economic reforms and mobilize external financing over the medium term.

Armin-Detlef Riess,
IMF African Department

A CRY FOR CAPITAL

Wanted: A new economic order

The planet needs billions of dollars: to lift Kuwait and Iraq out of ruins, to bring East European countries into the market economy, to avoid letting the South sink into indigence. The new world order is also a new world order of capital. Debt cancellations, aid, credits—will there be sufficient savings for these? Will it be possible to set in motion a development dynamic? On this point, the answers are troubling: Poland is collapsing under loans that it cannot use for lack of profitable projects. And Egypt, which is about to benefit from the dividends of its commitment against Iraq, needs to feed an additional 1 million mouths every year. Two trillion dollars, the equivalent of two years' worth of output for a country such as France, is the cost of bringing East European countries back on an even keel, according to Jacques Attali, president of the European Bank for Reconstruction and



Observateur

Development. The rebuilding industry that is opening up today will last 15-20 years. At the same time, the bill for the Persian Gulf is beginning to circulate: $80 billion-$100 billion for Kuwait and perhaps $200 billion for Iraq, according to Iran's spiritual leader Ayatollah Ali Khamenei. And, during that time, the financial pump of the American deficit continues to suck up billions of dollars every year. The countries of the South, whose growing distress has been eclipsed in the media in the past few months, continue to need international aid. But who will pay?

Is the world economy moving inevitably toward a gigantic depletion of savings? The answer is far from simple, and economists are divided—for two reasons. First, the talk of all of those billions of dollars is for the moment only words. Second, the former communist countries, which are not solvent, have nothing in common with those of the Gulf, which can count on income from oil.

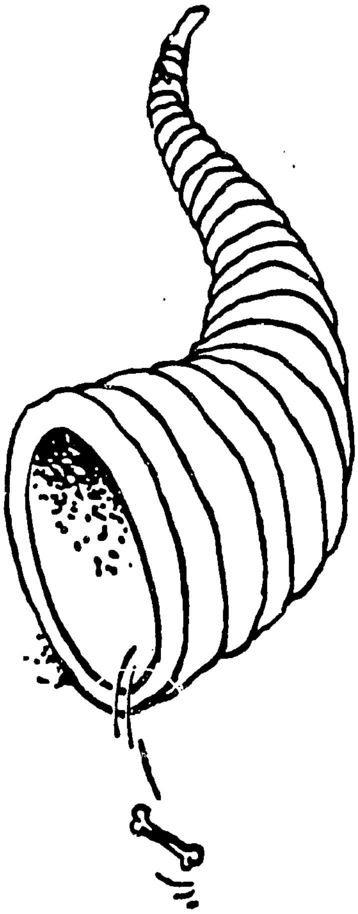
Let us go back to the first point. Attali's $2 trillion, for example, does not tally with anything yet. The Soviet Union has received barely $10 billion from the West, according to estimates. And industrialized nations may never help the Soviet Union. "For the most part, the effort will have to be furnished by the Soviet Union itself," warns Jean-Paul Fitoussi, president of the OFCE, a French business-oriented think tank, and one of the authors of a report on the Soviet economy commissioned by several international agencies. "The Soviet Union is not only abundantly endowed with natural resources but also with human capital."

Lionel Stoléru, France's secretary of state to the prime minister, who heads the country's five-year economic plan, says, "Money must only be given to reforms [in the Soviet Union]. For the time being, the talk about market socialism is 98 percent socialism and 2 percent market. But if the Soviet Union committed itself to the path of reform, then the need for financing would be colossal."

The scenario is hardly different in the East European countries (Bulgaria, Czechoslovakia, Hungary, Poland, and Romania). Granted, the group of 24 donor-industrialized nations have already committed themselves to $42 billion. And the OFCE has calculated that these five countries will receive $85 billion between now and 1994—more than the Marshall Plan brought to Europe after World War II. But unlike what happened then, these sums include few donations—and many loans at market rates.

So far this money exists only on paper. "Many credit lines are intact," says Jean-Michel Six, president of DRI Europe, a private business-consulting organization, "be-

By Thierry Gandillot and Dominique Nora; from the leftist weekly "Le Nouvel Observateur" of Paris.



Horn of Plenty

Skis/Wokanda, Warsaw

cause the East is incapable of using these sums in an efficient manner." According to Stoléru, aid plans for Eastern Europe can in no way be compared to the Marshall Plan for another reason. "The Marshall Plan put gas into the motor of the European economy. The problem is not getting gas; it is changing the motor," he says.

The second problem is the Gulf nations. Unlike in East European countries, in the Gulf the money is going to be spent. For the time being, though, no one knows how much the rebuilding of Kuwait and Iraq will cost. But nobody is planning to make donations to either nation. Kuwait has the means to restore its former splendor; the government in exile was working on it even before the hostilities ended. On the Iraqi side, any aid would be linked to the possible departure of President Saddam Hussein.

The uncertainty regarding the sums really at stake in Eastern Europe and the South is compounded by a question about the current needs regarding the U.S., Japan, and Europe. There are the optimists, such as DRI's Six, who says that economic indicators, especially the inflation rate, are conducive to business. Another, Anton Brender, director of the Center for Prospective Studies and International Information in Paris, sees no financing problem. "The needs of the East and the Gulf are a drop in the ocean of world savings," he says. "Furthermore, the real problem—the U.S. trade deficit—is in the process of shrinking rapidly." A sign of this loosening in the capital market is that interest rates are beginning to slacken.

Jean-Michel Charpin, director of studies at the Banque Nationale de Paris, thinks that this détente in the capital markets is fleeting. "The current calm on the savings front is provoked in part by the recession," he says. "When the economy picks up, the problems encountered in 1988-89 will re-emerge. They will be aggravated by German reunification, which devours capital, by reconstruction around the Gulf, and by the resurgence of military spending. Since the war, nobody—and especially not the military—talks about reducing it."

Pessimists prefer to sound the alarm immediately. "There will be a colossal need for financing," warns Stoléru. "To pull through, oil will have to be quite expensive; otherwise we will lack capital. It is a kind of forced world savings." Michèle Debonneuil, director of studies at Banque Indosuez, a French bank, says, "The world, and developing nations in particular, need a lot of money to stimulate growth. Otherwise the gap between rich and poor countries will become unbearable."

There is one area of agreement between optimists and pessimists: Saving must be encouraged at all costs. Without it, it will have been of no use to have knocked down the iron curtain in order to build a silver wall. ■

76

Global Capital Markets Might Behave Differently in the 1990s, Says BIS Study

International capital markets might become less permissive of current account imbalances in the 1990s than they were in the 1980s, according to Philip Turner of the Monetary and Economic Department of the Bank for International Settlements (BIS). In a study entitled *Capital Flows in the 1980s: A survey of Major Trends*, Turner provides an overview of the main characteristics of capital flows during the last decade, examines the behavior of the main components of these flows, and considers some implications for the future.

During the 1980s, the world monetary system underwent three revolutions all at once, according to Turner: deregulation, internationalization, and innovation. Consequently, gross capital flows, which in 1979 were below $100 billion, soared to about $600 billion by 1989. Moreover, "capital movements came more and more to have a life of their own." Unlike the 1960s and 1970s, countries with large and persistent current account deficits could continue to attract foreign capital, thus weakening external pressures for policy adjustment.

Key Trends in the 1980s

The underlying structure of capital flows in the 1980s has, however, been quite different from the pattern set in the nineteenth century, according to Turner. Specifically, in the 1980s,

- Capital movements increasingly took the form of transactions among industrial countries, with developing countries left largely on the sidelines.
- Capital inflows substituted for declining domestic saving in capital importing countries (the United States, for example), instead of providing for more investment.
- Aggregate two-way capital movements (that is, all transactions between residents and nonresidents, including both inflows and outflows) increased dramatically, reflecting the much greater liquidity and diversity of international assets than under the gold standard.
- Direct investment, especially among the industrial countries, grew rapidly.
- Capital flows became increasingly "securitized," with bonds replacing bank lending—although since 1985, bank lending has recovered.

At the end of the 1980s, the United Kingdom became the largest provider of direct investment capital

Components of Capital Flows

Discussing the behavior of the major components of capital flows in the 1980s, Turner considers foreign direct investment, portfolio investment, short-term bank flows, and official intervention.

Foreign Direct Investment. Turner notes that foreign direct investment flows have increased sharply in recent years, reaching about $185 billion in 1989, compared with about $50 billion a year, on average, in the first half of the decade. This increase was almost entirely accounted for by flows to industrial countries, with those to developing countries hardly changing even in nominal terms.

The pattern of flows to industrial countries changed radically, however. Notably,

- Inflows into the United States rose to about one half of total inflows to industrial countries, compared with about one third in the 1970s, and with barely over one tenth in the 1960s.
- Inflows into the European Community (EC) became more important. Although a significant portion of these represented intra-EC flows, those to the EC from nonmember countries also rose.
- Foreign investment declined in Australia and Canada, both of which were relatively heavy capital importers in the 1950s and 1960s.

Looking at the sources of foreign direct investment in the 1980s, Turner points out that the most salient feature was the decline in the importance of the United States. Toward the end of the decade, the United Kingdom became the largest provider of direct investment capital—much of it related to mergers and acquisitions, notably in the United States. But in 1989, Japan replaced the United Kingdom, providing about one fourth of total outward direct investment.

Turner emphasizes three reasons for the increased pace of direct investment activity in the 1980s. First, there were cyclical causes; direct investment flows were strongly pro-cyclical, varying more than proportionately with economic activity. Moreover, the shifts of direct investment toward the United States and Europe since the mid-1980s were both in line with developments in relative demand. Second, direct investment flows were

11

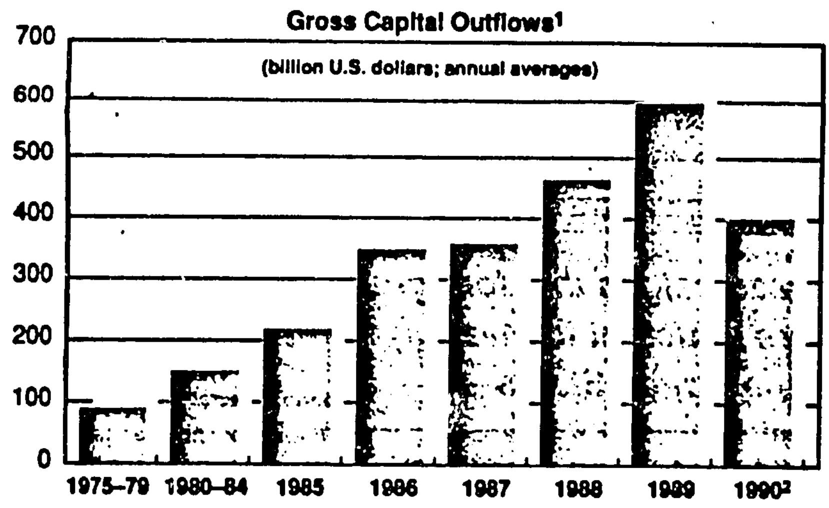
partly fueled by cross-border mergers and acquisitions, which amounted to about $120 billion by 1989, compared with just under $40 billion in 1986. Third, companies were increasingly driven by lower labor costs, exchange rate changes, or the fear of protectionism to relocate production abroad.

Portfolio Investment. As with direct investment, the sharp rise in portfolio investment in the 1980s was almost entirely accounted for by industrial countries. A general reason for the rise lay, according to Turner, in the activities of major financial institutions—pension funds, insurance companies, and investment trusts. He points out that "while banks financed global imbalances in the 1970s, it is nonbank financial intermediaries that have financed the still larger imbalances of the 1980s." He cites three main reasons for this change: the channeling of household savings to institutional investors and away from ordinary bank accounts; the huge expansion in private sector wealth, with the rise in equity, real estate, and other asset prices; and a massive diversification into foreign assets by institutional investors—although U.S. institutions were a striking exception to this trend.

Turner points out that in the 1980s, portfolio flows were dominated by transactions in bonds, investment in which was many times larger than that in equities. And although the global stock of equities has now caught up with that of bonds, foreign holders seem to prefer bonds to shares. However, the increased importance of equity-related bond issues has, to some extent, blurred the distinction between bonds and equities

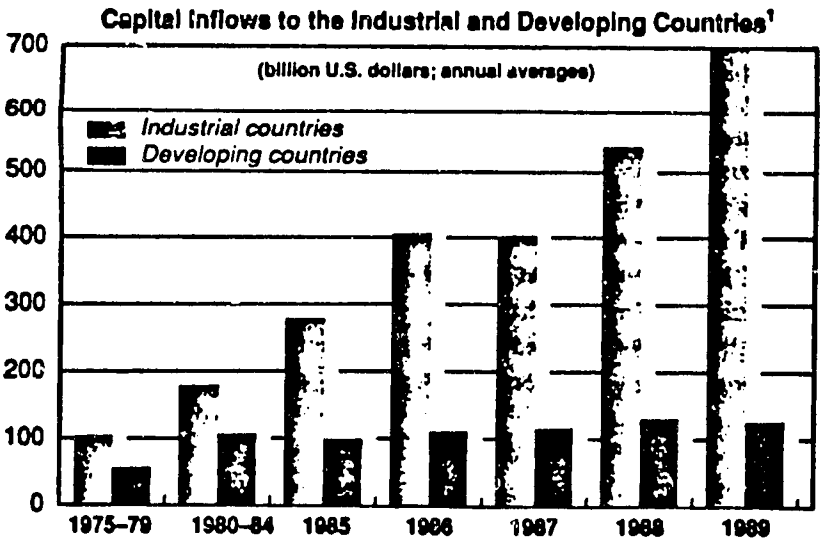
Short-Term Bank Flows. Turner notes that aggregate net short-term bank flows for the 15 larger industrial countries (Austria, Australia, Belgium-Luxembourg, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, United Kingdom, and United States) averaged almost $80 billion a year during 1985–89 and have, as a proportion of GNP, increased, compared with the 1975–84 period. Among the major players (Germany, Japan, United Kingdom, and United States), the United Kingdom and the United States ran sizable current account

Capital Flows Soared in the 1980s . . .



Note: Data is for industrial countries, namely Austria, Australia, Belgium-Luxembourg, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, United Kingdom, and United States.
[1] Sum of direct investment, portfolio investment, and long-term bank lending.
[2] First three quarters only, at an annual rate; for some countries, data are partly estimated.

. . . With the Bulk Going to Industrial Countries



[1]Sum of gross inflows, excluding reserve movements.

Data: *Capital Flows in the 1980s: A Survey of Major Trends* deficits in the second half of the 1980s. Of these, the United Kingdom has relied most heavily on short-term bank flows in recent years, as high short-term interest rates have attracted large inflows of funds into sterling deposits.

But perhaps more interesting, according to Turner, is the position of the surplus countries—especially the contrast between Germany and Japan. Whereas Germany had a short-term outflow of about $84 billion during 1985–89, Japan had an inflow, amounting to just under $200 billion. The lion's share of German bank outflows was denominated in local currency and took place in the interbank market.

Official Intervention. The 1980s can be divided into two phases in which official intervention practices were markedly different, according to Turner. In the first phase, which spanned the years 1981–85, intervention was negligible. Net official monetary movements amounted to less than 1/10 of 1 percent of GNP for the three largest economies (Germany, Japan, and United States). Moreover, there was relatively little year-to-year variation. Policies changed in mid-decade, however. The years 1986–89 witnessed substantial intervention by some major industrial countries to keep exchange rates within officially desired ranges. Net official monetary movements of 1/3 of 1 percent of GNP became the norm.

Turner points out that a notable and paradoxical feature of official intervention in the 1980s was that countries with large current account surpluses sometimes intervened to support their currencies, while those with deficits did the opposite. This was partly because, in some years, there was a tendency for nonofficial flows to more than finance large current account imbalances. In 1989, for example, the net official reserve position of the United States improved by almost $17 billion, despite a current account deficit of some $110 billion. Conversely, nonofficial capital outflows more than recycled the surpluses of Germany and Japan, so that net official reserves fell substantially in both countries. A similar pattern was evident elsewhere. Capital inflows into countries with higher-than-average inflation and interest rates led to upward pressure on their exchange rates, despite significant current account deficits. Italy and Spain were the most striking examples.

There are already signs that foreigners are more reluctant to invest in the United States

Implications and Prospects

Turner draws three broad conclusions about the implications of trends in capital flows in the 1980s. First, he notes that, although the increase in the volume of capital flows in the second half of the decade has "marked a quantum leap in the scale and apparent efficiency of international financial intermediation," it is less clear how much this increase has enhanced the stability of financial markets. "On the contrary," he suggests, "prices in virtually all financial markets have become much more volatile. And disturbances in one market have been more quickly transmitted to other markets, often irrespective of the underlying fundamentals."

The root causes of such volatility may well lie in the real economy, according to Turner. "Yet it is impossible to dismiss entirely the suspicion that greater capital mobility has contributed to herd behavior and has itself made volatility worse."

Second, Turner suggests that there is only limited evidence that greater foreign direct investment has been a major factor in making current account imbalances more sustainable; "a number of imbalances have had no . . . direct-investment counterpart."

Third, and perhaps most fundamental, the greater mobility of financial capital has allowed current account imbalances to persist longer than in previous decades.

What of the future? Turner notes that there is probably a consensus that international financial market liberalization is, in practice, irreversible and that much of it is desirable. However, "there are several reasons for doubting that net capital flows will prove quite such strong pillars of international current account imbalances in the 1990s as in the 1980s."

One is that, as the pre-eminence of the United Kingdom and the United States as financial centers erodes, one of the supports for global current account disequilibria would be weakened. Indeed, Turner suggests, there are already signs that foreigners have become more reluctant to invest in the United States and that American investors are beginning to invest more heavily overseas than they used to.

Another reason for skepticism about the extent to which capital flows can help equilibriate imbalances is that these flows themselves might contract. The author points out that following the recessions that began in a number of countries in late 1990, the pace of mergers and acquisitions has slowed; equity-related fund-raising in international markets has declined; and bank lending has weakened, especially as many financial institutions have become overexposed. But perhaps the most compelling reason to doubt the sustainability, if not the scale, of the pattern of capital flows seen in the second half of the 1980s, Turner says, is that capital imports have been used to substitute for, rather than to supplement, domestic saving.

Signs that international capital markets may be becoming less permissive of imbalances than before were already evident in 1990, according to Turner. Not only were there substantial reductions in the major imbalances, but there was also evidence that some forms of international financial activity were beginning to decline. Notably, aggregate gross capital flows from industrial countries fell significantly.

"In these circumstances," Turner concludes, "avoiding the too abrupt reversal of earlier capital flows—and ensuring that the world economy copes smoothly with the transition—is the delicate task of economic policy."

Vikram Khanna,
Assistant Editor, *IMF Survey*

8C

THE JOURNAL OF COMMERCE, Tuesday, May 21, 1991

Mr. Attali's Grand Vision

By CURTIS J. HOXTER

On April 15th a new international organization made its debut. The European Bank for Reconstruction and Development, dedicated to uplifting the economies of Central and Eastern European nations, has been controversial from the moment of its conception. But many of its real problems are centered around one individual who is expected to provide the EBRD with momentum: France's Jacques Attali.

That Mr. Attali has aspirations beyond serving as the president of the new institution could be noted from a speech he delivered in Tokyo. He predicted that the 12-nation European Community will swallow all the European countries, which eventually will become independent and sovereign members of the confederation. "Such a confederation, linked by a common infrastructure democracy, market economies and joint institutions, (such as a single currency, a central bank and unified political institutions) will be open to the world . . ."

Mr. Attali, not satisfied that the EBRD operate solely as a bank, also proposed a temporary tax on successful enterprises in Eastern and Central Europe to help the regions' poorer performers. The tax would be charged on the value added by an enterprise to its products. Revenue raised by the temporary tax would be used as a tax subsidy to enterprises, adding less than average value to their products. Both proposals have created controversy among the bank's stockholders — the 40-odd member governments.

This evidently does not bother the ebullient Mr. Attali. He goes so far in his grandiose outlook that he claims the EBRD will be the "first institution of the new world order." With the help of the EBRD, he predicted, "Europe will become geographically, politically and culturally united for the first time." While this is a noble objective, this is not within Mr. Attali's capabilities alone and the shareowners do not harbor such objectives.

Mr. Attali likes to have the EBRD referred to as "the European Bank," much to the consternation of influential economic and financial leaders such as Bundesbank President Karl Otto Poehl. Their reason: Only the European Central Bank, if the EC ever reaches that stage of monetary union, should be known as the "European Bank."

Mr. Attali's image problem has been further fueled by his own inability to attract an American to become the Number Two officer in the bank. Initially, the focus was on the able and experienced Senior Vice President of the World Bank, Ernest Stern, who finally rejected the offer. So far no other candidate has been found because, as word around Washington has it, nobody feels comfortable with the domineering Jacques Attali.

On the other hand, Mr. Attali has attached some outstanding persons to posts in the EBRD, including the former Prime Minister of Hungary Miklos Nemeth, the former Russian Finance Minister Boris Fedorov, the capable Swedish banker Anders L. Jungh and prominent Wall Street lawyer Andrew Newburg.

But the other stockholders generally have struck out, even in designating their executive directors. For instance, Bonn is sending an unknown economics professor, whose only fame is that he is a personal friend of Chancellor Helmut Kohl and a long-time officer of the Christian Democratic party.

And so, the new institution is getting ready to impose itself on the economic and financial affairs of the newly emerged Eastern and Central European nations with all kinds of strikes against it.

U.S. officials saw some danger early on that the bank would become a clearing house for handouts and would not really help foster long-term growth in Eastern Europe. So they insisted that numerous restrictions be added to the Articles of Incorporation to confine the bank to activities that would not interfere with competition. Among these was a stipulation that the bank deal only deal with infrastructure investments. If the bank is in competition with private enterprises, it is required to take a back seat.

The EBRD negotiations also produced a structure that eliminated some mistakes Washington felt were evident in the World Bank and the regional development banks. Thus, the president of the bank now must take his orders from the executive directors.

The United States also was made unhappy by the prospect of the Soviet Union as a stockholder. Not only would the Soviet Union directly influence the operations of the bank, but it could pose a conflict of interest since it probably would be a recipient of assistance.

A compromise finally was reached allowing Moscow a 6% equity participation and limiting its assistance to that amount. The wrangling over this issue took months to resolve and proved to Washington that Jacques Attali was an "unguided missile," likely to give continuous headaches in the future, possibly jeopardizing Congressional approval for U.S. funding.

The United States is on the right course. Eastern Europeans have charged that the United States, preoccupied with the gulf region and domestic matters, is abandoning them. But both the U.S. administration and Congress realize there is no point in arguing over how much foreign aid is needed to cure the ills of a region crippled by four decades of central planning and state-controlled ownership.

No one country can put up the $50 billion needed to correct the existing imbalances. Sums of that magnitude only can be generated through private investments. Thus, the objective of the European Bank for Reconstruction and Development, must be directed to make Eastern and Central Europe more attractive to foreign business enterprises.

The EBRD should be confined to to infrastructure activities and support action and should not be used to open up new assistance flows in direct competition with the World Bank and the IMF. That is the U.S. position and it is a sound one. If stockholders can manage to keep Mr. Attali in line, this objective won't be compromised.

Curtis J. Hoxter heads his own consulting firm in New York City.

81

THE JOURNAL OF COMMERCE, Friday, May 31, 1991

Healthy Banks for the East

By GARY N. KLEIMAN

The recent launch of the Polish Stock Exchange — Eastern Europe's third after previous stock market openings in Hungary in Yugoslavia — symbolizes the region's commitment to embracing capitalism. But progress in forging viable securities operations will continue to be hampered by a basic lack of progress in banking systems. Successful capital market reform first requires a resolution of the endemic balance-sheet weaknesses at state-owned financial institutions.

Governments in Eastern Europe have "commercialized" banking only by separating monetary and policy functions from business ones. They have not tackled the massive payments arrears and defaults that have accumulated on financial institutions' books. International Monetary Fund and World Bank programs to impose discipline through the introduction of real interest rates and credit ceilings are positive macroeconomic steps. But East European financial regimens still lack the necessary microeconomic steps — loan reserve allocations and write-offs, for example — to make banks safe and sound.

The historical role of socialist banks as passive conduits of funding for politically designated companies has changed in theory, but not in practice. The largest state units have been reorganized, but the old banking nomenklatura, adverse to adjustment, remains entrenched.

Among the countries of the region, the shift to a "two-tier" sectoral framework, as East European officials have termed it, has been virtually identical. In Czechoslovakia after the 1989 "Velvet Revolution," half the assets and the entire branch network of the State Bank were transferred to the newly formed Komercnia Banka. In Hungary and Poland, a similar restructuring occurred even before the collapse of communism. In Yugoslavia, two years ago the parliament passed legislation fashioning government financial institutions into joint stock entities to be overseen by outside supervisory boards.

Bank management in these countries is now to be guided by profit considerations and banks are to exercise independent credit judgement. But so far these principles are mostly ignored and subordinated to long-standing patronage ties. Witness a recent scandal in Serbia, where the main provincial bank, at the order of leading officials, secretly channeled $1.5 billion to ailing firms.

Throughout Eastern Europe professional banking skills and the physical infrastructure of financial institutions are far below Western norms. Even elementary concepts like checking and account processing are unfamiliar.

Technical capabilities are steadily improving with multilateral assistance. And foreign financial concerns, where they are permitted, are stimulating local competition. But in countries with essentially insolvent banks — and where private property and share ownership have yet to be clearly defined — equity market growth will be slow.

While broader privatization will expand stock listings and turnover, these lingering obstacles will continue to deter potential investors. Market size is another hindrance, particularly in countries with several exchanges. Yugoslavia will have financial markets operating in Belgrade, Ljubljana, and Zagreb and in Czechoslovakia activity will be split between Bratislava and Prague. The fragmentation of these markets makes stock investment inefficient and discourages participation by international investment banks and securities firms.

So far the several country funds launched by these organizations have experienced severe disappointment. Most investors' holdings have been invested in cash because the portfolio possibilities are so limited. The glacial pace at which the fundholdings are invested in stock has frustrated outside participants, who pay the fund sponsors a stiff management fee.

On the seldom occasions where stock accounting and settlement procedures have been applied they have been highly error-prone and complex. To smooth difficulties, East European exchanges are increasingly "twinning" with Western counterparts that offer tutelage.

Warsaw paired itself with Lyons, France bourse, while German exchange representatives are helping Czechoslovakia and Hungary. Missions from the European Community, North American and Japan also have visited Albania, Bulgaria, Romania, and even the Soviet Union at their request, as these nations plan future equity dealings.

The emphasis on the stock market by both Western and Eastern European financial communities, yields important cosmetic value. But Eastern Europe needs to focus initially on bank reform that will purge nonperforming credits and cultivate merit-based executive talent. Only by taking these steps can local populations — accustomed to keeping their money under a mattress for safe-keeping — gain confidence in stockbrokers and learn to channel funds into savings accounts and securities that finance economic growth.

For the near term, the most profitable exchanges between Eastern and Western capital market professionals will be those "knowledge transfers" that take place off the stock market floor. American banks in particular, with their experience over the past few years in minimizing damage in of bad leveraged buy-out and real estate loans, can make a unique contribution by exporting some of their techniques and technology to Eastern Europe's infant free market financial institutions.

American banks can derive benefits by charging fees for this expertise. And in the process they will benefit from learning that, compared with their counterparts in Czechoslovakia, Hungary, Poland and Yugoslavia, U.S. financial firms have never been in better shape and have much to offer.

"Stay"

Gary N. Kleiman is president of Kleiman International Consultants Inc. in New York.

Exchange Rate Policy in Developing Countries: Some Analytical Issues

by Bijan B. Aghevli, Mohsin S. Khan, and Peter J. Montiel

VI Summary and Conclusions

The conduct of exchange rate policy in the developing countries has undergone a marked evolution over the past decade and a half. Fluctuations in exchange rates of major currencies, as well as an upsurge of inflation within the developing countries themselves, have required more frequent adjustments in exchange rates in these countries. Moreover, during the same period, a variety of adverse external shocks have depreciated the equilibrium real exchange rates of many developing countries. The combination of all these factors has resulted in a pronounced shift in the pattern of exchange rate regimes adopted by the developing countries toward more flexible arrangements, and in more frequent devaluations—either discrete or as part of a rule—in those countries that have retained a pegged regime.

A review of the theoretical literature has identified a number of criteria for choosing an optimal exchange rate to stabilize the economy in the face of transitory shocks. These criteria include the specific objective function of the authorities, the nature of exogenous shocks, and the structural characteristics of the economy. In practice, however, it is difficult to apply these theoretical criteria to specific cases owing to problems associated with the identification of the external shocks and the potential conflict among various policy objectives.

To the extent that for many developing countries the balance of payments is a binding constraint, their exchange rate policy needs to be aimed at protecting external competitiveness. In general, movements of real exchange rate indices provide critical information for assessing competitiveness. However, the fact that the equilibrium real exchange rate is affected significantly by various domestic and external shocks has obvious implications for real exchange rate rules adopted by a number of developing countries in recent years. These rules are designed to maintain external competitiveness by adjusting the nominal exchange rate in line with the differential between domestic and foreign inflation. The authorities' persistence in maintaining a real exchange rate target, however, may indeed be destabilizing if the equilibrium real exchange rate is changing, even if this target is set correctly at the outset of a program. Another adverse consequence of a real exchange rate rule is that it may leave a small open economy without a nominal anchor for domestic prices, possibly generating a high rate of domestic inflation. Thus, it seems desirable to retain a role for the exchange rate as a nominal anchor by requiring that at least some of the burden of adjustment in the real exchange rate be borne by changes in the domestic price level brought about through restrictive financial policies, rather than by automatic adjustments in the nominal exchange rate.

A related issue is the relationship between the exchange rate arrangement and financial discipline. The experience of developing countries in the 1970s and 1980s suggests that the average rate of inflation has been lower in countries with pegged exchange rates than in countries with more flexible rates. This evidence, however, is far from conclusive. Many of the countries with a pegged regime have experienced high rates of inflation owing to a lack of adherence to appropriate financial policies, while at the same time many of the countries with a flexible arrangement have recorded low rates of inflation by adopting prudent financial policies. Therefore, the effectiveness of a pegged exchange rate arrangement in enhancing financial discipline remains open to question on empirical grounds.

On theoretical grounds, the recent macroeconomic literature suggests some general principles for assessing the relationship between financial discipline and the exchange rate arrangement. A pegged exchange rate would be viable only if the public sector is perceived to be financially solvent over the longer term—that is, the present value of anticipated primary surpluses of the public sector plus seigniorage is at least as great as the face value of the public sector's net debt. To the extent that the solvency condition is not satisfied and other fiscal adjustments are not forthcoming, the government would have to rely on the inflation tax, as it would no longer be able to borrow abroad. The consequent acceleration of domestic inflation and

83

the decline in international reserves would lead to recurrent devaluations.

The above discussion demonstrates that a pegged arrangement does not necessarily impose financial discipline so long as the government retains the option of periodically devaluing the currency. To the extent that the government has an incentive to attempt to increase the level of output through generating unanticipated inflation, there is an inherent tendency in the system to produce bursts of inflation and recurrent devaluations. The benefits of unexpected inflation, however, would disappear as the public comes to expect the government to engineer inflation surprises. In such an environment, the government could increase social welfare if it can commit itself to price stability in a credible fashion.

Establishing the credibility of the government's commitment to financial discipline is difficult for countries with a long history of expansionary policies and high inflation. In such cases, it may be desirable for the authorities to precommit to a policy of price stability by making it costly to alter the exchange rate. An effective means to achieve this would be to enter into a currency union arrangement. Such a rigid arrangement, however, may prove to be too costly as it would preclude exchange rate adjustments even in the event of large real shocks, such as a substantial deterioration in the terms of trade. An alternative arrangement would be to grant considerable autonomy to a central bank that has a reputation for having a strong bias in favor of price stability and fixed exchange rates, without ruling out the possibility of an exchange rate adjustment in exceptional circumstances.

In view of the above discussion, it is clear that analytical arguments do not support uniform policy prescriptions for exchange rate management. The specific country circumstances will enter into the picture in an important way to guide exchange rate policies. Nevertheless, the issues discussed in this paper lead to several general observations relating to the role of exchange rate arrangements in enhancing financial stability and adjustment in developing countries.

First, in a country with a well-established reputation for financial discipline, it is of small consequence whether a pegged or a flexible exchange rate regime is maintained. By contrast, in a country lacking financial discipline, serious macroeconomic problems would emerge regardless of the exchange rate regime in operation. A fixed exchange rate would not, in and of itself, impose financial discipline, and, in fact, would compound these macroeconomic problems because of the loss of external competitiveness associated with domestic inflation.

Second, most developing countries undertaking adjustment programs fall in between these polar cases. Consequently, in adopting measures to improve external competitiveness, these countries need to strike an appropriate balance between restrictive financial policies and exchange rate adjustment. Such a balance must take into account the relative short-term costs associated with restrictive financial policies, on the one hand, and those associated with devaluation, on the other hand. In general, it is difficult to envisage a situation in which a substantial overvaluation of the real exchange rate can be corrected entirely by restrictive financial policies and without any exchange rate adjustment.

Third, a more difficult issue relates to the management of the exchange rate after the level of external competitiveness has been corrected at the outset of an adjustment program. In countries in which the authorities are not in a position to refrain completely from resorting to inflationary finance, a certain degree of flexibility in the exchange rate will be needed to prevent a deterioration in external competitiveness. This flexibility, however, should not become a substitute for undertaking as strong an effort as possible to implement prudent financial policies.

Fourth, while arguing for some degree of flexibility, the analysis provided in this paper suggests that real exchange rate rules designed to protect external competitiveness by rigidly linking exchange rate adjustment to domestic inflation could be destabilizing and even lead to hyperinflation. Rules can, under some circumstances, reduce the incentives for financial discipline. An effective arrangement for countries that need to rely on a moderate inflation tax would be to devise a nominal exchange rate rule, under which the rate of the crawl of the nominal exchange rate is fixed. Under such an arrangement, the authorities would be compelled to put in place appropriate financial policies to contain the inflation rate to a level consistent with the predetermined rate of devaluation.

Finally, when the authorities are genuinely determined to establish financial discipline and price stability, but lack credibility because of their past record, a commitment to fix the nominal exchange rate for an extended period would help provide a strong anchor for price stability.

INTERNATIONAL MONETARY FUND
Washington DC
March 1991

BILATERAL ASSISTANCE

Doherty, Carroll J. "A World of Difference Lurks Behind Foreign Aid Vote," Congressional Quarterly, June 22, 1991.

Sewell, John W. and Peter M. Storm. United States Budget for a New World Order, Overseas Development Council, 1991. (Introduction)

Partnership for Sustainable Development: A New U.S. Agenda For International Development & Environmental Security, Report of an Environmental and Energy Study Institute Task Force, May, 1991. (Summary)

Schuh, G. Edward. "Revitalizing U.S. Economic Cooperation," National Planning Assoc., Volume XII, Number 4, 1991.

Steinberg, David L. "Foreign Aid Askew," The Christian Science Monitor, April 3, 1991.

Hyland, William G. "Down Grade Foreign Policy," The New York Times, May 20, 1991.

Doherty, Carroll J. "Congress Clears Refugee Aid; Bush's Signature Expected," Congressional Quarterly, May 25, 1991.

Morrison David C. "Operation Kinder and Gentler," National Journal, May 25, 1991.

Doherty, Carroll J. "Disasters Strain Tight Relief Budgets," Congressional Quarterly, May 11, 1991.

Priest, Dana. "Givers Are Responding to a Flood of Disasters," The Washington Post, May 30, 1991.

"Central America: Toward The Year 2000," USAID Highlights, U.S. Agency for International Development, Volume 8, Number 1, Spring 1991.

Adelman, Carol C. Statement for The Subcommittee on Foreign Operations, U.S. Senate Committee on Appropriations, April 16, 1991. (Introduction)

Cohen, Herman. "The Administration's FY 92 Assistance Request," Statement before The Subcommittee on Foreign Operations, U.S. Senate Committee on Appropriations, June 4, 1991.

Tutwiler, Margaret. "Recent Developments in Ethiopia," Statements by Department Spokesman, US Department of State Dispatch, June 3, 1991.

Doherty, Carroll J. "'Grand Bargain' Promises Debate on Future U.S.-Soviet Relations," Congressional Quarterly, June 8, 1991.

Kondracke, Morton. "Soviet Democracy - Cheap at $100 Billion," The Wall Street Journal, June 14, 1991.

Samuelson, Robert J. "Aid Won't Save Them," The Washington Post, June 13, 1991.

Charny, Joel R. "Bangladesh Needs Reform, Not Just Aid," The Wall Street Journal, May 22, 1991.

Rowen, Hobart. "Family Planning, U.S. Policy and the Deaths in Bangladesh," The Washington Post, May 9, 1991.

Yett, Sheldon P. "With Court Decision Not to Act, Family Planning Fails to Hill," Congressional Quarterly, June 8, 1991.

Davis, Phillip A. "The Greening of Foreign Aid," Congressional Quarterly, June 15, 1991.

Doherty, Carroll J. "Panel Pushes to Cut Off Flow of Weapons to Middle East," Congressional Quarterly, May 25, 1991.

Child Survival 1985-1990. A Sixth Report to Congress on the USAID Program, U.S. Agency for International Development, May, 1991. (Summary)

APPROPRIATIONS

A World of Difference Lurks Behind Foreign Aid Vote

House bill sets terms for Soviet assistance, Mideast arms; veto is threatened over funds for family planning

With a strong vote of approval that belied serious divisions, the House on June 19 approved a $15.2 billion foreign aid appropriations measure for fiscal 1992.

The legislation (HR 2621 — H Rept 102-108), approved 301-102, would reduce by $500 million the administration's request for a key category of military assistance. It would increase funds for development and population aid, along with a range of programs aimed at helping children. *(Vote 181, p. 1706)*

Rep. David R. Obey, D-Wis., chairman of the House Appropriations Subcommittee on Foreign Operations and the prime architect of the legislation, called the bill the second installment "in a five-year plan to adjust foreign aid spending to the end of the Cold War."

The bill includes an ambitious plan to stem the flow of arms to the Middle East, which could require the administration to temporarily halt weapons sales to the region. While providing $15 million in aid for the Soviet Union's Baltic republics, the legislation also provides guidelines for changes by the Soviet central government that would merit aid from the West. *(Weekly Report, p. 1452)*

Obey and his Republican counterpart on the Foreign Operations panel, Mickey Edwards, Okla., were perhaps most proud that the legislation would set aside $135 million to reduce the federal deficit. Edwards called the provision "one of the most important of the entire bill."

But prospects that the foreign aid legislation will ever become law have been undermined by a long-running controversy that has little to do with foreign policy.

Obey's subcommittee included $20 million for the United Nations Population Fund, in spite of an administration pledge that the president would veto any bill that provides aid for the fund. The administration opposes such aid because of the U.N. agency's activities in China, which has had a policy of coerced abortions.

By Carroll J. Doherty

Obey

Edwards

APPROPRIATIONS '92

The Wisconsin Democrat devised an amendment, approved by the full Appropriations Committee, under which the U.N. agency would receive the funds only if Congress backs the administration's request to grant most-favored-nation (MFN) trading status to China. *(Weekly Report, p. 1599)*

The administration all but ignored Obey's unique proposal linking the two issues and reiterated the threat of a veto if the bill remains in its current form. But the administration and its congressional supporters refrained from a full-scale battle in the House over the issue, hoping that the provision will be stripped from the bill in a House-Senate conference on the legislation.

"This is not the final step for this bill." Edwards said. Obey insisted that a veto threat would not have been necessary if White House Chief of Staff John H. Sununu had heeded his plea to reach a compromise with backers of aid to the U.N. agency. He said he would have supported any such compromise "sight unseen."

But Obey said the administration did not try to negotiate a compromise until one hour after his subcommittee began marking up the bill, "obviously too late to have an effect on anybody or anything."

Limiting Amendments

For many Republicans, the continuing dispute over population fund aid was secondary to the frustrations they encountered in attempting to amend the bill once it was on the floor. Many chafed under what they viewed as an overly restrictive rule that barred floor amendments that had not been submitted in advance.

The night before the House took up the foreign aid bill, Minority Whip Newt Gingrich, R-Ga., interrupted debate on another bill to lambaste the rule, calling it "an absolute assault on the middle class" because it prevented lawmakers from cutting spending from the appropriations measure.

But Obey defended the restrictions, noting that in recent years the House has generally limited debate on foreign aid spending bills. In addition, he said that the administration has sought most of the items in the bill and would benefit from a more restricted debate.

Minority Leader Robert H. Michel, R-Ill., complained that the rule violated a "time-honored tradition" by failing to allow members to strike provisions from the bill. But he said he settled for Democratic assurances that such restrictions would be used more sparingly in the future. The House voted, 264-145, to accept the restrictive rule. *(Vote 180, p. 1706)*

Coincidentally, the House also resumed consideration of the foreign aid authorization bill (HR 2508) — with virtually no restrictions on debate — during the week of June 17. *(Story, p. 1683)*

The contrast in the way in which the

House dealt with the two bills could not have been more striking: While lawmakers spent five days on the authorization bill, conducting scores of recorded votes, the appropriations measure breezed through with minimal debate in less than three hours.

Even potentially contentious issues, such as assistance to Jordan, were resolved with little fuss. The House approved an amendment by Harold L. Volkmer, D-Mo., to cut off all military aid to Jordan for the next fiscal year. The administration had requested $27 million in military assistance for the kingdom.

But Obey modified the amendment significantly, allowing the president to provide the assistance if he determines that it is "in the U.S. national interest" and certifies that Jordan has terminated aid for Iraq and is backing the Middle East peace process. The authorization bill included much tougher conditions on assistance to Jordan.

The other amendments added during House debate were uncontroversial. An expected battle over military assistance for Turkey never took place. The bill reduces the administration's aid request for Ankara from $625 million to $500 million, retaining the congressional custom of providing $7 in military assistance for Greece for each $10 given to Turkey.

Edwards had considered an amendment that would have permitted the administration to lift the ceiling on military aid for Turkey. But he avoided forcing a divisive debate on the issue, hoping that the Senate will restore the administration's full request. The chairman of the Senate Appropriations Committee, Robert C. Byrd, D-W.Va., is Turkey's strongest congressional backer.

In what has become something of a tradition, the House approved by voice vote an amendment offered by Rep. James A. Traficant Jr., D-Ohio, that would require an across-the-board cut of 1 percent in foreign aid funding. Obey modified that amendment as well, exempting countries whose aid levels are set by Congress — nations that receive earmarked assistance — from the 1 percent cut.

Without that change, Israel, Egypt and Turkey would have been subject to the aid reduction. Traficant had already exempted anti-narcotics funding and the deficit reduction provision from the cut.

The House approved Edwards' proposal to increase the amount provided to the Democracy Contingency Fund, an account the president can tap to aid emerging democracies, from $25 million to $50 million. The administration had requested $100 million for the fund.

Like all of the amendments considered, it was approved by voice vote.

Changing Priorities

The basic thrust of the foreign aid spending plan approved by the Foreign Operations Subcommittee was unchanged by the full House. It sets significantly different priorities than the administration's foreign aid request.

> **"The priorities in the administration's budget do not address the real challenges and opportunities."**
>
> **—Committee report on HR 2621**

"The committee believes that the priorities in the administration's budget do not address the real challenges and opportunities" the United States is confronting in a world that is "undergoing rapid changes," said the report accompanying the bill. The panel urged the administration to "present a more realistic budget for next year."

The bill would reduce the administration's request for foreign military financing grants by $500 million, from $4.6 billion to $4.1 billion. While the legislation would enable the administration to provide $404 million in low-interest loans, almost $100 million more than the administration's request, the total for military grants and loans is nearly $410 million below the request.

In its statement on the bill, the Office of Management and Budget said the reduction would "hinder the president in fulfilling U.S. commitments to our key friends and allies."

Aside from Turkey, military aid for two other European nations where the United States has military bases — Portugal and Greece — would be fixed at fiscal 1991 levels. Portugal would receive $100 million, $25 million under the request. Greece would receive $350 million, the amount sought by the administration.

The bill also would transfer half of the military aid requested for the Philippines, another country where the United States has "base rights," to development assistance. The legislation fully funds the administration's $160 million request for a multilateral assistance initiative for the Philippines, but it would shift $100 million of the $200 million military aid request to development assistance.

That pattern extends throughout the legislation. In reducing overall spending on military assistance, the bill would increase funds for most development aid, as well as health and child survival programs.

The primary program supporting Africa's development needs, the Development Fund for Africa, would be funded at $1 billion, $200 million over the administration's request. And the bill would provide $400 million in aid to Eastern Europe, a slight increase over the administration's $369.7 million request.

The legislation would provide a $104 million increase over the administration's $479 million request for children's health and welfare programs, including the United Nation's Children's Fund, programs to combat AIDS and specific programs in Cambodia, Romania and Laos.

The bill also would provide $680 million, nearly $170 million more than the administration had sought, to aid refugees around the world. The report accompanying the bill notes that the administration made its estimate of refugee needs in late 1990, well before the massive outpouring of refugees from Iraq in the immediate aftermath of the Persian Gulf War.

In addition to slashing requests for increased military aid, the House also rejected the administration's request for a $12.2 billion contribution to the International Monetary Fund.

In a reflection of continuing congressional hostility to any form of debt forgiveness, the legislation would provide only $65 million of the $304 million sought by the administration for the debt-reduction portion of the Enterprise for the Americas initiative, a program aimed at promoting economic reform in Latin America.

And the House retained current prohibitions barring the Export-Import Bank from financing arms sales overseas.

The Middle East

As has been the case for several years, approximately one-third of the funding in the foreign bill is directed toward Israel and Egypt. Israel would receive $3 billion, all of it in security-related aid — the same amount that was provided in fiscal 1991.

In addition, the bill would retain a

provision, first included in last year's appropriations bill (PL 101-513) under which Israel would be eligible to receive up to $700 million in military equipment drawn down from U.S. stocks. Any materiel provided during the current fiscal year would be deducted from that total.

The bill also would extend a provision granting the president the authority to locate up to $300 million in military stockpiles in Israel during fiscal 1992. The legislation earmarks $80 million in refugee aid for the resettlement of Jews from the Soviet Union and Eastern Europe who have emigrated to Israel.

Egypt would receive $2.15 billion in security-related aid, $1.3 billion in foreign military financing grants and $815 million in economic support assistance — the same amount provided during the current fiscal year.

Other Issues

The House bill also:

- Deferred the divisive issue of military aid to El Salvador until September at the administration's request. During the floor debate, Matthew F. McHugh, D-N.Y., said the action was delayed to allow both sides to negotiate a truce in the country's long-running civil war.

"If either side fails to negotiate in good faith, or acts to scuttle the talks, it should have a profound effect on our decision in the fall," McHugh said.

- Approved $20 million in development and humanitarian aid for Cambodians, in addition to the $5 million in assistance for Cambodian children.

But the report accompanying the bill expressed frustration that the administration thus far has provided aid only to the non-communist resistance in Cambodia, which has cooperated militarily with Khmer Rouge rebels. The Khmer Rouge murdered millions of civilians during its rule of the country in the late 1970s.

The report said the committee "would expect" the president to certify that no cooperation is occurring between the Khmer Rouge and the resistance before more aid can go to the resistance. In addition, the report strongly urges the administration to make "a genuine effort" to support civilians other than those involved with the resistance.

- Retained the current restriction on aid to Pakistan, which the administration had sought to have lifted. The president is required to certify that Pakistan does not possess a nuclear device before Islamabad is eligible to receive U.S. aid. ■

Foreign Aid Spending

APPROPRIATIONS '92

Following are budget authority totals in the fiscal 1992 foreign aid appropriations bill (HR 2621 — H Rept 102-108), as passed by the House on June 19 *(in thousands of dollars)*:

Program	Fiscal 1991	President's Request	House Bill
Multilateral Aid			
International Monetary Fund (U.S. quota)	$ 0	$12,158,000	$ 0
World Bank	110,592	70,126	70,126
Global Environmental Facility	0	0	50,000
International Development Association	1,064,150	1,060,000	1,060,000
International Finance Corporation	40,331	0	40,331
Inter-American Development Bank	78,299	77,889	77,889
Enterprise for the Americas investment fund	0	100,000	100,000
Asian Development Fund	126,854	174,955	158,793
African Development Fund	105,452	0	135,000
African Development Bank	10,136	8,987	8,987
European Development Bank	70,021	70,021	70,021
Other multilateral banks	23,602	223,026	41,026
State Department international programs	254,730	231,850	282,250
Fund for Agricultural Development	30,000	18,362	18,362
Subtotal	**$ 1,914,166**	**$14,193,217**	**$ 2,112,786**
Bilateral Aid			
Development assistance	1,313,683	1,277,000	1,376,635
Sub-Saharan Africa, development aid	800,000	800,000	1,000,000
American Schools and Hospitals	29,000	30,000	30,000
International disaster aid	40,000	40,000	70,000
Agency for International Development (AID)	474,884	521,039	519,039
Enterprise for the Americas:			
Debt reduction	0	304,340	65,000
Economic Support Fund	3,991,000	3,228,000	3,216,624
International Fund for Ireland	20,000	0	20,000
Assistance for Philippines	100,000	160,000	160,000
Sector assistance	0	0	100,000
Assistance for Eastern Europe	369,675	400,000	400,000
Peace Corps	186,000	200,000	200,000
International narcotics control	150,000	171,500	150,000
Migration and refugee aid	520,648	510,557	680,000
Other bilateral assistance	175,367	189,611	185,361
Subtotal	**$ 8,170,257**	**$ 7,832,047**	**$ 8,172,859**
Bilateral Military Aid			
Foreign Military Financing	4,259,921	4,600,000	4,100,000
Direct Concessional Loans (subsidies)	0	39,800	50,900
(estimated loan program)	0	(313,981)	(404,000)
International Military Education and Training	47,196	52,500	47,196
Special defense acquisition fund			
(limitation on obligations)	(350,000)	(275,000)	(275,000)
Peacekeeping operations	32,800	28,000	28,000
Other military assistance	1,036,061	20,200	10,000
Subtotal	**$ 5,375,978**	**$ 4,740,500**	**$ 4,236,096**
Export Assistance			
Export-Import Bank	750,000	555,778	650,613
Export Assistance (loans)	0	(9,525,000)	(11,000,000)
Trade and Development	35,000	35,000	40,000
Subtotal	**$ 785,000**	**$ 590,778**	**$ 690,613**
Deficit Reduction	0	0	135,000
Across-the-board cut	0	0	150,622 [1]
TOTAL	**$ 16,245,401**	**$ 27,620,542 [2]**	**$ 15,196,532**

NOTE: Figures may not add due to rounding

[1] *Cut does not apply to narcotics control, earmarked aid or deficit reduction.*

[2] *Administration request includes $270 million to refinance foreign military sales.*

United States Budget for a New World Order

The massive political, social, and economic changes in the world over the last two years provide decisionmakers with an unprecedented opportunity to rethink and reorganize U.S. government policies, programs, and spending priorities in the section of the U.S. federal budget for "promoting national security and advancing America's interests abroad."

The recognition of these changes is widespread in both Congress and the Executive. President George Bush has spoken eloquently about the need for a new world order. At the United Nations last October, he called for a new partnership of nations that transcends the Cold War. To promote our security and well-being, he said that we need ". . . serious international cooperative efforts to make headway on the threats to the environment, on terrorism, on managing the debt burden, on fighting the scourge of international drug trafficking, and on refugees and peace-keeping efforts around the world."[1] Similarly, a number of influential members of Congress have called for a rethinking of America's global priorities. The successful effort to persuade countries from East, West, North, and South to join the multilateral effort to reverse Iraq's aggression in the Persian Gulf underscores the new opportunities to address the challenges of a post-Cold War period.

Promoting National Security and Advancing America's Interests Abroad FY1992

The Administration's foreign policy priorities are presented each year in that part of the annual budget request to Congress which contains resources to support the U.S. government's international programs. This year, the President's budget[2] requests $34 billion to fund economic aid to developing nations, including strategic allies such as Israel and Egypt; military aid to over 100 countries; contributions to international organizations; refugee and narcotics control programs; diplomatic and cultural exchanges around the world, including broadcasting activities; the U.S. contributions to the World Bank and the International Monetary Fund; and many other programs intended to promote American interests.

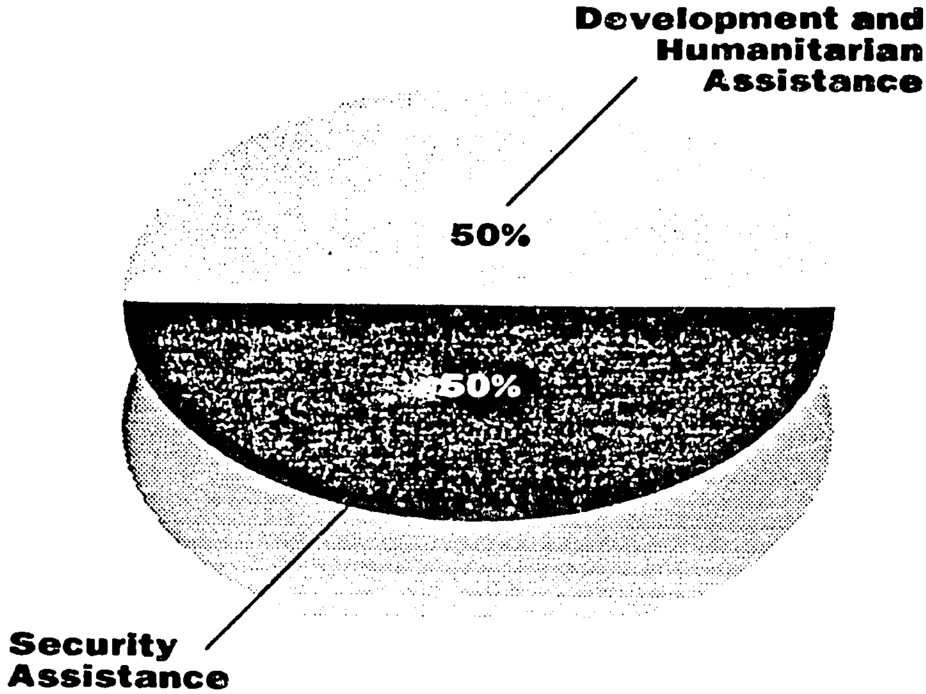
The annual debates over this section of the federal budget have become increasingly stale in recent years. Discussions have not focused on foreign policy priorities but on whether particular countries or programs should get a few dollars more or less than last. Absent is any serious assessment of the continuing usefulness of existing programs, or of new important policy goals that might claim available resources.

John W. Sewell and Peter M. Storm
Overseas Development Council

This alternative international affairs budget has been developed to facilitate a debate over the implications of a new world order for U.S. international programs. It analyzes the changing nature of U.S. interests in a post-Cold War world, and proposes a fundamental conceptual restructuring of priorities within the international affairs budget.

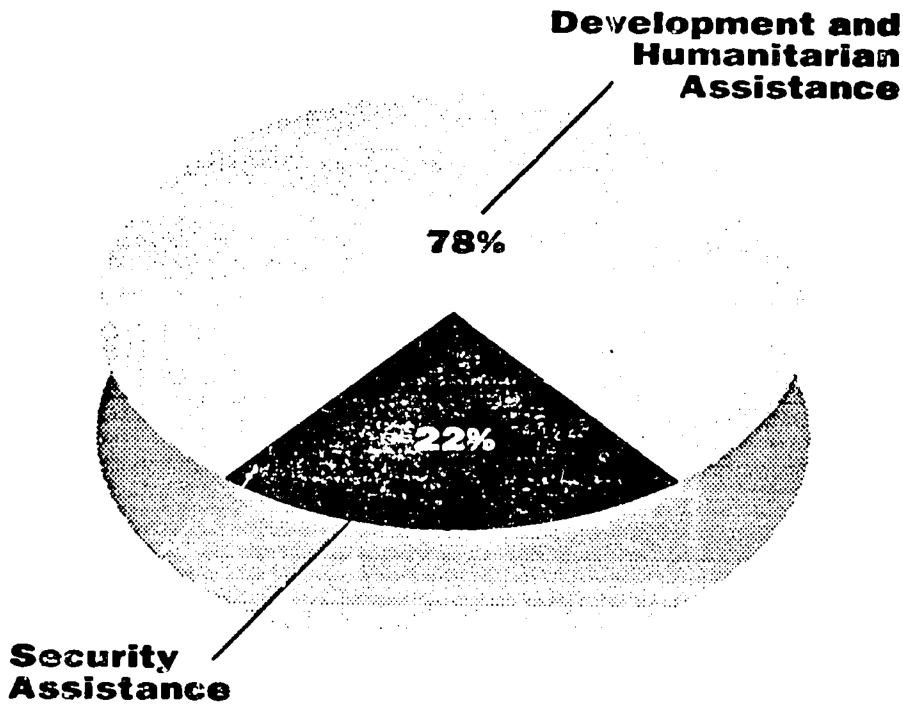
Overseas Development Council
Washington DC, 1991

PRESIDENT'S REQUEST, FY1992



TOTAL FOREIGN AID: $15.9 BILLION

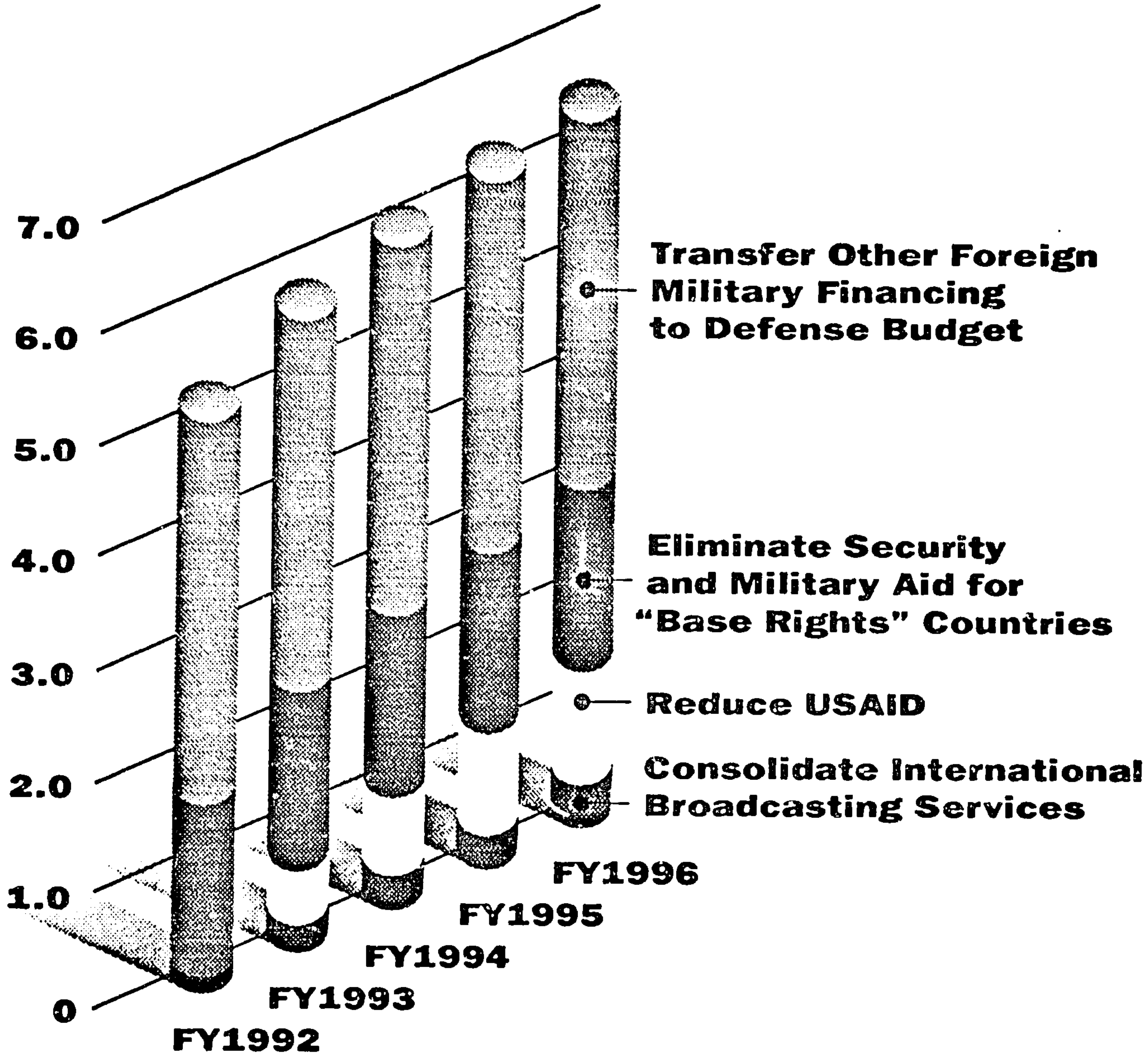
ALTERNATIVE BUDGET, FY1992



TOTAL FOREIGN AID: $14.3 BILLION

SAVINGS FROM THE PRESIDENT'S BUDGET PROPOSAL

($Billions in Budget Authority)



TOTAL SAVINGS FY1992–1996: $28.9 BILLION

92

Summary

The Four Horsemen of the modern age have been the Cold War and the nuclear arsenals it has spawned, the widespread suppression of human rights, global poverty and hunger, and humanity's unrelenting assault on the environment. In developments of great historical significance, the Cold War is at last winding down, and democracy is rising around the globe. But no comparable progress has been made in reducing world poverty and reversing environmental deterioration.

Nowhere are these problems more acute than in the developing world. One billion people in developing countries live in poverty and hunger. Forty thousand children die daily from causes related to this deprivation. Meanwhile, expanding populations and inappropriate development are destroying the fragile base of soils, water, forests and fisheries on which the futur· depends. The deserts are advancing, while the tropical forests, with their immense wealth of life forms, are in retreat. One and one-half acres of these forests disappear every second; scores of species are committed to extinction every day. Each of these problems is deepened by the addition of almost a billion people to the world's population every decade.

A new era of international cooperation is urgently needed to address these challenges, and the United States should play a major role in bringing it about. The time is ripe for a new U.S. mission internationally, one focused on promoting cooperative action to sustain the earth and its people.

Expanded U.S. cooperation with developing countries should be part of a larger North-South partnership founded on the mutual interests of all countries in economic progress and environmental protection. Leading the way toward such a global partnership for sustainable development is decidedly in the U.S. interest. In a world that is growing ever more interdependent, this country's economic fate is inextricably tied to that of the developing countries. So is the fate of the environmental niche Americans inhabit. The United States can no more keep its climate within the comfort zone without developing countries' cooperation than developing countries can revive their flagging economies and relieve the vicious circle of poverty and resource degradation without America's cooperation.

Given the herculean challenges of the developing countries and the United States' stake in helping to meeting those challenges, our country needs a bold, integrated program to cooperate with and assist developing countries. Unfortunately, the United States lacks such a program. U.S. funding of development assistance has been declining as a proportion of gross national product (GNP) for many years, and serious gaps exist in U.S. policies affecting sustainable development.

It is vitally important to our nation's future that these trends be reversed now and that the United States support initiatives for international cooperation in environment, development and population that match the grave challenges at hand. Major new U.S. initiatives are urgently needed. America's task must be to help stimulate the kind of economic growth that will provide sustainable livelihoods for the poor and to promote concerted actions that conserve the resource base, guard public health, reduce population pressures and mitigate global environmental threats.

Within this framework, our Task Force has developed a broad agenda for U.S. action that we recommend for consideration by the Congress, the administration and the public. Specifically, the Task Force recommends that the United States:

1. Launch a new capacity-building initiative designed to help both low- and middle-income developing countries shift to environmentally and economically sustainable development paths.

2. Support the creation of "sustainable development facilities" within the multilateral development banks to catalyze an increase in the quality and number of projects aimed at conserving natural resources and increasing their productivity.

- 3. Propose the negotiation of a global partnership to save tropical forests, involving national plans for halting the loss of tropical forests linked to debt reduction and other financial and technological support.

4. Create a multilateral authority to reduce developing country debt — both official and commercial — while promoting policy reforms for sustainable development.

5. Help stabilize world population in the next century at the lowest possible level by sharply increasing U.S. support for meeting the global demand for family planning services.

6. Launch a global initiative to raise the social and economic status of women in developing countries.

7. Urge increased market access for labor-intensive and processed developing country exports in multilateral trade negotiations.

8. Work to make the world trade regime, the General Agreement on Tariffs and Trade (GATT), more responsive to environmental needs and objectives.

9. Adopt strong domestic economic incentives to increase U.S. energy efficiency and reduce U.S. emissions of carbon dioxide and other atmospheric pollutants.

10. Promote the building of a network of centers for training and research on energy efficiency and renewable energy in the developing countries.

11. Create a National Commission on Environment and National Security to reassess "national security" in light of changed political and military conditions and new environmental threats.

12. Establish a high-level body within the federal government to integrate these and other needed initiatives into a coordinated U.S. program of cooperation with developing countries.

Several of these recommendations are relevant to the deliberations leading to the "Earth Summit" — the 1992 United Nations Conference on Environment and Development (UNCED) — and to current international negotiations on various economic and environmental issues. They should be pursued by the United States in these and other appropriate settings as well as through other congressional and presidential actions.

NATIONAL PLANNING ASSOCIATION
Vol. XII No.4

Revitalizing U.S. Economic Cooperation

by G. Edward Schuh

Dr. Schuh is Professor and Dean of the Humphrey Institute of Public Affairs, University of Minnesota, Minneapolis.

Almost a year ago, the Board for International Food and Agricultural Development and Economic Cooperation established a task force to study the revitalization of U.S. foreign aid. The original mission of BIFADEC was to revitalize foreign aid for agricultural development. However, the implications of the study go far beyond this nation's interest in agricultural development. Hence, the final report's analysis and recommendations will include other sectors.

The U.S. Agency for International Development (AID) has contributed financial resources for the study, as have the Ford and Rockefeller Foundations and the U.S. Department of Agriculture. These agencies and institutions have granted resources to the Humphrey Institute of Public Affairs to ensure independence in the study's analysis and conclusions. The task force is supported by an advisory committee whose members are drawn from both the private and the public sectors.

WHY ANOTHER STUDY OF FOREIGN AID?

Recent years have witnessed a plethora of foreign aid studies. Some academics have probed in depth the successes and failures of foreign aid programs since their inception. Others have focused on how foreign aid can be reformed to make it more effective and to better serve U.S. interests. Congress completed its own study in 1989 in the form of the Hamilton Report, and AID has undertaken a significant self-study.

Despite this considerable effort, BIFAD (the predecessor of BIFADEC) was motivated by three factors in appointing the task force. First was the need to build a new coalition in support of foreign aid. The United States ranks last among the 17 industrialized countries in the share of gross national product it allocates for foreign economic assistance. That share is now

This article is a preliminary report of the BIFADEC Task Force that is studying how the U.S. foreign aid program could be revitalized to better serve its national interests. Dr. Schuh is Chair of the task force.

95

only slightly more than one-tenth of 1 percent of GNP, a far cry from the 3 percent allocated during the Marshall Plan. This small share does not seem consistent with the stated U.S. goal of helping those in desperate straits in the developing countries.

Second was the belief that a new and cohesive rationale was needed for foreign economic assistance if the national effort was to be revitalized. This nation began making a major commitment to foreign aid in the aftermath of World War II. Political and economic conditions both here and abroad have changed significantly since that era. The rhetoric that motivated America then is no longer relevant in today's world.

Third, BIFAD believed that a new paradigm was needed for America's aid program. Given the enomous changes in the international economy and the international political system, it seemed clear that new ways of extending a hand to other countries were badly needed. The task force has taken on the important assignment of designing such a paradigm.

Foreign economic assistance is widely discredited by the U.S. body politic. Yet there are success stories around the world. A recently published study by Willis Peterson of the University of Minnesota shows that the social rate of return on investments in foreign economic assistance has been 50 percent or more in real terms, an unusually high rate of return.

IMPORTANT ISSUES

A number of important issues have surfaced as the task force has worked through its analysis and begun to design the new paradigm. It is worth noting, however, that one of the distinguishing factors of this study is the extent to which it focuses on changes in the economics of U.S. foreign aid programs.

Declining Attention to Agriculture

The task force is concerned about the decline in attention being given to agricultural development, not only by bilateral agencies such as AID, but also by multilateral lending agencies such as the World Bank and regional development banks. The task force believes that this reduced attention to agriculture is misguided and will lead to reduced productivity in foreign economic assistance.

The reduction in emphasis on agriculture appears to be based on a failure to understand how agriculture contributes to general economic development and what is happening in global agriculture. With respect to the first failure, it is now generally recognized that agriculture's share of a nation's labor force and GNP declines as economic development increases. That is progress, because it moves away from past efforts to use agriculture as the employer of last resort. However, that tendency does not mean that agricultural development efforts should be abandoned or that development efforts should be redirected exclusively to the nonfarm sector.

Agriculture's importance is determined for the most part by the fact that everybody eats food. Therefore, the benefits of supply-side development efforts that lead to a reduction in the real price of food are widely distributed among the members of society. Moreover, because low income consumers spend a larger share of their budgets on food than do upper income groups, the benefits of such development efforts are distributed in favor of the poor. This is why the social rate of return on investments in agricultural research to produce new technology for food commodities is so high—from 70-80 percent to, in some cases, more than 100 percent in real terms.

Spreading the benefits of economic development so widely is a sure means to stimulate secondary growth on a broad scale because the increased income goes to consumer groups that have a high propensity to spend. In addition, agriculture has a comparative advantage in many developing countries. Introducing new technology into the sector, which raises productivity and lowers the real prices of these commodities in the domestic economy, helps make the country more competitive in the international economy and thus helps increase foreign exchange earnings. These earnings are needed to service debt incurred in the past and to finance higher rates of economic growth.

The other failure is the lack of understanding about what is taking place in the global agricultural sector. The apparent success of the Green Revolution and the accumulation of stocks in developed countries have led many observers to conclude that the world food problem is solved. Nothing could be further from the truth. First, the costly stocks carried by the European Community and the United States are largely a consequence of their misguided agricultural policies, which subsidize producers at unsustainable levels. Second, potential gains from miracle wheats and rices have largely run their course, and there is nothing on the international scene to replace them. Dwarfing these plants, which causes their increased yields, can go only so far. In the case of rice, for example, the International Rice Institute, which created the high-yielding rice varieties, obtained the highest yield in 1968. Nothing created since has produced a higher yield. Moreover, the high-yielding wheats and rices have spread geographically about as far as they can. Increases in output from this source are expected to be smaller in the future.

Finally, and perhaps most serious, the developing countries' economic crises of the 1980s caused a wane of financial support for nascent graduate training programs and established research systems in those countries. Brazil is an outstanding example of a country whose capacity to train its agricultural scientists and to perform agricultural research has declined dramatically. But Brazil is not unique; the same is happening in many other developing countries. The capacity to produce new technological breakthroughs adapted to local ecological and economic conditions is declining at a rapid rate.

When the economies of the developing countries recover from the crises of the 1980s—and all the evidence shows that this will occur in the 1990s—the demand for food will expand rapidly. Unless there are sustained efforts to develop the capacity for agricultural research in these countries, the food and agricultural sector will impose a constraint on that expansion early in the process.

Changes in the International Economy

Changes in the international economy have altered dramatically the conditions under which foreign economic assistance is provided. For example, when foreign aid began after World War II, there was a dollar shortage and virtually no international capital market. Under those circumstances, it was logical for the United States to provide capital on a government-to-government basis. But the world is not like that today. A large international capital market exists from which countries that pursue sound economic policies can borrow. Thus, the need for bilateral and multilateral development agencies to provide capital on concessional terms for countries other than the poorest of the poor is much weaker now than it was then. The need today is for high quality capital, human capital, which international capital markets do not do well in financing.

Another important change in the international economy is the shift from the Bretton Woods fixed exchange rate system to the present system of bloc-flexible exchange rates. Under the current system, transfers of capital to a developing country may well bid up the value of its national currency, thus giving it "the Dutch disease" by making it less competitive in international markets. This is occurring in a number of African countries where lending consortia have provided large resource transfers in relative terms. It can occur in any country when the emphasis shifts to balance of payments support instead of longer-term investments in augmenting the economy's capacity. This suggests that the issue is not so much the quantity of capital as the quality.

International trade has also grown rapidly in the post-World War II period. This increases the developing countries' ability to earn the foreign aid they need to finance a higher rate of economic growth.

Changed U.S. Interests in Foreign Aid

For most of the post-World War II period, the U.S. commitment to foreign aid was driven in large part by the Cold War. The United States competed with the Soviet Union for the minds of developing countries in helping them to obtain higher rates of economic growth. The Cold War appears to be over, and the Soviet Union's economy and political systems are collapsing. Foreign aid for this purpose is no longer needed.

The rationale for a sound program of economic collaboration with the developing countries must have a new base. The task force believes that there are two such bases. The first is rooted in narrow economic interests. The United States now imports more than 50 percent of 13 raw materials judged to be critical to America's industrial sector. Many of these raw materials come from developing countries. In addition, if developing countries experience economic growth, they will constitute larger markets for the U.S. economy. These markets can form the basis of U.S. economic growth in the future.

The second base is more pervasive and, over the longer term, more important. U.S. hegemony in the international economy and in the international political system has declined significantly over the years. In the aftermath of World War II, the United States accounted for approximately 50 percent of global GNP. It was also the technological and scientific leader of the world and maintained a military presence around the world that allowed it to protect its widespread economic and political interests.

That situation no longer prevails. The U.S. share of global GNP has declined to about 25 percent. It has lost its technological and scientific leadership in field after field. America has let its own economy slip into disrepair, with the result that it no longer commands the presence it once did. Perhaps most important, in the decades ahead and for the first time in their history, billions of people in developing countries may be empowered with Western-style economic growth. All of this means that in the future, America as a nation will increasingly have to live by its wits. Therefore, it should give high priority to learning more about the rest of the world and to accessing the new technology being produced on an ever greater scale in both developing and developed countries.

Changed Interests in Developing Countries

As the U.S. motive to give foreign aid has changed significantly, so has the developing countries' motive to receive it. These countries increasingly recognize that investments in science and technology are the basis of economic growth and development. They increasingly want to access knowledge, or the ability to produce that knowledge, in other countries. In addition, they are more chary of the dependence that comes with misguided foreign aid programs.

OTHER ISSUES

The task force is also addressing other issues, including the emergence of the newly liberated countries of Eastern Europe, the growing recognition of the seriousness of global environmental problems, and the increasing importance of providing assistance to establish democratic societies

THE NEW PARADIGM

The new paradigm for America's foreign aid program has a number of important elements. First, the task force believes that the United States should abandon the concept of foreign aid per se and articulate what it does in terms of international collaboration. What America does should be conceived as in its best interest, and America should stop justifying its programs on the basis of benevolence except for the humanitarian aid it provides during natural disasters. Second, the U.S. emphasis should be on investing in the development of human capital, both at home and abroad. The United States should seek collaborative efforts in research and education, not only in developing countries but in developed countries as well. These endeavors will help other countries, but they will also help this country by developing a stock of people knowledgeable about the rest of the world at the same time that they add to the knowledge base. The realization of such complementarities should guide all of America's actions.

Developing viable institutions should be an important goal of U.S. international collaborative efforts. In helping to develop more viable institutions in other countries, the United States needs to undertake a major reform of its own education and research institutions. This is of major significance to American universities and other education institutions, which badly need an international perspective. But it is also significant to America's health institutions and to others that the nation uses to engage the international economy. In addition, the United States should include a broader range of domestic institutions, such as the Department of Agriculture, in its international collaborative efforts.

Finally, food aid programs should focus on increasing school attendance of low income groups in developing countries. If directed toward that end, such programs will not only reduce the specter of malnutrition and starvation on the international scene, but also improve the educational attainment and health status of disadvantaged groups.

OPINION

Anticommunism used to govern the distribution of aid; now the guiding principle could become development of markets for US exporters

Foreign Aid Askew

By David I. Steinberg

THE Gulf war has focused discussion of United States foreign aid on rebuilding that area of the world. But a more pervasive, and perhaps more important, issue is now surfacing.

Two generations of Americans have been told by their leaders that the rationale for foreign aid was anticommunism and security. Since the Marshall Plan in Europe following World War II, all administrations, Democratic and Republican, have sold the foreign aid program to Congress and the American people as a means of supporting the "free world."

True, aid did other things. It provided humanitarian relief to needy peoples and disaster assistance in times of calamity. The bulk of the aid, however, was to reward friends, to shore up shaky governments – a few democratic, many not, to prevent internal revolution or external aggression, and to encourage support for international policies felt to be in the US national interest.

IN contrast to Japan, foreign aid has never been popular in the US, either in Congress or among the people. To counter this, various administrations have combined the national-interest sales pitch with more locally directed selling: how much of every American dollar authorized for foreign assistance went back to the US, and indeed to individual congressional districts, for the purchase of local goods and services.

Often academic institutions that benefited from technical-assistance contracts or training programs have been encouraged to let their representatives in Congress know how important foreign aid was to them.

With the end of the cold war, the justification of foreign aid is palpably shifting. Humanitarian assistance, disaster relief, and a variety of other well-meaning and needed programs will certainly continue. The Bush administration has come up with a new configuration of priorities, including encouraging democracy, the private sector, family values, a better environment, and more effective management. These categories represent new packaging, but a continuity of previous emphases. Every administration wishes to place its own public stamp on foreign aid.

The European Community and Japan in their foreign aid programs are also likely to stress democratic values.

The essential changes in the new approach lie not in the new categories – they are well-meaning, if somewhat simplistically appealing to an essentially American audience. The more fundamental issue is in the redefinition of the underlying national interest in the foreign-aid program away from security.

The national interest is now defined as economic – a strong appeal to immediate American concerns. A major portion of foreign aid is to be used to support the private sector overseas. This is nothing new; it was emphasized as long ago as the Kennedy administration, but had its full flowering under President Reagan. What is new in the Bush plan is an effort to assist directly American businesses that compete on certain world markets with exports in which the US has a distinct advantage: telecommunications and transportation equipment, for example, and major infrastructure construction materiel.

Previously, administrations supported the private sector conceptually – that is, both foreign and indigenous private sectors. Now the emphasis has shifted to direct support to American corporations. This will be achieved through "mixed credits," capital provided both at commercial and at subsidized (through the aid program) interest rates.

Use of the foreign-aid program to help the US be competitive on world markets is based on a number of assumptions: that the volume of aid is significant even if targeted toward certain countries, that the US will be competitive in certain fields if interest rates are in part subsidized (as they are in other countries, so the argument goes), and that the US can provide goods and services that will help these societies develop.

There are major dangers in this approach. It once again emphasizes the short-term US need – now economic interests and greater exports instead of combating communism – rather than the longer-term goals of raising standards of living and thus promoting eventual markets and economic stability.

This approach also encourages greater expenditures on infrastructure, where the US has some advantage in the supply of heavy equipment, rather than on the alleviation of poverty.

If pursued, this plan could lead the US to abdicate the conceptual leadership of the world in foreign assistance.

THE Foreign Assistance Act of 1973 still focuses on the poor in developing countries. True, the act needs reform. It has so many different provisions for reaching the poor that any administration or agency may pick from a menu of priorities and do whatever it wishes. One of those approaches was to expand employment through the private sector as a means of alleviating poverty.

Now, however, the administration has explicitly indicated that the private sector is supported "as an end in itself."

Many in the US will not be comfortable with a foreign-aid program that will direct profits toward specific industries and businesses. First, it is one thing to uphold the virtues of local and international marketplaces, but quite another to skew these markets. This approach once again leaves the poor behind, as even secondary beneficiaries.

Further, US officials could be involved in assisting individual industries; this raises the specter of special interests, insider deals, and favoritism. There should be better means than the foreign-aid program to encourage exports through more responsive and competitive American businesses.

■ *David I. Steinberg is distinguished professor of Korean Studies at Georgetown University, Washington.*

NEW YORK TIMES May 20, 1991

DOWN GRADE FOREIGN POLICY

Horacio Fidel Cardo

By William G. Hyland

We are in another Great Debate about American foreign policy. Before the gulf war, the emerging conventional wisdom was that America was in decline, about to be replaced by the new economic giants, Japan and Germany. Military power would count for less, and economic factors would be decisive in shaping the new world order.

> We must take a psychological turn inward and face our domestic crisis.

The gulf war shattered most of this. No power other than the United States could have managed the crisis or fought the war. It was a great victory, but thus far it has been more a stimulant to American morale than a guide to the future.

Gen. Norman Schwarzkopf's brilliant campaign was of little help to Treasury Secretary Nicholas Brady when he pleaded with Japan and Germany for lower interest rates; nor has it strengthened Secretary of State James Baker's diplomatic hand. Nations pay in the expectation of future favors, not in gratitude for past ones. The Arabs' ingratitude apparently knows no bounds.

In any case, the "defining moment" President Bush has spoken of was not the war against Iraq, but the end of the cold war. The United States has never been less threatened by foreign forces than it is today. But the unfortunate corollary is that never since the Great Depression has the threat to domestic well-being been greater. By winning the cold war, however, we have earned about a decade of freedom to reorient our foreign policy and concentrate our resources, energy and attention on dealing with the domestic crisis.

We need a new order in both foreign and domestic policy. To dramatize the shift in priorities, President Bush should issue a broad statement of principles and aims for domestic policy, as President Truman did for foreign policy with the Truman Doctrine, the Marshall Plan and the creation of NATO. It is no longer sufficient to submit separate programs for education, crime or transportation. No matter how meritorious, they convey an impression of business as usual. A doctrine that recognizes that we do, in fact, face a domestic crisis and that outlines a program for dealing with it is sorely needed. And such a doctrine has to be supported with real money, just as the Marshall Plan was.

Of course, it is naive to believe that simply by proclaiming a new doctrine we can then reduce foreign aid by one-half and transfer $17 billion for, say, the war on drugs. Nor would wrenching another $25 billion "peace dividend" out of the defense budget mean more resources for education. Unfortunately, Washington does not work that way.

What is desperately required is a psychological turn inward. It will of necessity be a careful turn, but it must begin soon.

This turn will affect foreign policy. Taking on new commitments in the Middle East and Persian Gulf while maintaining most of the old ones in Europe and the Far East cannot be justified in the face of a disastrous domestic agenda: crime, drugs, education, urban crises, Federal budget deficits and a constant squeeze on the middle class, the backbone of our democracy.

Without a major change in attitude and a diversion of resources, by the turn of this century the nation will still be caught up in a social and economic crisis, but our foreign policy will also be floundering for lack of public support or understanding. The American people are not likely to endorse a foreign policy constantly justified as a "moral" obligation that helps everyone else from Kurdistan to Bangladesh. Nor will they happily forgive huge foreign debts or pay for a $200 billion to $300 billion defense budget if the main enemy is not the Red Army but "instability."

We need to start selectively disengaging abroad to save resources and seize the unparalleled opportunity to put our house in order. We should avoid new entanglements in the Middle East, withdraw the bulk of our armed forces from overseas and cut back drastically on foreign aid.

There is no longer a persuasive threat that requires keeping more than 500,000 ground, air and naval forces in Europe or the Far East. Why should Americans pay to defend rich European allies, or spend $800 million a year to rent naval and air bases in the Philippines? If large American forces do remain abroad, they will become pseudo-occupation troops to guard against the resurgence of Germany and Japan.

We have to learn to trust the Germans and the Japanese, difficult as that may be. That trust will be evident if we pull our forces out, leaving behind only a skeleton structure for emergency redeployments. We can safely withdraw, because neither China nor the Soviet Union will pose a threat for the remainder of this decade. The only conceivable exception is Korea, but there is no longer any need to keep ground troops there.

In the Middle East, the situation is obviously different. There are still threats to our interests. We badly overestimated, however, the impact of our victory over Saddam Hussein. It was predictable that Secretary Baker would encounter resistance to an Arab-Israeli peace conference: Arab leaders fear that they jeopardized their regimes by aligning themselves so closely with the Americans; Israeli leaders believe they set a dangerous precedent by acceding to American pleas not to retaliate against the Scud attacks.

In our frustration, it is tempting to increase our leverage through weapons sales, joint military exercises and prepositioning of equipment, and even air and naval bases. This policy will not only be costly but eventually it will bring us into confrontation with Israel — a strange outcome for a war fought in the name of freedom.

The gulf war bought us time. The situation is less dangerous. The immediate issue is not a grand conference, nor progress on the West Bank, but whether Syria is at long last willing to take the path of Anwar el-Sadat. Quiet diplomacy might bring this about, but not if we now guarantee the security of the Arab states for nothing. A better course would be to bargain any new American military commitments for Arab concessions in the Israeli peace process.

Since Pearl Harbor, we have been able to take care of our domestic problems and guard our national security. In a crisis, we could continue as before, although at an increasing cost. But the point is that we no longer have to. The enemy is not at the gate, but it may already be inside. □

William G. Hyland is editor of Foreign Affairs magazine.

POSTWAR IRAQ

Congress Clears Refugee Aid; Bush's Signature Expected

In the immediate aftermath of the Persian Gulf War, it would have been impossible to predict that the United States' military triumph would come with a price tag of more than $500 million for relief operations in and around Iraq. Now, few lawmakers believe that a half-billion dollars will be enough to meet humanitarian needs there and elsewhere.

UNITED NATIONS

Kurdish men haul water to cope with shortages in Erbil, Iraq.

Congress took the first step toward addressing those needs May 22, approving the conference report for a $572 million supplemental appropriation bill (HR 2251) for fiscal 1991. It would include $556 million in disaster and refugee relief aid.

The conference report (H Rept 102-71) passed with virtually no opposition in either chamber. The House approved it, 387-33, while the Senate cleared the measure by voice vote. *(Vote 113, p. 1408)*

The president is expected to sign the legislation, which the administration originally requested to fund the U.S. assistance program for Kurds and others displaced in Iraq's postwar chaos.

The House and Senate approved an $85 million increase over the administration request for State Department disaster and refugee aid accounts, which have been drawn down to respond to the Kurdish crisis as well as emergencies in Bangladesh, the Horn of Africa and elsewhere.

The spending bill includes $235.5 million for State Department activities, to be derived largely from interest accumulating on foreign contributions to the U.S. war effort. The conference report states that the contributions themselves could also be spent.

Most of that money, $210 million, would replenish the department's disaster and refugee aid accounts, and $25.5 million would support peacekeeping activities of international organizations such as the United Nations. In addition, the interest on foreign donations would be tapped to provide $16 million for private organizations that provide services to U.S. military personnel and their families.

The remaining $320.5 million, which would fund the U.S. military's relief operations, would be drawn from a separate Treasury Department account established for war costs.

Because HR 2251 was intended to defray incremental costs associated with the war — and because the funding was either previously appropriated or has come from interest on foreign contributions — the measure was deemed to be exempt from federal spending limits.

Expecting More Costs

The consensus among members of the House and Senate Appropriations Committees, which met May 21 to resolve differences over the supplemental, was that it probably will not be the last such measure this fiscal year.

Administration officials concede that the legislation will only provide enough money to fund the U.S. military role in the Iraq relief operation through the end of May. The administration has indicated, and lawmakers agree, that more money also will be needed to respond to other emergencies in this country.

The legislation would require the administration to report to Congress within 10 days of enactment on "unfunded dire emergencies because of floods, droughts, tornadoes, unemployment" and other disasters.

In conference, House negotiators agreed to drop a provision in their version of the bill to fund the extra $85 million in State Department spending from unspent foreign aid, mostly assistance for Pakistan.

The aid program for Pakistan has been suspended since last October, when the president failed to certify that Pakistan does not possess nuclear weapons. That automatically triggered a law requiring the suspension.

But the administration opposed using the funds. The State Department maintained that the frozen aid for Pakistan might be needed later for other purposes, including further disaster funding or increased economic aid to Haiti, Honduras and Nicaragua.

House negotiators accepted Senate language funding the State Department's activities entirely from interest on foreign contributions, but they won inclusion of a requirement that the administration notify Congress before reallocating the Pakistan aid.

The House conferees also agreed to a Senate amendment that would remove restrictions on the International Trade Administration's expenditures for export promotion.

The agency's budget was appropriated but not fully authorized, because the president vetoed the bill which included the authorization. Without congressional action, the agency could have faced a cut of $12.9 million.

And senators dropped their objection that providing $16 million for organizations that aid military personnel would trigger similar requests by other private groups. ■

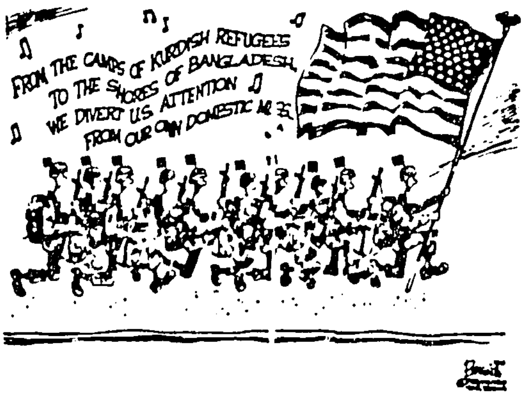
By Carroll J. Doherty

DEFENSE

DAVID C. MORRISON

OPERATION KINDER AND GENTLER

When U.S. military forces are dispatched to foreign lands, usually it is with guns blazing and aircraft bombing—or at least with the explicit threat that they soon might be. What, then, are all of these American troops doing in northern Iraq and Bangladesh? Among other things, they are exercising what is emerging as an expanded post-Cold War military mission for the United States: humanitarian relief.



In what the Pentagon has dubbed Operation Provide Comfort, U.S. transports have helped haul more than 13,000 tons of relief supplies to Kurdish refugees. More than 10,000 U.S. troops are assisting the hundreds of thousands of hard-pressed victims of the uprising that followed Operation Desert Storm, the American-led war against Iraq.

And, in Operation Productive Effort, an eight-ship task force with 4,600 marines and 2,965 sailors has dropped anchor in the Bay of Bengal to help 10 million survivors of an April 30 cyclone that killed more than 100,000 Bangladeshis. "It is great to be here doing the reverse role of a soldier," a Navy commander told the Associated Press. "People think soldiers are trained only to kill. That is not so."

Pentagon spokesman Louis A. (Pete) Williams denies any wider significance to this flurry of humanitarianism. "It's very much a case-by-case basis," he said. "If you look at the situation in northern Iraq, that is a result of Operation Desert Shield and Desert Storm. In Bangladesh, it's a matter of matching up the United States military's unique ability to respond quickly with a great number of helicopters and hovercraft. There's really no other place to go for that kind of a response."

In its various annual reports this year, however, the defense establishment places a heavy new stress on its ability to deliver not only bombs and paratroopers anywhere in the world, but also rescue and relief services. "The humanitarian and civic assistance programs of the Department of Defense have significantly advanced U.S. national security objectives," Defense Secretary Dick Cheney told Congress in his 1991 annual report. By providing such excess materiel as food, medical supplies and tents, he says, the Pentagon "has assisted people in need in over 40 nations and strengthened our security relationships with friendly governments."

This is hardly a new role for the U.S. military; the Air Force says it has run 360 humanitarian missions since the end of World War II. But with the Soviet Union in full retreat and last year's Third World bogeyman—Iraq—recently humbled, the services are eager to talk up nontraditional, budget-justifying roles. And so, while counternarcotic operations were the leitmotiv of last year's budget presentations, the emphasis now is on humanitarian missions.

"We can no longer plan our deployments on traditional assumptions of Cold War confrontation," Adm. Frank B. Kelso, the chief of naval operations, recently told Congress. "During the coming decade, deployed naval forces will still perform their traditional missions of deterrence, routine presence and crisis response," he said. "However, they will increasingly be called upon to perform such missions as humanitarian assistance, disaster relief, counternarcotics operations and peacekeeping."

The Army's 1991 report echoes that view: "Traditionally, [our] expertise has been used in connection with military operations; however, these skills are now being applied in innovative ways," it says, by providing "health, technical and management assistance to nations to further their development and promote their stability."

Not all such missions are overseas. *Outside the Storm*, a pamphlet heralding the Army's post-Persian Gulf war "vital missions and important work," touches on the war on drugs and "protecting planet Earth" (even reprinting a syrupy ode to environmentalism from the 1989 Sierra Club Wilderness Calendar). But it also spotlights the 2,700 troops deployed in the wake of Hurricane Hugo in 1989 and the 23,171 Army National Guard troops activated last year for domestic crises, including "providing security for armories being used as shelters for the homeless."

The Army booklet also devotes a section to "helping Panama rebuild." Like most other American wars—though not Vietnam—Operation Just Cause, the December 1989 invasion to bust Manuel A. Noriega, has led to a relief effort. In Panama, it is Operation Promote Liberty, a "nation-building" effort to restore some of what was destroyed. "Everyone has benefited," the Army reports. "U.S. soldiers gain from doing their jobs, getting good training constructing buildings, paving roads or treating patients. The people of Panama get much-needed medical treatment, new roads and better school buildings."

The Pentagon is also underlining its ability to carry out rescue missions. In Operation Sharp Edge, a four-ship amphibious group with 2,335 marines sailed to Liberia during that African nation's civil war in August. By December, some 2,600 foreign nationals, including 330 U.S. citizens, had been evacuated and hundreds of thousands of Liberians given relief assistance. In early January, Marine Corps helicopters flying from two amphibious ships for Operation Eastern Exit rescued 260 people from 30 countries, including the U.S. and Soviet ambassadors, from another war-torn African state, Somalia.

The American military really does have a "unique ability" for rapid-response relief operations, and so the new emphasis on this mission is unlikely to arouse policy critics—unlike the military's role in the drug war. Anyway, besides being a life-saver for people in Bangladesh and elsewhere, the new humanitarianism also boasts some realpolitik benefits.

"Humanitarian operations in response to disasters also play a role in supporting U.S. national security objectives by providing foreign populations with a favorable image of the United States," Air Force Secretary Donald B. Rice noted in testimony earlier this year. Or, as the Joint Chiefs of Staff observe in their 1991 *Joint Military Net Assessment* report, nation-building exercises and the like "extend our political good will and access to foreign markets. ■

102

Disasters Strain Tight Relief Budgets

When relief officials describe the enormity of this season of far-flung disasters, they turn to biblical metaphors. "It's like the 10 plagues," said one official with the U.S. Agency for International Development (AID). "I just don't know where it will hit next."

As members of Congress broaden their focus beyond the Kurdish refugee crisis in and around Iraq, the list of disasters is daunting: The cyclone and flood in Bangladesh claimed nearly 200,000 lives, with more deaths likely. A cholera epidemic is spreading in Latin America. Costa Rica and the Soviet republic of Georgia have been wracked by deadly earthquakes.

CATHOLIC RELIEF SERVICES

Members are advocating U.S. assistance to relief efforts such as this center that feeds famine victims in the Sudan.

Yet all of these catastrophes will probably be dwarfed by the emerging famine in the Horn of Africa. According to a recent report from the U.N. World Food Program, 21 million people are at risk of starving in the Horn, including 9 million to 11 million people in the Sudan alone.

"Only a massive international relief effort can avert further human suffering and loss of life," said a report from the U.N. Food and Agriculture Organization.

But a massive effort has also been urged in behalf of Bangladesh. Storms and floods left 10 million people homeless, and 4 million have nothing but the clothes on their backs, said Thomas W. Drahman, a regional director for CARE.

According to Rep. Stephen J. Solarz, D-N.Y., who called for $50 million in emergency aid for cyclone victims, "the relief and rehabilitation requirements will be enormous."

Stretched Resources

Drahman, who has been in relief work for 25 years, said, "I cannot recall a period in our collective history when the challenges have been so great and our resources stretched so thin."

It is a problem shared by private relief organizations, such as CARE, and governments. Andrew S. Natsios, director of AID's Office of Foreign Disaster Assistance, said his agency's annual $40 million budget was depleted "some time ago."

To compensate, the office has shifted $20 million from development-assistance accounts to provide emergency relief for Kurdish refugees and drought victims in Africa. A supplemental appropriation passed by both chambers would provide $27 million in disaster aid for the Kurds, and $40 million for the disaster aid office to respond to emergencies elsewhere. *(Story, p. 1211)*

It is not unusual for the agency to exhaust its resources so quickly or to "borrow" money from other accounts, according to Natsios. What is unique about this year is that millions of people are still at risk in the Sudan and the rest of Africa.

Among factors that make the Sudanese tragedy almost impossible to manage: The ongoing civil war has turned food deliveries in the countryside into a life-threatening venture; the Khartoum government only recently acknowledged the famine and has not cooperated with relief agencies; and the country is half the size of the United States, with villages dispersed across a huge area.

"Imagine driving from here to St. Louis on dirt roads in order to deliver food," said Tom Getman, director of government relations for World Vision, a private organization active in the Sudan.

Rep. Hall Urges Intervention

Rep. Tony P. Hall, D-Ohio, who has closely monitored the crisis as chairman of the House Select Committee on Hunger, charges that the famine is largely the result of "criminal" policies by the government of the Sudan, which "uses food as a weapon" in the country's civil war. As a result, he said, "under the best situation, we'll probably lose about 300,000 people."

Hall has urged the United States and other Western nations to take radical steps, similar to the policy adopted toward Kuwaiti refugees, to address the famine. He said donor nations should bypass the government and deliver food directly to those in need.

"We need a way to get around the sovereignty of a country — if we have to — in order to prevent a humanitarian disaster," he said.

During the Kurdish relief operation, the United States and its allies have violated Iraq's sovereignty to provide aid to refugees. But the intervention, which the allies have justified under U.N. resolutions, is an exception to the rule of international law that places paramount importance on a nation's territorial integrity. Indeed, the administration went to war to preserve Kuwait's sovereignty.

Hall concedes that his proposal would be less than popular with most governments. But Natsios candidly acknowledged that the United States is occasionally willing to overlook national borders to help people in need. "We violate the sovereignty of other countries all the time," he said. "We just don't talk about it."

—Carroll J. Doherty

103

Givers Are Responding to a Flood of Disasters

Some Charitable Organizations Report American Donations Running Ahead of Last Year

By Dana Priest
Washington Post Staff Writer

The bad news has been relentless: Starvation in Iraq and Kurdistan. Flooding and death in Bangladesh. A cholera epidemic in Peru. Famine in Africa. Earthquakes in Iran, Soviet Georgia and Costa Rica.

But despite the mind-numbing string of human tragedies and a recession at home, many of the largest U.S.-based relief organizations report that charitable giving by Americans is up.

"We do feel the public is being generous," said CARE spokeswoman Mary Johnson. "However, the need is so great."

In the first 15 days of May, CARE, a private relief and development organization, raised $4 million, compared with $1.27 million the same period last year.

As of April 1, Oxfam America's receipts were about 13 percent below last year. But by May 16, they had surpassed last year's.

By April 30, Church World Services, an umbrella group of U.S. church-sponsored relief and refugee assistance programs, had collected 18.3 percent more in donations than the same time a year ago.

And the American Council for Voluntary International Action, an umbrella group of 132 private relief and development agencies, reports that this year's contributions likely will equal or surpass the $1.5 billion the organizations collected last year.

"The self-centeredness of the 1980s has given way to a more caring attitude," said Kenneth H. Phillips, chairman of the council. "Other than for the recession, I think donor response has gone up."

Initially, agency officials worried that the unusual number of disasters would produce "donor fatigue," a feeling that an individual's contribution does not make a difference, so why bother. But that has not happened.

"I don't think people get used to it," Phillips said, "in the same way as when the house down the street gets burned down, people respond."

Agency officials believe that Americans see the Bangladesh cyclone, the Kurdish refugee problem and the damage caused by earthquakes as problems with specific solutions and are more likely to give because of this.

Also, the high level of news media attention to these disasters has helped make the case for American help, they said.

"All you have to do is put something on television and donations increase," said Neal Flieger, spokesman for the House Select Committee on Hunger. "People give when they know about a problem, and they don't when they don't. It's that simple."

Still the wave of misfortune probably has been unsettling to some potential donors.

"We haven't seen this kind of convergence of disasters before," said Ann Stingle, a spokeswoman for the American Red Cross, which has raised $8.4 million for Persian Gulf War-related services since February. "People don't know what to fix on. It makes it a little more complicated."

This year's disasters occurred at a time when some Americans have become more conscious of poverty in the United States and have chosen to give their charitable dollars to local programs. A few relief groups that had focused solely on the Third World have sensed this trend. Oxfam America, part of the worldwide grass-roots hunger and development organization, has decided to begin a project in the United States sometime next year, said Bernard Beaudreau, Oxfam's director of fund-raising.

"There's a limited charitable dollar and when people see state and local governments doing less and they are actually stepping around [homeless] people on the street, that's what moves people," he said.

Relief officials also worry that the recent rash of calamities has eclipsed longer-term and ultimately more deadly human calamities. War and famine in Ethiopia, Somalia and Sudan, which threaten to kill nearly 1 million people this year—more than the earthquakes, cyclones and Persian Gulf War combined—are only now gaining renewed attention.

Horn of Africa policy groups agree that the problems in that region are primarily driven by internal instability and that unless the United States brings its diplomatic weight to bear on ending civil conflicts, "all the food in the world is not going to bring a solution," said Kraig Klaudt of Bread for the World, a Horn of Africa policy advocacy group.

So instead of concentrating on fund-raising, some of the African groups have turned to a letter-writing campaign in support of the Horn of Africa Recovery and Food Security Act, which has been introduced in Congress. The bill calls for, among other things, mobilizing international pressure to resolve regional disputes.

USAID Highlights
Vol. 8, No. 1
Spring 1991

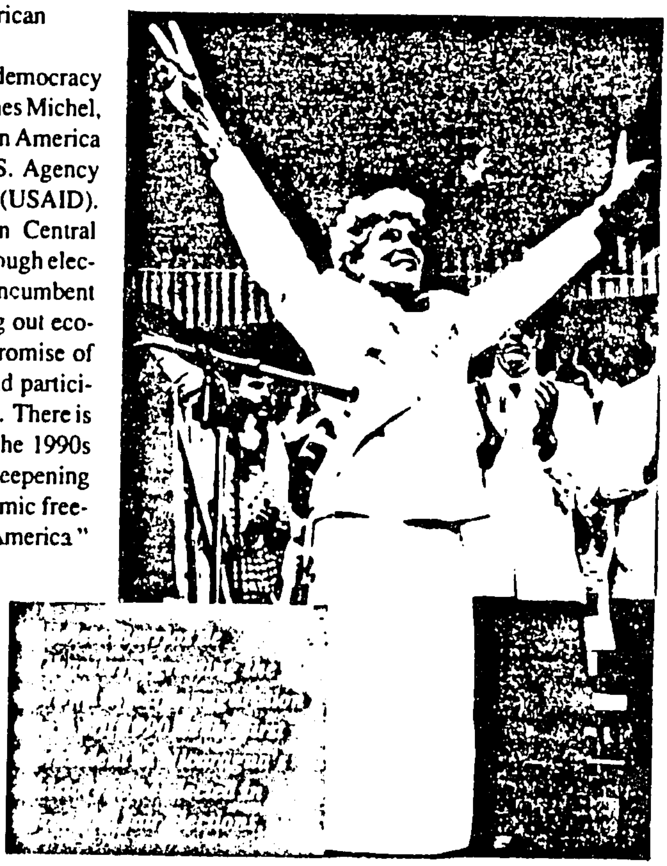
Central America: Toward the Year 2000

"Now it falls to us to strive toward a developed Central America, one capable of meeting by itself the basic needs of each of our citizens. We see integration as the means for achieving this development, and aspire to see Central America linked to the world in mutually productive and respectful interdependence...."

Declaration of Antigua, June 1990

When you look at the map of the isthmus today, you're seeing a new Central America. For the first time in history, all the countries of the region—from Guatemala to Panama—have democratically elected governments in place. Ten years ago, that was true of only one Central American country, Costa Rica.

"The movement toward democracy has been remarkable," says James Michel, assistant administrator for Latin America and the Caribbean for the U.S. Agency for International Development (USAID). "The civilian governments in Central America all came to power through elections in which they defeated incumbent governments. All are carrying out economic reforms that hold the promise of opening their societies to broad participation in the benefits of growth. There is reason for real optimism that the 1990s will be a decade of progress in deepening the roots of political and economic freedom in each country of Central America."



Support by the United States for the ongoing efforts of the Central Americans toward democracy and development takes many forms. The Enterprise for the Americas Initiative, announced by President Bush last June and well received by Central Americans, envisions a democratic hemisphere enjoying the benefits of free trade, increased investments, reduced debt and a clean environment. A companion initiative, the Partnership for Democracy and Development in Central America, will encourage broad support from the international community for the region.

To support the president's initiative, the Agency has devised a new U.S. economic assistance strategy for Central America in the 1990s. The strategy is in keeping with the broad objectives identified by the Central American presidents in the Declarations of Antigua (June 1990) and Puntarenas (December 1990). The Agency's economic assistance programs will focus specifically on three objectives—the development of stable, democratic societies; the achievement of broad-based, sustainable economic growth; and the attainment of effective regional cooperation.

It is clearly in the U.S. interest to assist its neighbors in proving that the expectations of democracy are well founded. If elected governments, with their market-based economic policies, cannot demonstrate that their principles work in practice for the benefit of all segments of society, then desperate people may again be tempted by extremists. And today's brightening prospects for long-term stability and broadly based growth in the hemisphere may be placed in jeopardy.

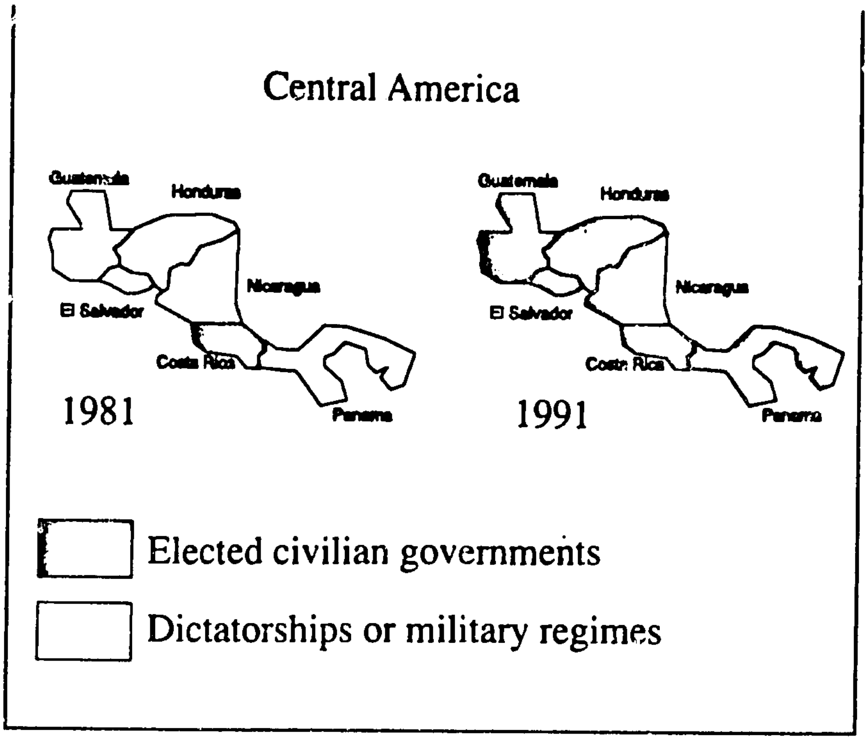
Background

The civil war in Nicaragua was only one manifestation of the problems that beset Central America in the 1980s. Early in the decade, economies throughout the region were reeling under the combined impact of the oil crisis,

ISSN 0899-6016

Published by the U.S. Agency for International Development

the subsequent recession and lower world prices for traditional commodities, high interest rates and their effect on the ballooning debt burden. These external factors were exacerbated by internal conditions of political instability and inadequate economic policies. For Central America, the economic decline in the 1980s was the worst since the 1930s. Per capita gross national product fell; extremely high unemployment was commonplace; at least $1.5 billion in capital left the region between 1980 and 1982; public and private debt skyrocketed to more than $10 billion; and private investment, both domestic and foreign, plummeted. Sharp falls in income (12 percent in Central America as a whole and as much as 20 percent in El Salvador alone) heightened the political crises. Even stable Costa Rica saw sharply falling incomes, high inflation and rising unemployment.



Without substantial assistance from the United States and other donors, the economic and political crises of the 1980s almost certainly would have been deeper and longer. While it is clear that the countries themselves had to make tough choices on their own, U.S. assistance played a critical role.

U.S. assistance also has helped most recipient countries address the critical needs of the poor. The result is reflected in improved social indicators for Central America for the decade:

- More than 1.8 million additional people now have access to potable water;
- Infant mortality rates fell from 62.5 per 1,000 live births in 1980 to 45 per 1,000 live births in 1990;
- Vaccination coverage grew from 40 percent to 66 percent;
- 400,000 more children now are attending primary schools.

Democracy

Even though elections have been held throughout the isthmus, many democratic institutions are still weak. While achieving broad-based growth and social progress is vitally important to strengthen the legitimacy of democratic governments, to create stable democratic societies also requires:

- Strengthening the competence of government institutions so they will merit the confidence of the people;
- creating a pluralistic, autonomous, vigorous civil society that can balance and limit state power while providing channels for the articulation and practice of democratic interests; and,
- strengthening democratic values, attitudes, beliefs and information that support democratic pluralism and are required for effective leadership.

To help Central Americans deepen the roots of democracy, USAID continues to provide training and technical assistance in areas such as legislative organization and management, the administration of justice, financial management systems and standards for professional journalism. The Agency also supports the development of indigenous public policy research centers and seminars for labor leaders and other advocacy groups, as well as assists organizations devoted to the protection of human rights in Central America.

USAID has worked actively to institute programs to help Nicaragua and Panama in their transition to democracy. Panama and Nicaragua were devastated by years of authoritarian rule. Last year the U.S. Congress passed emergency legislation to address the special needs of these two countries.

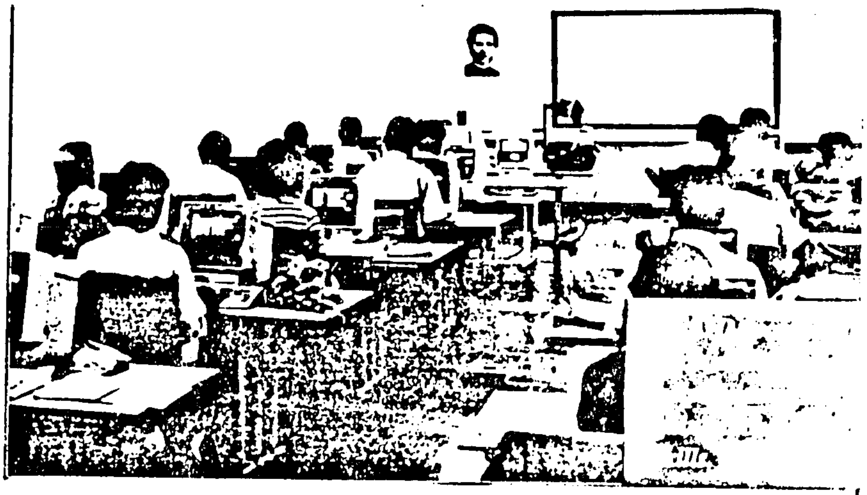
In Panama, the Agency is managing a $461 million program providing housing for displaced families, putting the unemployed to work, reconditioning the country's infrastructure and making credit available to small businesses trying to rebuild. USAID also is helping strengthen Panama's judicial system, improve government financial management, streamline the way government policy is made and provide incentives for growth in the private sector.

USAID's $537 million program in Nicaragua is helping bring greater political, economic and social stability to the country. Part of the Agency's strategy is to help the Nicaraguan government turn around a devastated economy. Unemployment, inflation and debt have all been extremely high. The Agency is encouraging macroeconomic policy improvements, as well as helping attract investments from international financial institutions, other countries and the private sector.

In the short term, USAID is providing assistance to repair the country's infrastructure through a number of projects that will provide temporary work for as many as 40,000 Nicaraguans. Projects include rehabilitation of urban roads and related drainage improvements, local water and sewerage systems, public markets, health clinics and schools.

The Agency also is working to improve Nicaraguans' desperately needed vocational skills. Over the next two years, some 7,400 young people ages 18 to 25 will receive vocational training. In addition to training, the students will receive courses in civic education and will get career counseling and job placement assistance.

Moises, from Nicaragua's Atlantic coast, is one such student. The 21-year-old is the eldest of 11 children, and he works to support his mother and siblings. Last April, he was able to leave the army, into which he had been conscripted by force 19 months earlier. He wanted to return to his studies but had given up hope of ever continuing his education. Now he is one of 120 enrolled in an Agency-sponsored computer course, and he has opportunities he had not dared dream of before.



Open Trade

The region has begun to realize the benefits of economic policy reform and trade liberalization. The Caribbean Basin Initiative went into effect in 1984 as a 12-year effort to increase U.S. trade with the 27 nations of the Caribbean and Central America. The initiative offered a duty-free U.S. market to most products, increased U.S. economic assistance to the region and promoted trade, investment and tourism.

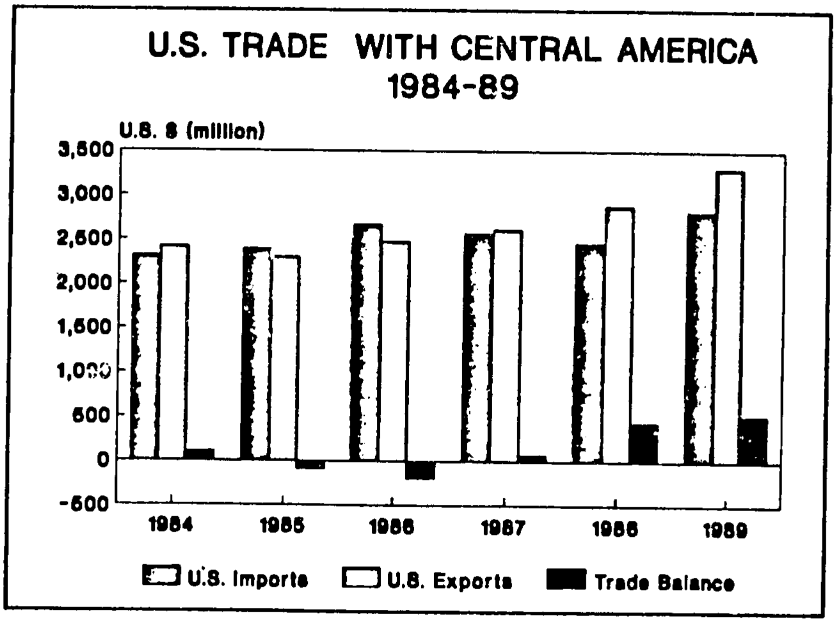
"Since the Costa Rican government undertook major policy reforms in 1982, non-traditional exports from that country have been growing rapidly, and new products have overtaken the four traditional agricultural exports—bananas, coffee, sugar and beef—that had been the mainstay of Costa Rican exports for decades," says James Fox, senior economist for the Bureau for Latin America and the Caribbean.

Most of this growth has been exports to the U.S. market, making a wider variety of products available to the American consumer. In each of the last seven years, non-traditional exports to the United States have grown by more than 25 percent. Costa Rican exports of these products rose from $80 million in 1982 to an estimated $652 million in 1990.

Guatemala also has achieved extremely rapid growth of non-traditional exports over the past five years. The economic success of these countries is closely related to their willingness to introduce policy and institutional changes to support export growth. Such changes can help produce sustained economic growth.

"The key is to identify and address bottlenecks to exporting," says Fox. "As each bottleneck is cleared, new products become export-competitive, producing further gains in income, employment and productivity."

An Agency program in El Salvador has helped encourage exports, increased rural incomes and employment and increased foreign exchange earnings by increasing production of non-traditional products. Through the National Cooperative Business Association, USAID has provided training in the cultivation and packing of cantaloupes and honeydew melons for members of the Hoja de Sal Cooperative in the La Paz department of El Salvador. The melons are shipped in U.S.-made crates and exported to the United States through R.L. Wheatley & Son of Cambridge, Md.



This type of joint enterprise is helping make agricultural entrepreneurs of families that before were subsistence farmers. According to co-op president Adilio de Jesus Renderos Diaz, the number of member families has doubled in the last two years, growing from 70 to the present 140. Including non-members, 280 families are employed year-round. The land for the co-op was made available through El Salvador's agrarian reform program.

Hoja de Sal is one of 24 cooperatives that the Agency assists in El Salvador. Five U.S. companies based in Texas, Florida and Maryland market the Salvadoran produce in the United States, making winter fruits and vegetables available for American tables.

As a country's exports grow, so does its ability to import, increasing opportunities for U.S. businesses. Central America is increasingly looking to the United States as a major supplier. Under the Caribbean Basin Initiative, U.S. exports to Central America have nearly doubled from $2.1 billion in 1983 to an estimated $3.8 billion in 1990.

Many U.S. businesses are already looking to Central America as a good place to conduct business. In addition to quickly improving quality of products, services and labor, other positive aspects of the region are drawing U.S. businesses, such as the shorter shipping routes and the fact that the region shares U.S. time zones.

The Agency is working actively to link local and U.S. businesses for joint ventures, as well as promoting investment and trade opportunities for U.S. businesses in the region. Together with the Department of Commerce, the Agency recently established the Latin America and Caribbean Business Development Center. The center serves as an information clearinghouse and a "one-stop-shop" in the Commerce Department for U.S. businesses interested in all of Latin America, including Central America.

Economic Growth

After a decade of economic decline and rising unemployment, Central Americans are looking for ways to reduce widespread poverty and improve the overall quality of life. Sustainable economic development is the only viable way to reduce poverty and increase opportunities for participation in society. If economic growth does not occur, very little can be done to alleviate poverty. The Agency is helping Central American governments carry out economic and sectoral policy reforms designed to promote growth and address the needs of the poor. The poor need economic growth that leads to real and lasting jobs.

Roberto Sanchez, a sheep farmer in the western highlands of Guatemala, is among those poor Central Americans who have benefited from Agency projects. The sheep he has always raised were the descendants of the original milk sheep brought to colonial Guatemala by the Spaniards. Through a USAID-funded program, he and other farmers in the area are learning to improve the quantity and quality of the wool they produce.

Part of the program involves the introduction of imported Corriedale rams, especially selected for their wool quality and adaptability to the tough highland conditions. Sanchez is enthusiastic about his new, larger crossbred sheep and about the technical education he is receiving at the Technical Assistance Center.

"For example, a few of us learn the new shearing method, and then we teach the others," he says. "We are all learning together what we couldn't learn alone."

With the introduction of movable corrals, sheep producers and their children no longer have to follow their flocks. By rotating the locations of the corrals, the scarce pasture is put to better use. The more than 200 families benefiting from the project now have time for other productive activities, and many men and women are learning to knit and crochet sweaters, scarves and horse blankets. Children no longer have to tend flocks all day and now go to school, some for the first time.

Regional Cooperation

The challenge facing Central America now is that of working together as a region. Many of the problems facing each country are rooted in common regional problems. In the Declaration of Antigua, the Central American presidents pledged to strengthen intraregional integration and cooperation.

"Progress made thus far has been Central American-driven," Toni Christiansen-Wagner, deputy director of the Agency's Office of Central American and Panamanian Affairs, says. "While we provide assistance, it is really the Central Americans who are responsible for taking the initiative. It is they who must carry out the necessary changes and adjustments in order to achieve their goals for democracy and development in the 1990s."

After a decade of civil strife, economic decline and rising unemployment, Central Americans are looking with increasing optimism toward a more peaceful and prosperous future. The 1990s present an unprecedented opportunity for the region to achieve political stability, economic prosperity and social justice. The U.S. Agency for International Development is dedicated to helping the people of Central America work to achieve that future.

STATEMENT OF CAROL C. ADELMAN
ASSISTANT ADMINISTRATOR
BUREAU FOR EUROPE AND NEAR EAST
AGENCY FOR
INTERNATIONAL DEVELOPMENT

COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON FOREIGN OPERATIONS

U.S. SENATE
APRIL 16, 1991

I. INTRODUCTION

Mr. Chairman and members of the Committee: I welcome the opportunity to appear before you today. I would like to outline the substantive priorities and content of the assistance program in Central and Eastern Europe funded by A.I.D. under the guidance of the Coordinators, and report to you on some of the activities that are under way.

II. PROGRAM OBJECTIVES

This Administration has established three objectives for its program of assistance to Central and Eastern Europe:

- assist in the *development of democratic institutions* that form the foundation for enduring political freedom, ensure the rule of law, and encourage broad-based participation in civic and economic affairs;

- assist in the *transformation of centrally planned economies to market-based economies* led by the private sector and integrated with Europe and the world economy; and

- assist Eastern Europeans to *maintain or improve a basic quality of life* while they undergo the disruptive processes of economic restructuring and political reform.

101

STATEMENT OF ASSISTANT SECRETARY

HERMAN COHEN

BEFORE THE SENATE APPROPRIATIONS COMMITTEE

SUBCOMMITTEE ON FOREIGN OPERATIONS

ON THE ADMINISTRATION'S FY 92 ASSISTANCE REQUEST

JUNE 4, 1991

Expanded statement for the record

Mr. Chairman and Members of the Sub-committee:

It is a pleasure to appear before you as we mark the beginning of a new era in American foreign policy. Areas of historical international tension have diminished. The opportunity to promote the universal goals of peace, prosperity, democracy and human rights has not been greater in living memory.

Far from self-marginalization on the periphery of world events, African countries are asserting themselves on the world stage in positive, productive ways. There is no better example of Africa's determination in this regard than its performance in the events of the recent Gulf crisis. African countries, almost without exception, joined wholeheartedly in the worldwide chorus condemning Iraqi aggression. The four African members of the UN Security Council during Operations Desert Shield and Storm -- Zimbabwe, Ivory Coast, Zaire and Ethiopia -- stood firmly and decisively with us and other Security Council members to take forceful UN-mandated action in the Gulf. Three countries -- Senegal, Niger, and Sierra Leone -- contributed contingents to the coalition forces.

We believe that Africa must take part fully in realization of our historic opportunity. To help Sub-Saharan Africa realize its potential, the Administration is requesting $828 million in economic assistance, $147 million in food assistance, and some $33 million in military assistance for FY 92. In all, our request for Africa totals just over one billion dollars.

110

THE NEW ERA IN AMERICAN FOREIGN POLICY

Secretary Baker has articulated five key foreign policy objectives for the decade before us -- democracy, market economies, meeting transnational challenges, conflict resolution, and relief of human suffering. Our FY 92 request for Africa addresses forcefully each of these objectives.

For several years, African countries have been rejecting the false promises of Marxism and other state-interventionist economic systems on the evidence of their utter failure. At this point, almost three-quarters of the countries of Africa have embarked on economic reform, directed at reducing the role of the state and according a greater role for private initiative and market dynamics.

Africans throughout the continent have increasingly joined the positive trend towards insistence on greater participation in their political systems -- they want and deserve democracy as much as everyone else. Africans are also succeeding in creating democracies in places that may not have appeared promising just a short time ago. Newly independent, democratic Namibia is perhaps the most dramatic example of this movement. But in addition to established democratic societies in The Gambia, Senegal, Botswana, and Mauritius, within just the past year Benin, Mozambique, Cape Verde, Sao Tome & Principe and Gabon have made enormous progress toward democracy. Many other African countries have begun the process of liberalizing their political systems. As Freedom House put it, Africa is experiencing "a sweep of multipartyism that presents the most significant phenomenon since decolonization three decades ago." Today, in many areas of Africa, domestic debate is lively and less controlled or indeed controllable; free elections have been held; political opposition is recognized as legitimate; people are successfully insisting they determine their political destinities for themselves.

Recent Developments in Ethiopia

Statement by Department Spokesman Margaret Tutwiler, May 21, 1991.

We have been officially informed by the government of Ethiopia that President Mengistu Haile Mariam has resigned and departed the country for exile. Vice President Tesfaye Gebre Kidan has, under the constitution, replaced Mengistu. Ethiopia is thus embarked on an important political transition.

We welcome these developments and hope that the door is now open for the establishment of peace and democracy in this war-ravaged country.

In light of these developments, we urge that all government and opposition forces immediately cease military operations in order to allow a political dialogue to begin.

The United States is moving ahead with its plans to hold a meeting in London beginning May 27 including both the government and insurgent groups to discuss a peaceful transition.

Statement by Herman Cohen, Assistant Secretary for African Affairs, London, England, May 28, 1991.

I would like to summarize for you our consultations in London with representatives of the outgoing government, the Ethiopian People's Revolutionary Democratic Front (EPRDF), the Oromo Liberation Front (OLF), and the Eritrean People's Liberation Front (EPLF). The subjects covered were:

- The establishment of a transitional government;
- The situation in Addis Ababa, and
- The facilitation of international relief efforts.

At this point, the United States government makes the following recommendations and observations.

Transitional Government. A transitional government should be established in Addis Ababa as soon as possible. The transitional government should assume all legal and political responsibility for the governance of Ethiopia.

The transitional government should be broadly representative of all Ethiopian society, including diverse political groupings, and should, wherever appropriate, utilize the existing civil administrative structures in carrying out its responsibilities.

The primary responsibility of the transitional government should be to prepare the country for free, democratic, internationally monitored elections in 9-12 months to produce a constituent assembly to prepare a new constitution for Ethiopia.

The new constitution should guarantee fundamental individual rights and should respect the identity and interests of all the different peoples of Ethiopia.

The transitional government should consider an appropriate amnesty or indemnity for past acts not constituting violations of the laws of war or international human rights. Any persons accused of such offenses should be afforded due process of law in accordance with international norms, and all procedures should be open to observers from internationally recognized organizations.

Discussions should continue in London regarding the composition of the transitional government.

Addis Ababa. Elements of the EPRDF armed forces have entered Addis Ababa and taken up garrison positions. The city should be demilitarized as soon as possible. Hostilities throughout Ethiopia should cease as soon as possible.

International Relief. All parties should continue to cooperate with ongoing international relief efforts. The US government calls on the international donor community to make all possible efforts to help maintain essential services and continue providing relief assistance.

The United States calls on the parties to conduct their activities in the spirit of reconciliation and justice and to create the conditions necessary for the establishment of democracy. The United States stands ready to assist them to achieve this goal.

Statement by Department Spokesman Margaret Tutwiler, May 29, 1991.

The United States welcomes the May 28 joint declaration in London on the Ethiopian combatants who have agreed to organize an all-parties conference to select a transitional government no later than July 1, 1991. This decision reflects a commitment to a democratic process. We hope that Ethiopian political organizations will take advantage of this opportunity to help plan a pluralistic future for their country.

We also welcome the decision of the Ethiopian People's Revolutionary Democratic Front (EPRDF), who will establish an interim administration in Addis Ababa, to work with the existing administrative structures with the support of Ethiopia's dedicated and competent professional civil servants. The willingness of the Eritrean People's Liberation Front (EPLF) authorities in Eritrea to maintain all existing economic linkages with Ethiopia will contribute to the rapid stabilization of the region.

The United States wishes to reiterate that the development of Ethiopia's great economic potential can be assured only if the democratic process initiated by the combatants in London is fulfilled by a free and fair election within a reasonable time frame.

In the interim, the United States will continue to provide humanitarian relief for the Ethiopian people who continue to suffer the effects of extended civil conflict. ■

112

COVER STORY

'Grand Bargain' Promises Debate On Future U.S.-Soviet Relations

Whether one thinks of it as a grand deal, a grand bargain or a grand mistake, the idea of providing large-scale economic assistance to the Soviet Union is likely to set off a grand debate on Capitol Hill.

The pace of developments in U.S.-Soviet relations has been quickening. Late last month, administration officials opposed inviting Soviet President Mikhail S. Gorbachev to meet with participants in the economic summit of industrialized nations in London next month.

During the week of June 3, President Bush indicated he would have no problem if Gorbachev were invited after all. The next step in U.S.-Soviet trade, an agreement to grant most-favored-nation (MFN) trading status to Moscow, is on the president's desk and could be sent to Capitol Hill at any time, congressional sources said during the week.

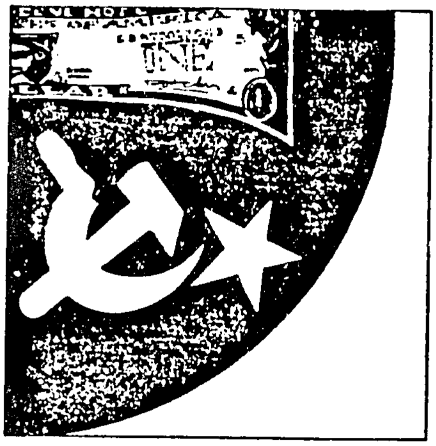
And a summit between Bush and Gorbachev appears all but inevitable, perhaps early next month. In this climate of warming ties, the last obstacles to ratification of a treaty reducing conventional arms have been removed, and there was rapid progress on a pact to limit strategic weapons.

These developments would have seemed all but impossible a few months ago, when Moscow was cracking down on rebellious republics and edging away from its path toward economic reforms. Yet they pale by comparison to what once seemed the most audacious notion of all: direct U.S. economic aid for the Soviet Union.

A "grand bargain" — massive Western aid in return for far-reaching Soviet political and economic reforms — was first raised by Soviet officials in informal talks with international finance experts. It was then refined by an informal group of Soviet economists and academics from Harvard University and given a wider circulation.

A pair of top House Democrats, Majority Leader Richard A. Gephardt, Mo., and David R. Obey, Wis., are now floating their own, more cautiously formulated, version of the proposal. They

By Carroll J. Doherty



have refrained from using the politically loaded term "grand bargain."

Both men say the administration is moving with excessive caution at a time when bold action is needed. The economic desperation of the Soviet Union and the thaw in superpower tensions have created a historic opportunity that should not be lost, they say.

But there is considerable caution on Capitol Hill as well. Members of both parties are wary of embarking upon what Rep. Richard J. Durbin, D-Ill., calls "the fast train to Moscow."

In part, the lawmakers have been overwhelmed by the groundbreaking events. It was easier to master the fundamentals of U.S.-Soviet relations during the predictable days of the Cold War.

With the Gorbachev government appearing to change its internal and external policies each month — is he a budding democrat or a throwback to a repressive era? — many in Congress are content to let the administration set the diplomatic course.

But Congress undoubtedly remains a player in U.S.-Soviet relations. The Senate already has weighed in, supporting $1.5 billion in agricultural credits requested by Gorbachev. That request, which preceded the talk of a grand bargain by several months, could soon be approved by the administration.

The Senate approved a non-binding resolution favoring the deal on May 15. But the 70-28 vote did little to demonstrate a consensus in Congress on Soviet affairs because the farm credits enjoy strong backing from farm-state lawmakers anxious to secure commodity sales for their constituents. *(Weekly Report, p. 1273)*

The White House paved the way for the credits June 3 by waiving the Jackson-Vanik restrictions on trade with the Soviet Union. The restrictions were imposed in 1974 because of Moscow's policy of limiting Soviet emigration. *(Box, p. 1517)*

The issues could get tougher. As is the case with China, Congress will vote on whether to provide trade benefits to Moscow. And with Gorbachev becoming increasingly strident in his pleas for Western aid as his country's economy declines, lawmakers eventually could face the momentous question of providing direct help for the Soviet Union.

Economics Dominate

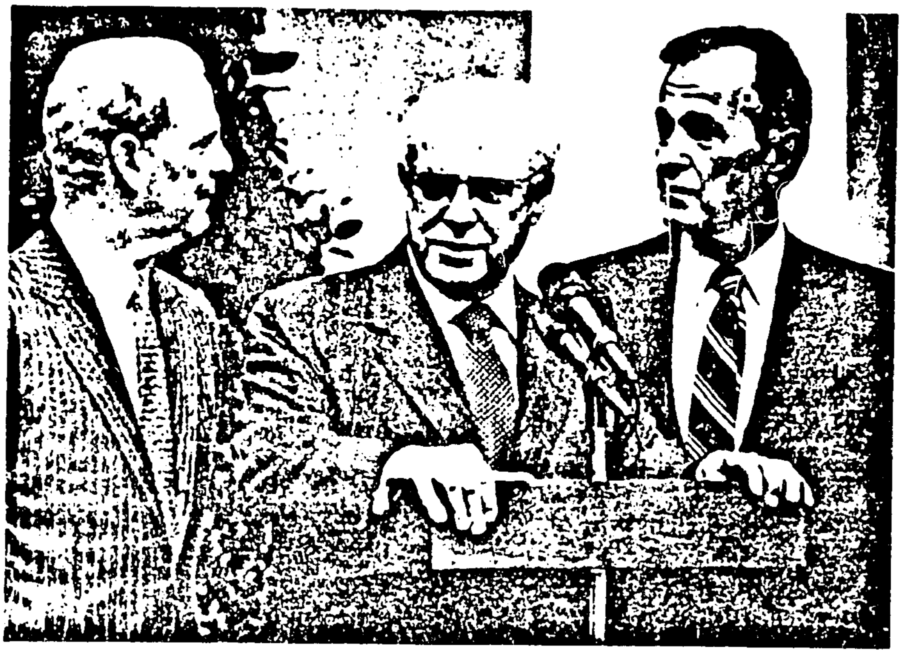
Economic issues are likely to preoccupy lawmakers, although the Senate is charged with ratifying the arms treaties being negotiated by the administration. The White House seemed more than willing to underscore the prospects for improving U.S.-Soviet business ties by nominating veteran Democratic insider Robert Strauss on June 4 to be the U.S. ambassador in Moscow.

That nomination might be the easiest Soviet matter for the Senate to consider. There was wide praise for the appointment of Strauss, who is nearly devoid of experience in Soviet affairs but is a skilled operator in politics and commerce.

"He'll be in Moscow at a time when a guy with his kind of skills would be particularly useful," said Sen. Joseph R. Biden Jr., D-Del., chairman of the Foreign Relations Subcommittee on European Affairs.

Although a few members privately expressed astonishment at the unorthodox selection of Strauss, his Democratic pedigree and close friendship with Bush and Secretary of State James A. Baker III seemed likely to ensure Senate approval of his nomination.

Earlier, Obey had raised the profile of the economic aid issue by including the proposal that also has won Gep-



THE ASSOCIATED PRESS

President Bush and Secretary of State Baker with Robert Strauss, the Democratic Party strategist chosen as envoy to Moscow.

hardt's support in the report accompanying the fiscal 1992 foreign aid bill approved May 29 by his subcommittee. *(Weekly Report, p. 1452)*

"While in the end these efforts may prove futile," the report says, "the committee believes that it would be negligent for the West to miss an opportunity to clearly lay out our conditions for assisting the Soviet Union," along with the "nature, timing and levels" of possible Western economic aid.

The conditions in the report are tough. Moscow would be required to hold scheduled elections and allow each of the dissident Baltic States to "determine the future of its own association with the Soviet Union."

In the economic sphere, the Soviet Union would have to put into place most of the elements of a free-market system, including a convertible currency and floating exchange rates.

Obey insisted that his panel was not trying to provide the last word on what obviously is a complex matter. "What we're trying to do is cooperatively push the administration forward," he said.

Sticker Shock

But lawmakers and the administration have begun to focus on an issue only indirectly addressed in the subcommittee report: At a time of declining foreign aid budgets, how can the United States afford to bail out the Soviet Union?

Many U.S. officials have been suffering sticker shock since hearing some of the aid amounts being floated by Soviet economists and U.S. academics.

Jeffrey Sachs, a Harvard economist who helped devise Poland's economic-reform plan and is one of the architects of the grand bargain, recently wrote an article in The Washington Post in which he estimated that the "radical market reforms" to be undertaken by Moscow should be backed with a Western aid package "on the order of $30 billion per year for five years."

According to some reports, Soviet officials have privately said that even more could be required — perhaps $250 billion over five years. Estimates of the U.S. contribution vary, but Sachs and Gephardt have indicated it could approach $[illegible] billion a year.

An aid package of that size would be a "tough sell," said Rep. Lee H. Hamilton, D-Ind., the chairman of the House Foreign Affairs Subcommittee on Europe and the Middle East, which plans to have hearings on the issue this month.

Hamilton said he believed that most members of Congress would fear the reactions of their constituents. A program for assisting a country that "only recently has been an enemy" would be difficult to accept "for anyone except the most sophisticated observers of international politics."

Administration officials have been harsher, openly deriding what Baker called the "big bang approach" of sending massive aid to the Soviet Union. Calling the proposal "really a non-starter," Vice President Dan Quayle said, "Don't ask the American taxpayer to subsidize an economic system that doesn't work."

Both Obey and Gephardt say they anticipated resistance to the idea. But they argue that it is important to get beyond the numbers and examine the alternatives, particularly what could happen if the United States and its allies do nothing.

The Harvard professors have speculated that if economic and political deterioration continues at its current pace, the West could soon be facing a doomsday scenario, in which the Soviet Union would be torn apart by civil conflict.

In a forthcoming article in Foreign Affairs magazine, Graham Allison and former Bush administration adviser Robert Blackwill pose the ultimate question: "Under conditions of chaos and civil war, would central control of nuclear weapons be maintained?" The authors, who have worked closely with Sachs, warned that "such possibilities stagger the imagination."

For Obey, a self-described "low dollar man" on foreign aid, the solution to the cost problem is simple: use some of the funds Western nations are now spending to defend themselves against the Soviet military threat. "We spend $120 billion a year" for that purpose, he said.

Shifting Patterns

The dramatically changed nature of U.S.-Soviet relations makes it difficult to gauge how lawmakers will respond to the bilateral issues ahead — from providing aid to granting MFN.

Illustrating the scrambled viewpoints on U.S.-Soviet relations, Minority Leader Bob Dole, R-Kan., a hawk on defense matters, sponsored the Senate resolution favoring agricultural credits, and liberal Patrick J. Leahy, D-Vt., argued against it.

Dole said there was a sound foreign policy rationale for the credits, but he also highlighted the tangible benefits that would flow to U.S. agriculture. "Certainly increased sales will help the American farmer," he said.

Leahy, chairman of the Agriculture Committee, charged that the Soviet Union does not qualify for the credits under the provisions of the 1990 farm bill (PL 101-624). "According to everything I read it would be a direct violation of the law," he said.

The politics of Soviet relations have shifted so drastically that a liberal critic of Moscow's policy toward the dissident Baltic States, Durbin of Illinois, has expressed concerns that the administration might be moving too quickly to help the Soviet Union.

Durbin worries that Western leaders might not be able to say no to a personal plea for aid from Gorbachev at the July economic summit. "I would like to slow this process down," he said in an interview.

At the same time, Durbin found much to recommend the proposal for systematic aid that has been promoted by Obey and Gephardt. Durbin said he liked its stiff conditions and believed that similar terms could be attached to any grant of MFN status.

The senior Republican on Obey's foreign operations subcommittee, Mickey Edwards, Okla., agreed that the conditions were the best part of the panel's proposal. "In my opinion what we did was say we will not consider aid to the Soviet Union until they take these steps," he said.

All of this could become moot if the Soviet Union rejects its part in the grand bargain. Gorbachev and other officials increasingly have chafed at the notion that the West may send aid only with strings attached.

The likely alternative to a sweeping aid-for-reform arrangement would be a far more modest and gradual series of steps to reward reform.

Under such a scenario, the administration would first move on the trade agreement and the agricultural credits. Then, if the Soviets implement economic reforms, the administration could respond with technical aid and perhaps support for Soviet membership in the International Monetary Fund.

While a cautious approach could prove more palatable in Congress, even that effort could draw opposition. Lawmakers eager to help the Baltic States in their quest for independence already have indicated that they might offer human rights amendments to the trade pact, similar to conditions proposed by Senate Majority Leader George J. Mitchell, D-Maine, for granting MFN status to China.

Administration loyalists, such as Edwards and William S. Broomfield, Mich., the ranking minority member of the House Foreign Affairs Committee, said they could have problems supporting any Soviet trade deal.

"We can't let down our concern for the Baltics," Broomfield said.

Assessing the comparative prospects for the two trade agreements, Broomfield says gaining approval for the China pact will be more difficult, "but I don't think the Soviet Union [pact] will be easy." ■

115

THE WALL STREET JOURNAL FRIDAY, JUNE 14, 1991

Soviet Democracy—Cheap at $100 Billion

By MORTON KONDRACKE

As The Wall Street Journal, President Bush, Richard Nixon, Sen. Bill Bradley (D., N.J.) and the New Republic all agree: The U.S. should not spend billions of dollars to bail out Mikhail Gorbachev. Not under present circumstances. Soviet troops continue to menace the Baltics. Mr. Gorbachev can't or won't commit to real free market economic policies. The Soviet Union continues to produce around 1,000 new battle tanks per year, double the U.S. number. The Communist Party and the KGB still are powerful factors in Soviet life. Russia has a popularly elected president, but the Soviet Union doesn't. It's absolutely right to say that under present conditions, aid to the Soviet Union would be a waste of money and would prop up an evil and inefficient political structure. Anyone who's visited Moscow lately can tell from the dirt in the streets and the despair in most people's talk that partial reform, Gorbachev-style perestroika, is not working.

Grand Bargain

But instead of ruling out an aid package, as the Journal and Sen. Bradley do, and instead of listing all the reasons why aid would be a mistake, as Mr. Nixon has done, the Bush administration ought to say that if the Soviets radically change policy, substantial U.S. assistance will be forthcoming.

Administration officials don't like the "grand bargain" formulated by faculty members at the Kennedy School of Government at Harvard on the basis of an economic reform package put together by visiting Soviet economist Grigori Yavlinsky. As administration aides say, the notion of trading Soviet cancellation of aid to Cuba for, say, $10 billion would be politically abhorrent both to the U.S. and the Soviet Union. Soviet reactionaries would accuse Mr. Gorbachev of selling Soviet national security policies to bankroll *perestroika*, and in a manner of speaking, they'd be right.

Without formulating specific payoffs, though, the U.S. ought to be ready to come up with money to help the Soviets through a painful transition period, assuming that they are willing to take a real plunge into the free market, move decisively toward full democracy and quit presenting a military menace to the world. Jeffrey Sachs of Harvard, who helped draft Poland's economic reform plan, says that the Soviets will need $30 billion a year over a four-year period from all the Western countries, mainly in loans and loan guarantees. His colleagues Graham Allison and Robert Blackwill recommend grants of $15 billion to $20 billion a year for three years.

It's a lot of money, but it's a lot less than the U.S. gave out in Marshall Plan grants to Western Europe after World War II, which Mr. Sachs says would amount to $300 billion in today's dollars. It's also a lot less than the U.S. currently spends annually on military forces designed to thwart a Soviet invasion of Europe. Per capita, it is about what the West is currently providing usefully to Eastern Europe.

Aid opponents say that Mikhail Gorbachev is no fit recipient of Western aid. They point to the fact that he's still general-secretary of the Communist Party, the chief parasitic organism afflicting the Soviet body politic, and has yet to endorse full political and economic reform. If we're going to aid anybody in the Soviet Union, the opponents say, it ought to be elected democrats in the republics and the cities, who are more likely to ensure that money flows to the people who need it and can use it productively, rather than through central government bureaucrats.

But let's be realistic: Mr. Gorbachev is still the leader of the Soviet Union. For the foreseeable future, he is the one we have to depend upon if we want the Soviet Union to vote with us at the United Nations, to complete troop withdrawals from Ea[illegible]rn Europe and to make the crucial [illegible]ecisions about the political and economic future of his country. Up to now, and intentionally or not, Mr. Gorbachev has been good for Western interests and values. He had a choice, after all, whether to get out of Afghanistan, let communist regimes fall without a shot in Eastern Europe, agree to the unification of Germany and its membership in NATO, and help the U.S. kick Saddam Hussein out of Kuwait. He chose right. His predecessors would not have. His successor might not.

The U.S. ought to help the Soviets, assuming that they plunge into the free market, move decisively toward democracy and quit presenting a military menace to the world.

This is not to say that Mr. Gorbachev deserves $100 billion to use as he pleases, that the West should channel all its aid through the central government, or that the Bush administration should continue to cast its policies so totally in a pro-Gorbachev direction. Boris Yeltsin comes to Washington next week as the first popularly elected leader in Russia's history. Mr. Bush should prepare a lavish welcome for Mr. Yeltsin, as the representative of the Soviet Union that Americans wish will emerge. Mr. Bush has relationship-mending to do with Mr. Yeltsin.

Still, having Mr. Yeltsin does not mean that we can cut off Mr. Gorbachev. We want to give him incentives, positive and negative, to do the right thing. We've done so in the past. During Mr. Gorbachev's six-month alliance with hardliners in the party and the military – the period of mayhem in the Baltics and Eduard Shevardnadze's dark premonitions of impending dictatorship – the Bush administration and even the European allies imposed a credit cutoff on the Soviet government. That, plus coal strikes, street demonstrations and a democratic resurgence, had a lot to do with forcing Mr. Gorbachev's April 23 turn back toward reform.

Whatever aid the West provides in the future has got to be strictly contingent on Mr. Gorbachev's good behavior. He has to commit to a full, rapid free market agenda – privatization and demonopolization of industry, floating prices, a convertible currency and a legal system that encourages enterprises. He has to fulfill the agreements he's made with Boris Yeltsin and the leaders of eight other republics to let them have autonomy over their economic life, and to schedule new elections for the Supreme Soviet of the Soviet Union.

It would help enormously if he agreed that the presidency of the Soviet Union would be filled by election before 1994. There ought to be other conditions on aid: freedom for the Baltics, a severing of Communist Party influence over government and economic decisions, an end to aid for Cuba and huge reductions in the Soviet military budget, which now consumes up to a third of the Soviet Union's shrinking GNP.

All of these moves would be good for the Soviet Union in and of themselves, but they involve political risk and considerable temporary hardship. The military-industrial complex, representing a majority of Soviet workers, needs to be converted to civilian activity. That will require seed money for new plants and equipment and retraining of workers. Moving to a free market, as has happened in Eastern Europe, will mean large-scale unemployment. AFL-CIO President Lane Kirkland suggested during a recent visit to the Soviet Union that there is great need for WPA-style projects to build infrastructure and clean up the environment. This costs money, though.

Improve the Odds

It's in America's national interest that the Soviet Union not fall into social chaos, which would send refugees flooding west, burdening shaky Eastern European democracies. It might also bring anti-Western elements back to power in the Soviet Union.

If the Soviet Union could transform itself into a free-market democracy, that would also be in America's national interest, too. We shouldn't simply pour money into the Soviet Union in blind hope that the best will happen, but we should offer the prospect of aid to improve the odds that it will. If $30 billion a year in loans could help create a stable, democratic Soviet Union, that would be a grand bargain, indeed.

Mr. Kondracke, a senior editor of The New Republic, is the moderator of PBS's "American Interests."

116

WASHINGTON POST June 13, 1991

Robert J. Samuelson

Aid Won't Save Them

The ghost of the Marshall Plan stalks our relations with the Soviet Union. Between 1948 and 1952, the United States provided Europe with $13.3 billion of grants and loans. The aid helped revive Europe's war-ravaged economy and, arguably, halted the spread of communism. It was one of the great triumphs of American foreign policy, and the idea of staging a repeat performance with the Soviet Union is enormously seductive. We supply the aid; they embrace democracy and a market economy.

It won't work.

The Soviets' plight differs dramatically from that of postwar Europe. The need then was for temporary assistance—grain, coal, machinery—to give Europe the means to recover from World War II. Hungry people can't work; machines won't run without fuel. The Marshall Plan (named after Secretary of State George Marshall) provided stopgap relief. But Europe had experienced managers, a tradition of private property and established markets. The Soviet Union lacks all of these things.

Its problem is not rebuilding but something much harder: inventing a new economic system. The present system is collapsing. PlanEcon, a consulting service, estimates that Soviet output may drop 15 percent or more in 1991. (By contrast, U.S. output in the current recession is down 1 percent.) Piecemeal economic reform and political liberalization have wrecked the Soviets' command economy, which relied on production quotas and supply allocations, without creating a replacement. Huge budget deficits have flooded the country with rubles and, by destroying the value of money, eroded already weak work incentives.

The disintegration of Soviet society doesn't serve our interests. A right-wing government might restore order through repression and revert to the Cold War. Civil war, nationalistic strife and attendant blood baths are possibilities. Europe fears waves of immigrants. And in the background looms the specter of some ill-defined nuclear incident. But we delude ourselves if we think that massive aid will somehow eliminate these dangers.

Cost is not the main issue. On an annual basis, Marshall Plan aid averaged about 1 percent of U.S. gross national product. The U.S. GNP now totals $5.5 trillion; the European Community's GNP is about $6 trillion, Japan's $2.9 trillion. Together, we could surely afford to help the Soviet Union. If aid would create democracy and a market economy, it would be a spectacular investment. The trouble is that it won't.

The first defect of too much aid, provided too liberally, is that it enables countries to avoid reforms by sustaining (through imports) consumption and investment. The Soviets have already received big foreign credits and grants. Between 1988 and 1990, Soviet net foreign debt rose nearly 70 percent to $45 billion. Germany provided more aid in return for Soviet disengagement from East Germany. What happened? The economy deteriorated.

The remedy to this problem would seem to be a "grand bargain" of the sort being suggested by a group of Harvard University experts and some Soviet economists. It would tie pledges of new aid to specific Soviet reforms. As sensible as this sounds, it's impractical. It would unwisely inject the United States, Europe and Japan into the middle of Soviet politics in ways that would make consensus on economic and political reform harder to reach. The result would be either stalemate or a sham.

The more aid we pledged, the more influence Americans (and European and Japanese, too) would want over Soviet affairs. Zbigniew Brzezinski, national security adviser under President Carter, argues that a condition of aid should be the "demilitarization of the Soviet economy and society" [op-ed, June 5]. It's hard to see how any Soviet leader could accept that demand. Every Soviet faction and republic would try to use us to gain its own goals. Would our aid go directly to the 15 republics or to the Soviet Union? Differences would emerge among Americans, Europeans and Japanese. Negotiations would become hopelessly tangled.

The Soviets must resolve basic conflicts themselves. The difficulties are staggering. A power-sharing agreement reached in late April between the Union and nine republics may be a good start. But even if it holds, there remain daunting problems of economic reform. A market economy requires free (not controlled) prices, private property, competition among companies and acceptance of the profit motive. Budget deficits would have to be cut sharply. Each of these steps is socially wrenching and hard to implement. It's not clear that the Soviets have either the necessary competence or the political will.

Our policy should be friendly but not foolish. We should provide technical assistance—on anything from road construction to banking—and, if needed, humanitarian aid. We should encourage the Soviets to negotiate a reform plan with the International Monetary Fund and indicate that we might provide aid for genuine reforms. But there should be no pledges in advance, and we should do nothing that might lead to an open-ended commitment to protect the Soviet economy against failure. The Soviet Union has almost 300 million people. Even aid of $60 billion annually from industrial democracies amounts to only $200 per person. (Soviet incomes are probably between $2,000 and $5,000 per person.)

Even competent reform may not work. It won't instantly improve living conditions. Without subsidies and guaranteed markets, some companies go bankrupt. Poland adopted radical reforms. In 1990, its GNP declined 9 percent, estimates the Central Intelligence Agency. By the end of 1991, the World Bank expects unemployment to reach 11 percent. The hope is that profit-making investments will ultimately expand the economy and raise living standards. But there's no guarantee. Similar caveats apply to the Soviets. No one really knows whether Communist economies can be converted to market systems quickly enough to avoid a social breakdown.

The idea that resurrecting George Marshall can save Mikhail Gorbachev is a distraction. It's important to recognize the limits of our power. The truth is that we lack the power to bribe the Soviets to reform or to ensure that reforms succeed. Only the Soviets can save themselves, and they may not be up to the job.

119

WALL STREET JOURNAL May 22, 1991

Bangladesh Needs Reform, Not Just Aid

By Joel R. Charny

The current crisis in Bangladesh provides the perfect opportunity to ask some hard questions:

- Why does a hurricane striking the Atlantic coast of the U.S. claim 10 victims, while a similar storm in Bangladesh kills 200,000?
- Why do two-thirds of the people of Bangladesh live in absolute poverty after two decades of independence, during which time the country has received $25 billion in foreign aid?
- What policy changes on the part of donor governments, the private aid community, and the government of Bangladesh must occur before aid truly benefits the poor majority of Bangladesh?

Poverty causes the huge death tolls in the natural disasters that strike Bangladesh year after year. Poverty, the result of lack of access to land and the difficulty of finding off-farm employment, drives people in search of subsistence to more and more marginal areas, including coastal islands vulnerable to cyclones. Land tenure patterns, skewed in favor of local elites who control the bulk of village resources (especially land) force the majority into low-wage agricultural work. In the past decade the now-deposed military government attempted to offer idle government land to groups of landless villagers. But through their control of village-level governments, elites steered this land to landlord families.

The $25 billion of aid to Bangladesh have been channeled by the military governments of the past two decades largely to large-scale infrastructure projects, with donor countries making the purchase of material and equipment from their companies a condition of aid. The construction of roads, ports and dams has its place. But it must be complemented by the effective provision of basic services to the poor, as well as the provision of resources that they themselves can control. Relatively little of the aid has been spent in villages on behalf of and by the poor.

To their credit, major foreign donors are finally beginning to channel significant resources for development through local non-government agencies such as the Bangladesh Rural Advancement Committee, Grameen Bank, Proshika and others, instead of the government of Bangladesh. Over the past 20 years these organizations have built a solid base among the landless, rural poor by focusing on community organizing, literacy, reforestation, skill training and credit for basic agricultural production and small enterprise. But these organizations alone cannot address fully the root causes of poverty in the country.

In February, three months after a peaceful popular uprising that toppled the military government of Gen. H.M. Ershad, Khaleda Zia became prime minister in the first free elections in the country's 21-year history. With an elected government in place, Bangladesh must reassess the flawed approach of the past two decades. The country needs a combination of policy initiatives and a re-orientation of existing aid programs to shift to a development program centered on the needs of the poor majority, consisting of the following:

1) Land reform: Bangladesh's elected government can at last begin to address the land question. The government should implement a program for granting the landless title to idle government lands.

2) Investment in human and social infrastructure: Only a comprehensive program of investment in literacy (especially female literacy), health delivery, day care and other services can address the problem of over-population, commonly cited as the root cause of poverty in Bangladesh. Population control can be implemented successfully only as a component of women's programs that also build local women's organizations and expand economic opportunity through small credit programs.

3) Disaster prevention: Cyclones and monsoon flooding are part of the reality of Bangladesh. But investment in flood shelters, disaster-proof housing, community reforestation, small-scale earthworks and other projects can mitigate their destructive impact. An Oxfam America-funded community organization in the cyclone-affected area of southern Bangladesh has developed a housing design—featuring concrete pillars, raised plinth and tile roof—that can be constructed for $200 per unit using volunteer labor. A mere $5 million, a bit less than the U.S. government response to the cyclone disaster to date, could fund the construction of 25,000 houses. A massive housing building program in the cyclone-prone areas would save countless lives in future disasters.

The resources exist to implement these programs. But even simple, small-scale interventions cannot go forward until the Bangladeshi government, the donor governments and the private relief agencies act on the commitment to a new strategy for Bangladesh. Successful implementation will involve decreasing the power of the military over civilian institutions. It must also respect the non-governmental sector as a legitimate partner. Donor governments that underwrite the Bangladeshi budget must insist on democracy.

The American people, who give so generously when disaster strikes, must insist that the agencies they fund support the agenda required to prevent massive suffering in the future. Too often, when the huge transport planes have unloaded their cargo, and when the images of helpless people reaching out for a scrap of food no longer appear on the front page, the American people disengage. Having given generously to immediate relief assistance, donors express either justified satisfaction with their efforts or frustration at the all-too-familiar accounts of bureaucratic red tape and aid "rotting on the docks."

Either way, no one—Bangladesh's government, aid agencies or donors—gives enough thought to funding long-term recovery, preventing such disasters from occurring in the future, or creating real economic and social development for the millions of people affected by disaster. Without reform of the international aid system, the needless cycle of disaster and despair will continue not only in Bangladesh, but in other countries of the global South.

Mr. Charny is the overseas director of Oxfam America, a Boston-based relief and development agency.

118

WASHINGTON POST May 9, 1991

Hobart Rowen

Family Planning, U.S. Policy and the Deaths in Bangladesh

The death toll has hit a shocking 125,000 in Bangladesh and may reach 200,000. But don't blame it all on the cyclone and floods. The disaster also has its roots in abject poverty, which is linked to environmental problems and excessive population growth.

Bangladesh is a disaster-prone tiny corner of Asia, suffering from degradation of the watershed in the upper Himalayas that aggravates periodic flooding, creating vast numbers of landless poor. The per-capita income is a miserable $170 a year.

At the same time, Bangladeshi families produce an average of almost five children, an improvement over six in the early '80s, but still too high. About 115 million people—equal to about half the U.S. population—are jammed into an area 1/65th the size of the United States. The worst lies ahead: Bangladesh will nearly double to 199 million by the year 2025, according to the World Bank.

Misguided richer nations routinely pump multi-billions of loans into the Third World for economic "development" and then ignore the relative pennies that are needed for family planning or reforestation.

World Bank statistics show that despite money handouts, per-capita income in country after country in Asia and Latin America is declining. With too many mouths to feed, there's no mystery to the result.

Routinely, we hand out condoms in American classrooms these days. Yet because of the power of the antiabortion lobby, normally sensible politicians such as President Bush look the other way when poor mothers and fathers in the Third World beg for modern contraceptive devices and training.

The current crisis in Bangladesh gives added urgency to a report on global population problems sent this week to 300 members of Congress by the Population Crisis Committee, a Washington research agency.

A key recommendation is that Congress boost Agency for International Development funds for family planning from $322 million this year to $600 million next year and that AID scrap the "open hostility" evidenced at the very top of the agency and return to the much bolder population-control programs it guided until midway through the Reagan administration.

By promoting the availability and use of modern contraceptive techniques, AID helped slow the pace of population growth in the '60s and '70s. It was one of our real foreign aid success stories, notably in Thailand, Indonesia, Mexico—and Bangladesh.

But in 1984 President Reagan allowed then-State Department official James Buckley, as chief U.S. delegate to a population conference in Mexico City, to establish a new and circumscribed American policy. Buckley decided that no AID funds could be used to support any foreign population-control agency if that agency engaged in any abortion-related activities.

"The Mexico City policy says to groups overseas: 'If you use your own resources on abortion, you're ineligible for any grant from us for family planning,' " said the PCC's Joseph Speidel.

"AID programs are plagued by the ghost of the Reagan administration," said PCC Vice President Sharon Camp. "Reagan ideology claimed that

The Agency for International Development slowed the rate of Third-World population growth in the '60s and '70s.

population growth is a neutral factor in development—rather than a threat to economic progress, family health and the environment."

There is little doubt that Bush knows better. But he has willingly sublimated lifelong, on-the-record views on the desirability of strong American leadership on this issue to an effort to appease the GOP right wing.

This head-in-the-sand policy needs a new and urgent re-examination. The PCC estimates that 1 million women lose their lives annually in the Third World through illegal abortions. Good family planning could cut that figure in half. The PCC report notes that most demographers believe that the world's population will triple before it stops growing unless more couples adopt some form of birth control by the end of the 1990s.

Family planning advocates are not suggesting using American government money to finance abortions abroad. They want AID to finance what is legal in both the United States and in most Third World countries. That includes funding a comprehensive family planning program that will help couples obtain modern contraceptives and teach them how to use them effectively. They also want to educate Third World women on the dangers of illegal abortions and generate sex education for adolescents in Africa and Asia.

The United States should restore itself as a world leader in the field of family planning. This is an area where a Democratic leadership looking for issues has a real opening. Polls show that the vast majority of Americans support funding for family planning. Increasingly, environmental organizations that shied away from entanglements with population issues see the nexus between family planning and their own goals, as illustrated in Bangladesh.

Sen. Mitchell, Speaker Foley: What are you waiting for?

121

With Court Decision Not To Act, Family Planning Falls to Hill

Congressional efforts to overturn the Bush administration's restrictions on U.S. funding for family planning organizations internationally gained new significance when the Supreme Court on June 3 refused to hear a challenge to the policy.

The issue concerns the Mexico City policy, named for the location of a conference where President Ronald Reagan's administration announced the rule in 1984. It prohibits the Agency for International Development (AID) from funding foreign, nongovernmental organizations that provide abortions or abortion counseling.

The Supreme Court action in the case had been widely expected, given its decision in May upholding the administration's rule barring federally funded clinics in the United States from giving patients any advice on abortions. *(Weekly Report, p. 1375)*

"The Mexico City policy has . . . had a chilling effect on efforts to control world population growth."

—Rep. Chester G. Atkins, D-Mass.

In Congress, opponents of the Mexico City policy have launched a multipronged attack to repeal it but concede that their chances of success are slim. Last year, both the House and the Senate rejected attempts to overturn the policy, and President Bush has repeatedly vowed to veto any measure that would undo the restrictions.

Language to overturn the Mexico City policy has been written into fiscal 1992-93 foreign aid authorization bills by a Senate Foreign Relations subcommittee and the House Foreign Affairs Committee. *(Senate, p. 1523; House, Weekly Report, p. 1304)*

Reps. Chester G. Atkins, D-Mass., and Olympia J. Snowe, R-Maine, have introduced similar legislation (HR 1179) that would effectively repeal the policy by requiring the administration to evaluate private family planning organizations by the guidelines that apply to foreign governments.

"The Mexico City policy has totally distorted America's role in international family planning," said Atkins. "It's had a chilling effect on efforts to control world population growth.

The U.S. government spent $227 million in fiscal 1990 for population planning abroad.

The Mexico City policy effectively cut off funds to the International Planned Parenthood Federation (IPPF), one of the largest international family planning organizations. IPPF said it lost out on $3 million to $4 million in potential AID financing for fiscal 1991 because it would not agree to the abortion-related restraints.

Other family planning programs do not accept AID money or have agreed to comply with the regulations. The administration permits assistance to foreign governmental agencies that discuss abortion so long as the agency keeps the funds in a separate account that is not used to fund abortion-related activities.

Atkins has gathered 98 cosponsors but has drawn strong opposition from conservatives such as Christopher H. Smith, R-N.J. Smith told a hearing of the House Foreign Affairs International Operations Subcommittee on June 4 that the Mexico City policy has not reduced U.S. support for international family planning but has only redirected some funding to groups that agree not to provide abortion services.

The Mexico City policy, Smith said, "provides the most effective leadership possible because we're saying human life is sacred."

Atkins acknowledged that he is pinning his hopes on House passage of the provision in the foreign aid authorization bill. Even then, its fate in the Senate appears uncertain. No authorization measure has been enacted since 1985.

"It's going to be a long, hard struggle," he said, "but at least we're building an awareness of the issue." ■

By Sheldon P. Yett

120

The Greening of Foreign Aid

As the Cold War recedes as a primary concern of Congress' foreign aid legislators, global environmental issues are looming larger — enough so that the House the week of June 10 ignored the Bush administration and budgeted $50 million for a new World Bank environment fund.

The money is part of a $15.3 billion foreign aid appropriation (HR 2621) that reduces the administration's budget for military aid while increasing economic and environmental aid.

Ironically, environmentalists are not the ones who are pushing for more money — at least in the case of the World Bank. "This will be good money thrown after bad," said Bruce M. Rich, the director of the Environmental Defense Fund's international program and a sharp critic of the World Bank's environmental record.

The $50 million would go to the World Bank's new Global Environment Facility (GEF), an experimental $1.5 billion three-year project. It is designed to aid developing countries in managing home-grown environmental problems that have international effects: air pollution that adds to the "greenhouse effect" (or in other instances strips away the protective ozone layer); unrestricted dumping in international waters; and the destruction of biologically diverse forests. The project is about 7 percent of the World Bank's $22 billion 1991 lending portfolio.

WORLD BANK

The World Bank's environmental projects include reforestation in Costa Rica.

The facility has attracted international attention. Developing countries have complained that Western industrialized nations all had polluting phases in their development and that if the West wants expensive pollution control instituted worldwide, it will have to help pay for it. The World Bank fund is seen as a key experiment in the West's willingness to invest in the global environment.

Most Western industrialized nations have contributed to the facility or promised to do so. The major exception has been the United States.

The administration supports the concept of the facility, but instead of contributing money, the president sought to fund complementary projects through the budget of the Agency for International Development (AID).

But David R. Obey, D-Wis., chairman of the House Appropriations Subcommittee on Foreign Operations, said "AID was not playing real with the bank" — meaning that there was no true commitment by the administration. According to aides, Obey's subcommittee decided that if the United States wanted to get credit for participating in the GEF, it should make a direct contribution.

GEF Administrator Ian Johnson said he was pleased but also "frankly surprised" at the committee's decision, given the difficult U.S. budget situation. "This will certainly buy a seat at the table," he said.

Just as surprising was that the committee voted to approve the $50 million in the face of what members called the World Bank's "unsatisfactory" progress on issues such as assessing the environmental impacts of its projects, protection of forests and promotion of energy conservation.

Johnson said the bank "had lots and lots and lots to do" in its environmental awareness, but he said, "My own view is that it is a major stride."

Conservationists remain unconvinced. "The Global Environment Facility is a typical top-down, throwing-money-at-the-problem" effort that deals with symptoms, not causes, Jeffrey A. McNeely, chief conservation officer at the International Union for Conservation of Nature, wrote in the journal Canadian Biodiversity.

The House Appropriations subcommittee recommended that McNeely's organization help administer some GEF projects.

Meanwhile, foreign policy experts say the appropriators' action shows a greater willingness in Congress to face changing global realities. "The questions of environment and global warming are given much higher priority by the Congress than they are by the administration," said John Sewell, president of the Washington-based Overseas Development Council.

But, he added, "Congress is only beginning to come to grips with the whole idea of structural reform in the international affairs budget."

Sewell said, for example, the budget should have more debt relief, export promotion and development funds, while cutting what he called unneeded payments for base rights, military assistance grants and the broadcasting services that were a product of the Cold War.

Changing attitudes are also explicity reflected in the fiscal 1992-93 House foreign aid authorization bill (HR 2508), debated by the House during the week of June 10.

That bill, according to the committee report, "represents a substantial elevation in the importance attached to environmental concerns as part of U.S. economic assistance programs."

It makes "sustainable use" of natural resources one of four planks of U.S. economic assistance, along with sustainable economic growth, poverty alleviation and democracy.

Paying heed to the environmental effects of development has been a part of U.S. policy since 1975, when a federal court ruled that the National Environmental Policy Act of 1970 required AID to prepare environmental impact studies before it sold pesticides to developing nations.

—Phillip A. Davis

121

FOREIGN AID

Panel Pushes To Cut Off Flow Of Weapons to Middle East

Foreign Affairs' bill promoting non-proliferation may stall in Senate or face a veto

Proposals to stem the relentless flow of weapons into the Middle East have proliferated in the 102nd Congress. But on May 23 the House Foreign Affairs Committee became the first panel to approve an arms control plan, as it passed an amendment to the fiscal 1992-93 foreign aid authorization bill.

The question is where the proposal — and the authorization measure — will go next. The Foreign Affairs Committee completed its markup of the bill May 23 and plans to approve the legislation May 29. It could reach the House floor before the end of June, committee sources said.

Several obstacles stand in the way of the measure becoming law, however. In recent years, foreign aid authorization measures have bogged down in the Senate. And the Bush administration is less than enthusiastic about the committee's efforts. One State Department official said before the final markup session that "we have serious problems with this bill."

The panel preserved restrictions on U.S. aid to Pakistan and shifted $115 million in military aid for Turkey to economic assistance — in both cases over the administration's strenuous objections. The committee previously had overturned administration policy on funding international family planning organizations, an action likely to trigger a veto. *(Weekly Report, p. 1304)*

With its Middle East arms control proposal, the committee weighed in on another issue that is emerging as a significant point of dispute between Congress and the administration. Several members have sharply criticized the administration for moving too slowly on non-proliferation.

In response, senior officials said a proposal will soon be released, probably the week of May 27. Secretary of State James A. Baker III told the Senate Appropriations Foreign Operations Subcommittee on May 23 that "you won't have to wait too much longer." *(Baker, p. 1389)*

By Carroll J. Doherty

Fascell **Berman**

The Foreign Affairs Committee's proposal, similar to several bipartisan plans in both chambers, calls for the administration to declare a unilateral, open-ended moratorium on arms transfers to the region. During the moratorium, the United States and other weapons exporters would negotiate more permanent restraints on proliferation.

The committee's proposal, spearheaded by Chairman Dante B. Fascell, D-Fla., would lift the moratorium if the president determined that "another major arms supplier nation" has concluded an agreement to provide "major" military equipment to a country in the Middle East or Persian Gulf.

Some committee members said privately that they believed other suppliers would quickly move into the breach if the United States withdrew from the weapons business. Yet there was wide agreement that the provision, as Fascell said, could "jump-start" multilateral efforts to control proliferation.

"If other countries are brave enough or willing enough to take up the challenge, we ought to pursue it," the chairman said. Howard L. Berman, D-Calif., a driving force behind the measure, called it "a reasoned and well-thought-out attempt" at non-proliferation.

The committee plan also sets out an ambitious list of conditions for U.S. arms transfers to the region even after its moratorium. Only those nations that are "actively engaged" in the Arab-Israeli peace process, or that at least have expressed "willingness" to become involved, would be eligible to receive arms. Only weapons used for a credible "defensive mission" would be provided.

Both conditions appear to be open to widely differing interpretations. Even Baker is having difficulty determining which nations are serious about negotiating a Middle East peace.

Lagging Interest

The arms control proposal was one of the few issues that seemed to generate interest among committee members. Yet that amendment, like almost all others considered for the bill, was passed on a voice vote by only a handful of members.

Perhaps lawmakers believed the bill was doomed or were focused on other matters. Attendance at the sessions was lower than in recent years, when members were attracted by disputes rooted in the Cold War, such as fights over aid to the Nicaraguan contras or El Salvador's military.

But the markup sessions were not entirely lacking in drama. On May 21, Stephen J. Solarz, D-N.Y., stunned panel members when he announced that former Indian Prime Minister Rajiv Gandhi had been assassinated. Solarz then walked to the Capitol to inform the full House, which honored the murdered Gandhi with a moment of silence and approved a resolution expressing sympathy for India's loss.

As the authorization bill took shape, the administration achieved mixed results in its campaign to revise the foreign assistance law and eliminate the congressional conditions and mandates that have become endemic in the authorization process. In a letter to lawmakers last month proposing the changes to the law, President Bush was particularly adamant in seeking the end of restrictions on aid to Pakistan.

Under the so-called Pressler amendment, named for Sen. Larry Pressler, R-S.D., aid to Pakistan is permitted only if the president certifies that Islamabad does not possess nuclear weapons. Bush's failure to make that certification in October automatically caused a suspension of U.S. aid.

Bush's assertion that the administration would abide by the spirit of the Pressler provision even if it were lifted apparently fell on deaf ears. Solarz defended the recommendation from his Asian and Pacific Affairs Subcommittee to retain the Pressler restrictions and shift Pakistan's fiscal 1992 aid allocation of $259.5 million to other countries.

The committee rejected an amendment by Henry J. Hyde, R-Ill., to scrap Pressler. Hyde said punishing Pakistan while aiding other potential nuclear

122

powers represents a double standard. But Solarz argued that the adoption of the amendment "would pull the rug out from under" regional and global efforts at nuclear non-proliferation.

In one of the panel's few recorded votes, the Hyde amendment was defeated, 8-13, with members split along partisan lines. The committee then rejected, by voice vote, an amendment by Robert J. Lagomarsino, R-Calif., which would have exempted development aid from the Pressler amendment. The measure also would have broadened the nuclear-certification requirements to include neighboring India.

Administration officials concede that it will be difficult to alter the congressional habit of earmarking funds. After all, one of the more vexing amendments to the measure, in the administration's view, was attached by conservative Republican Christopher H. Smith, N.J. It would earmark $265 million for international health and child-survival programs.

The administration received some unanticipated cooperation from Democrats, however. The liberal chairman of the Africa Subcommittee, Mervyn M. Dymally, D-Calif., withdrew many of the earmarks on the Africa Development Fund that his panel had added. The full committee approved Dymally's proposal to raise the amount of aid to be provided the fund from $800 million to $1 billion in fiscal 1992.

There was bipartisan agreement to defer the contentious issue of military aid to El Salvador, pending the outcome of peace talks aimed at resolving that country's long-running civil war.

Turkey's Aid Cut

The committee supported a reduction in the administration's military aid request to Turkey, as recommended by the Subcommittee on Europe and the Middle East, and approved several amendments that could affect U.S. relations with nations in the Middle East.

The subcommittee had supported the proposal by its chairman, Lee H. Hamilton, D-Ind., to cut the administration's request for military assistance to Turkey by $125 million, from $625 million to $500 million. It shifted all but $10 million of the difference into economic support fund aid for Turkey.

Solarz again assumed center stage in the debate over aid to Turkey, supporting the administration's argument that the government of President Turgut Ozal earned increased military assistance by vigorously supporting the war against Iraq.

The New York Democrat offered an amendment to restore the aid levels the administration originally requested. "What we're talking about here is very important political symbolism," Solarz said. Cutting aid to Ankara would be "a slap in the face," he added.

But Solarz's amendment was rejected by voice vote, as the panel's members were far more concerned with the impact increased military assistance for Turkey could have on another U.S. ally, Greece. For more than a decade, Congress has given Greece roughly $7 in military aid for each $10 it has approved for Turkey.

Warned that an amendment could offend the emir of Kuwait, Rep. Peter H. Kostmayer, D-Pa., replied, "I'd like to offend him."

The administration has never embraced the so-called 7:10 ratio. Under its fiscal 1992 request, Greece was allocated $350.5 million, about 56 percent of Turkey's military aid package. But Foreign Affairs Republicans joined with Democrats to reaffirm their support for the 7:10 ratio.

Many argued that the ratio should be preserved until the Ankara government withdraws the estimated 30,000 Turkish troops on the island of Cyprus. "I want action on this issue," said ranking Republican William S. Broomfield, Mich., usually one of the administration's strongest supporters on the committee.

Disputing Solarz's contention that shifting funds from military to economic aid would insult Turkey, Hamilton said the country would still enjoy an "astounding increase" of 25 percent over fiscal 1991 assistance.

Hamilton added that the Ozal government got an "exceedingly generous" $1.3 billion in aid "from all spigots" in fiscal 1991, although its original allocation was less than half that amount.

Policy Amendments

To no one's surprise, the panel continued to earmark aid for the recipients of the most U.S. assistance, Egypt and Israel. The committee approved $2.5 billion in military and economic aid for Egypt and $3 billion for Israel for fiscal 1992 — about the same as in fiscal 1991. But it did raise military assistance for Israel by $200 million in fiscal 1993.

The committee also retained restrictions on contacts between U.S. officials and members of the Palestine Liberation Organization, added at the subcommittee level. And the panel approved sense of Congress language urging the administration to persuade "Arab coalition partners" to lift their economic boycott against Israel.

Rep. Peter H. Kostmayer of Pennsylvania added two amendments that would have a significant impact on U.S. Middle East policy. The liberal Democrat drafted a provision aimed to condition arms sales to Kuwait on the emirate's institution of democratic reforms.

Kostmayer said he was responding to recent trials of residents of Kuwait who allegedly collaborated with Iraq during the Persian Gulf War, especially the "outrageous" case of one man who reportedly received a 15-year sentence for wearing a T-shirt with Saddam Hussein's picture.

When one lawmaker said such a measure could offend the emir of Kuwait, Kostmayer fired back, "I'd like to offend him."

Under the amendment, which was approved by voice vote, the president would be required to certify that Kuwait has improved its human rights record and "acted to extend the right to vote to all citizens" before the administration could go ahead with military sales to the emirate.

Several members, including Kostmayer, proposed new economic sanctions on Syria. President Hafez al-Assad's government is already on the State Department's list of terrorist nations, and therefore is ineligible to receive U.S. assistance.

But Kostmayer, angered by reports that the government of Czechoslovakia sold tanks to Syria, offered an amendment to extend sanctions to other nations that provide military equipment to the Damascus government.

As it was originally drafted, the measure could have prohibited commerce with nations that provided any military materiel to designated terrorist nations — an action that would have had a drastic impact on U.S. trade worldwide.

After extended conversations among State Department and committee attorneys, the amendment was rewritten to bar U.S. assistance to any nation that provides "lethal military equipment" to terrorist nations. The president could waive the provision if he deemed it in the national interest.

The Kostmayer amendment was approved by voice vote. ■

CHILD SURVIVAL 1985-1990

A SIXTH REPORT TO CONGRESS ON THE USAID PROGRAM

EXECUTIVE SUMMARY

In 1985, the U.S. Agency for International Development (USAID) launched a major child survival initiative and committed itself to a course of action to bring about a significant reduction in the number of preventable child deaths in the developing world. Specifically, USAID undertook to reduce the infant mortality rate in USAID-assisted countries from the 1985 average of 96 to 75 per 1,000 live births, in large part by

- collaborating in an international effort to extend immunization coverage against the major vaccine-preventable diseases to 80 percent of children in the developing world and
- ensuring use of oral rehydration therapy in 45 percent of diarrheal episodes and making oral rehydration salts available to virtually every child in need of them.

Since 1985, USAID has committed over $1 billion to its Child Survival program (see Figures 1 and 2) and developed detailed strategies to guide the efforts of field missions working with over 60 host governments to plan and implement child survival activities. It has also mobilized U.S. universities, private voluntary organizations, and scores of other public and private agencies to take part in this historic undertaking. This report details the progress made in increasing child survival between 1985 and 1990 and presents both global accomplishments and USAID's role in bringing those accomplishments about.

In the five years since USAID's Child Survival program was officially launched, significant gains have been made in enhancing the survival and health status of infants and children in the developing world. Foremost among the gains in USAID-assisted countries have been the following:

- Infant mortality rates declined by 10 percent. In six countries with particularly strong programs, the percentage decline ranged from 15 to 52 percent.
- Vaccination coverage for the full DPT series (three shots for diphtheria, pertussis, and tetanus) rose from 40 to 72 percent and continues to increase. Forty-two countries achieved coverage levels of 80 percent or better and another 10 countries had coverage rates that were between 70 and 80 percent.
- Vaccination coverage for measles increased from 24 to 71 percent.
- The use of oral rehydration therapy for the treatment of diarrhea rose from 20 to 33 percent.

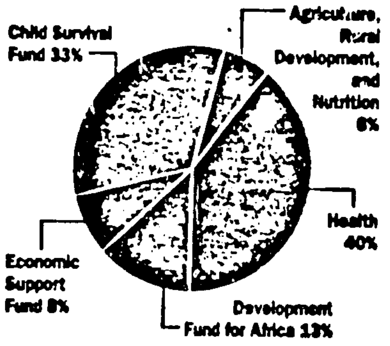
Throughout the developing world, USAID, working in partnership with the World Health Organization, the United Nations Children's Fund, and many other partners, and in concert with the governments of developing nations, has helped to bring down infant mortality rates from the 1985 average of 96 to 86 per 1,000 live births in 1990. The World Health Organization estimates that immunization programs now avert 2.6 million child deaths in developing countries each year from measles, pertussis, neonatal tetanus, and polio. The use of oral rehydration therapy against dehydrating diarrhea is estimated to save the lives of over 1 million children every year. Since 1985, the proportion of the population with access to oral rehydration salts has climbed from about 35 percent to 63 percent.

In addition to the twin engines of child survival – immunization and oral rehydration therapy to control deaths due to diarrheal disease -- USAID has developed and implemented an array of programs that attack the root causes of much of the child morbidity and mortality in the developing world. In particular, USAID has fielded programs that are working to –

- promote child spacing and other measures to reduce the number of high risk births;
- improve child nutrition through the promotion of breastfeeding, better weaning practices, vitamin A supplementation, and growth monitoring;
- improve maternal health and nutrition; and
- increase the availability of local health services for the prevention and treatment of acute lower respiratory infections and malaria.

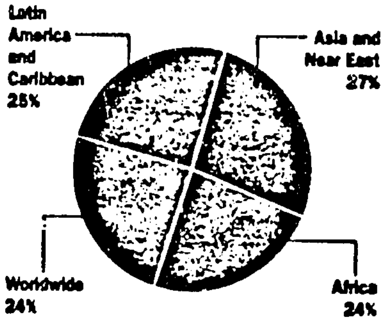
USAID FUNDING BY ACCOUNT

Total funding for child survival
FY 85 through FY 90: $1,031,881,000

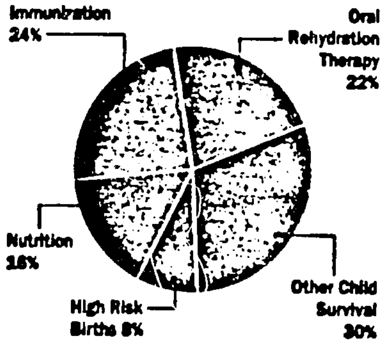


USAID FUNDING BREAKDOWNS

Total funding by regional distribution
FY 85 through FY 90



Total funding by intervention
FY 85 through FY 90



Underlying all USAID child survival programs are a number of key program strategies that are essential to achieving a lasting effect:

- focus on a few relatively simple, proven technologies;
- concentrate on countries with high infant and child mortality rates and in which the greatest impact can be made;
- collaborate with other donors and agencies, such as the World Health Organization, the United Nations Children's Fund, universities, and host country institutions;
- mobilize and work closely with the private sector, both private voluntary organizations and for-profit organizations;
- provide technical assistance to field programs;
- promote the development of sustainable services;
- increase program effectiveness through problem-solving applied research; and
- monitor, evaluate, and refine program services.

As detailed in the following pages, many of the causes of child morbidity and mortality are amenable to low-cost, relatively simple and proven preventive and curative measures. Since 1985, USAID and its partners in the global effort to increase child survival have made significant progress in making those measures available in more and more communities throughout the developing world.

This report describes what has been accomplished by this unprecedented global coalition as well as some of the challenges that remain. The experience of the past five years will provide valuable guidance on how to accomplish the tasks ahead. A major challenge will be sustaining these achievements in the coming years – experience has already shown that accomplishments not maintained with vigilance can slip away. The final section of this report summarizes the lessons from the past that are helping to chart USAID's child survival course for the 1990s.

U.S. Agency for International Development
Washington, D.C. 20523
May 1991

175

DEVELOPMENT STRATEGIES

Common Responsibility in the 1990's. The Stockholm Initiative on Global Security and Governance, Published By: Prime Minister's Office; Stokholm, Sweden, April 22, 1991. (Preface and Summary of Proposals)

Whitehead, John C. "The Hydra-headed UN," The Christian Science Monitor, May 29, 1991.

Minear, Larry. "Humanitarianism Across Borders," The Christian Science Monitor, May 16, 1991.

Bierman, John. "Competing for Charity," World Press Review, July 1991. (Taken from the newsmagazine "Maclena's" of Toronto)

Ali, Tawhid. "The Insoluble Problems of Absolute Poverty," The Harvard International Review, Harvard International Relations Council, Cambridge, Massachusetts, Spring 1991.

Novak, Michael. "Wisdom from the Pope," American Enterprise Institute for Public Policy Research, Number 26, 1991.

Israel Arturo. "The Changing Role of the State in Development," Finance & Development, The International Monetary Fund and The World Bank, June 1991.

"World Bank to Shift Urban Development Strategy," World Bank News, May 2, 1991.

Power, Jonathan. "World Gets More to Eat, Africa Gets Less Than Ever," Los Angeles Times, June 7, 1991.

Wolf, Holger C. "Time to Turbo-charge East European Development," The International Economy, May/June 1991.

Gurria, Jose Angel. "What Eastern Europe can Learn from Mexico," The International Economy, May/June 1991.

"Camdessus Outlines Multilateral Strategy for Economic Recovery in the Middle East," IMF Survey, April 1, 1991.

de Meule, Marah. "Human Rights and Development: Two Halves of the Same Walnut," Development Connections, Society for International Development, Volume XI, Number 8, May 1991.

Harcourt, Wendy. "Human Security and the Gender Perspective," Journal of SID, Society for International Development, Development 1991:1.

The State of The World's Children 1991. United Nations Children's Fund. (Summary)

COMMON RESPONSIBILITY IN THE 1990's

The Stockholm Initiative on Global Security and Governance

April 22, 1991

PREFACE

The world today has a unique opportunity to meet the global challenges. Securing peace, sustainable development and democracy requires nations, in their common interest, to create a new system of global security and governance. We believe that the time is right for nations to take that great step forward, living up to their common responsibility.

The transformation of relations between East and West has ended the Cold War, freeing minds and resources that for so long were bound by sterile confrontation. The momentous changes in East-West relations in the final years of the past decade have provided new openings for the world in the 1990's. Though the openings are real, the process is fraught with dangers, including, in particular, the extreme difficulties facing the transformation of the Soviet Union.

The conflict in the Middle East, following Iraq's invasion of Kuwait, has revealed the weaknesses in the present system for international peace and security. Freed from the constraints of the Cold War, the United Nations did respond in an unprecedentedly speedy way to the crisis. Yet the organization was neither in a position to prevent the crisis, nor to solve it in a peaceful manner.

World leaders must now act determinedly to build a new system for peace and security, on both a global and regional scale. Failing this, the 1990's may become a decade of dangerous instability. Such a [illegible] system must meet the interests of all nations, strong and weak alike. Resolute action must be taken by the United Nations whenever international law is broken. Fears must be allayed that double standards played a role in making possible the international response to the Gulf crisis, and we must now make sure that military culture is not given a new lease of life. A system of security, on global and regional levels, must build on principles of sovereignty and universality, and not on the military might of individual powers.

Peace and security will not be achieved unless international cooperation is extended also to deal with the threats that stem from failures in development, environmental degradation and lack of progress towards democracy. Injustices that prevail throughout the world are a constant threat to the security of nations and people. Increasing economic and ecological interdependencies have not been met by a corresponding strengthening of global cooperation and governance.

As we enter the new decade, the opportunities for progress in international cooperation are greater than ever before. Collective security can be achieved. Poverty can be reduced, and in foreseeable time extreme poverty can even be eradicated. Environmentally sustainable development is possible. Democracy and human rights are universal and increasingly potent values.

A new spirit of cooperation has been seen in many areas, but nowhere, perhaps, more evidently than in the trend towards revitalization of the United Nations. The organization has played a significant role as many regional conflicts moved towards resolution during the latter part of the 1980's.

After a decade, the greater part of which was characterized by selfishness and arrogance, we need to restore global morality. We need the vision of being one global neighbourhood. That is the idea of international solidarity, without which humankind might not survive the next century. We need a new world order, based on justice and peace, democracy and development, human rights and international law.

These visions led in the 1980's to a number of initiatives, taken by leading statesmen who shared the conviction that the increasing global interdependencies could only be dealt with by common action.

More than ten years ago, the former Chancellor of West Germany, Willy Brandt, formed an international **North-South Commission**. Being an independent group, the Brandt Commission could freely embark on a most imaginative project. In 1980, the Commission presented its analysis and its proposals for improving relations between industrial countries and developing countries. With its new thinking on mutual interests and solidarity between people and nations, the Brandt Report had quite an impact on public opinion.

In the report, Willy Brandt wrote that reshaping North-South relations is the greatest social challenge to mankind for the remainder of this century. He added:

> While hunger rules, peace cannot prevail. He who wants to ban war must also ban poverty. Morally it makes no difference whether a human being is killed in war or is condemned to starve to death because of the indifference of others.

However, the "Programme for Survival" could not convince the decision-makers of key countries. While they accepted the idea of a first North-South summit (held in 1981 in Cancun), they disliked most of the recommendations for a profound change in international economic relations. Similar was the response to the second report, "Common Crisis", that focussed on debt and energy issues. Obviously, the invasion of Afghanistan and the following East-West confrontation had heated the international political climate, in a way that was not conducive for improving North-South relations.

It was in the face of these deteriorating relations between East and West that in 1980 the late Prime Minister of Sweden, Olof Palme, founded his **Independent Commission on Disarmament and Security Issues**. It dealt with another major aspect of global interdependence, that of security and the threat of nuclear war. The Palme Commission discussed confidence-building measures and disarmament. It furthered a new concept, "common security", which in 1982 also gave the report its title.

Olof Palme wrote in that report:

> There can be no hope of victory in a nuclear war, the two sides would be united in suffering and destruction. They can survive only together. They must achieve security not against the adversary but together with him. International security must rest on a commitment to joint survival rather than on a threat of mutual destruction.

The aim of the Palme Commission was to promote a downward spiral in arms. It elaborated a broad programme for reducing the nuclear threat by test bans and non-proliferation agreements. It agreed on the need for a further build-down of conventional forces and a ban on chemical weapons. All these proposals are still valid. Like the Brandt Commission, it also proposed measures for controlling the arms trade. And forcefully, it argued the effectiveness of confidence-building measures. The Palme Commission also paid particular attention to the security needs of the South, and suggested ways of strengthening the United Nations.

Many of the key ideas of the Palme Commission, including the concept of common security, are now being taken up – but only after a costly delay. All through the 1980's, the arms race continued, and violent conflicts took the lives of millions of people.

In response to growing concerns about the global environmental situation, the **World Commission on Environment and Development** was set up. The Secretary-General of the United Nations called upon Gro Harlem Brundtland to chair the commission. It presented its report in 1987, called "Our Common Future".

The Brundtland Commission found that present development patterns could not be allowed to continue. While economic and social development suffered from severe national and international imbalances,

threats to the environment were becoming global in scope and devastating in scale. But the Commission also found that necessary changes were possible, that humankind had never before had greater possibilities to break out of the negative trends of the past. To do so would require political reform, a fair access to knowledge and resources and a more just and equitable distribution within and among countries.

The central concept introduced by the Brundtland Commission was that of "sustainable development". The report wrote:

> Sustainable development seeks to meet the needs and aspirations of the present without compromising the ability to meet those of the future. Far from requiring the cessation of economic growth, it recognizes that the problems of poverty and underdevelopment cannot be solved unless we have a new era of growth in which developing countries play a large role and reap large benefits.

The report emphasized the increasing importance of interdependence in coping with global environmental problems. It brought out the strong connection between problems of environment and problems of development and security, and showed that meeting these challenges requires a coordinated and integrated approach.

During the final years of the decade, another commission was formed, the **South Commission**. Chaired by the former President of Tanzania, Julius Nyerere, it dealt with the situation of developing nations, and in particular with the possibilities and needs of strengthening South-South cooperation. It presented its report, "The Challenge to the South", in 1990.

While recognizing the importance of a conducive international environment for development, and calling for efforts to revive the North-South dialogue, the report stressed the responsibility of developing countries to ensure a better future for themselves. It devoted much attention to economic and political reform and the importance of improving domestic economic management. It advocated a people-oriented strategy and came out strongly for strengthening democracy and for curbing authoritarianism, corruption and militarization.

The last paragraph of the South Commission's report expressed this clearly:

> In the final analysis, the South's plea for justice, equity, and democracy in the global society cannot be dissociated from its pursuit of these goals within its own societies. Commitment to democratic values, respect for fundamental rights – particularly the right to dissent – fair treatment for minorities, concern for the poor and underprivileged, probity in public life, willingness to settle disputes without recourse to war – all these

cannot but influence world opinion and increase the South's chances of securing a new world order.

There is one basic common denominator in the thinking of all the four independent Commissions: no nation can resolve its own problems without relying on others. The Commissions spelled out our interdependence. They emphasized that we must work together to be able to live in one world, to reach a common security, to have a common future.

In early 1990, after the momentous changes of 1989, Willy Brandt assembled members of his own Commission, together with several representatives of the other Commissions. They met at Königswinter, outside Bonn, and reviewed the 1980's and outlined new prospects for the 1990's. There was solid agreement that the major challenges of the 1990's could be mastered only by coordinated multilateral action.

As a result of the Königswinter meeting, Prime Minister Ingvar Carlsson, Sir Shridath Ramphal and Minister Jan Pronk were asked to form a Working Group. Their task was to make an assessment of the new opportunities, and to suggest major areas for multilateral action. One year after the Königswinter meeting, we assembled in Stockholm, at the invitation of Prime Minister Carlsson. Inspired by the themes of the earlier independent Commissions – and on the basis of a memorandum presented by the Working Group – we have tried to outline some elements of great relevance for the 1990's.

In this Stockholm Initiative, we put forward a number of proposals which we believe require urgent action. We may not all agree with each single suggestion, but the need for a comprehensive effort is recognized by us all. We are convinced that the present is a uniquely propitious time for an initiative to be taken, that responds with imagination and boldness to the manifest needs of the present and the future.

Stockholm, April 22, 1991

Ali Alatas

*Patricio Aylwin Azócar**

Benazir Bhutto

Willy Brandt

Gro Harlem Brundtland

Manuel Camacho Solis

Fernando Henrique Cardoso

Ingvar Carlsson

*Jimmy Carter**

Bernard Chidzero

Reinaldo Figueredo Planchart

Bronislaw Geremek

Abdlatif Al-Hamad

Mahbub ul Haq

*Václav Havel**

Edward Heath

Enrique Iglesias

Hong-Koo Lee

Stephen Lewis

*Michael Manley**

Vladlen Martynov

Thabo Mbeki

*Robert McNamara**

Bradford Morse

Julius Nyerere

Babucar Ndiaye

*Saburo Okita**

Jan Pronk

Shridath Ramphal

Nafis Sadik

Salim Salim

Arjun Sengupta

*Eduard Shevardnadze**

Kalevi Sorsa

Maurice Strong

*Brian Urquhart**

*Could not attend, but has agreed to support the paper.

SUMMARY OF PROPOSALS

PEACE AND SECURITY

We propose.

1. improved United Nations capabilities for anticipating and preventing conflicts, in particular the establishment of a global emergency system;
2. the elaboration of a global law enforcement arrangement, in line with the United Nations Charter, focussing on the role of sanctions and on military enforcement measures;
3. organizational and financial measures to strengthen the United Nations capabilities for peace-keeping and peace-making operations;
4. Regional Conferences on Security and Cooperation to be tried in regions also outside Europe;
5. that the monitoring of world arms trade, particularly by the United Nations, be strengthened with the purpose of eventually agreeing on global norms, regulating and limiting trade in arms, and focussing on both supplier and recipient countries;
6. a pledge by governments in the industrialized countries to allocate a specific part of the peace dividend for international cooperation;
7. a commitment by governments in the South to substantially reduce their armed forces, with the purpose of creating a peace dividend to be invested in human development.

DEVELOPMENT

We propose:

8. that the world community sets the goal to eradicate extreme poverty within the coming 25 years, through a committed effort to achieve sustainable development;
9. that the following targets for the year 2000 be emphasized and that countries' achievements be monitored closely:
   - primary education for all children,
   - equal participation of boys and girls in schools,
   - reduction of child mortality by at least one third,
   - reduction in maternal mortality by one half;
10. a strengthening of the multilateral framework of trade-related agreements, reducing protectionism on all fronts, and expanding opportunities for developing countries' participation in world trade;

11. a strengthened debt strategy, introducing a strong element of debt forgiveness to radically cut the debt overhang:
   - by terms and conditions in Paris Club reschedulings that go far beyond today's in providing relief and applying to a broader range of countries,
   - by commercial debt restructuring that better corresponds to the secondary market value of that debt,
   - by increased financing on appropriate terms by the international financial institutions;
12. that all industrialized nations set public time-targets to provide one per cent of their GNP for international development cooperation.

ENVIRONMENT

We propose:

13. that fees are levied on the emission of pollutants affecting the global environment, in particular carbon dioxide emissions from the burning of fossile fuels;
14. an international energy dialogue promoting a more efficient use of the world's energy resources, and, in particular, the use of alternative and renewable energy sources, e.g. solar energy;
15. that the United Nations be encouraged to take up environmental issues at the highest level in all appropriate fora;
16. that nations resolve to make the 1992 United Nations Conference on Environment and Development a breakthrough for achieving sustainable development.

POPULATION

We propose:

17. that national and cultural leaders mobilize the political commitment and the technical means for making a breakthrough in limiting population growth;
18. that the 1994 International Conference on Population and Development promote the implementation of policies and programmes to reach population stabilization goals.

DEMOCRACY AND HUMAN RIGHTS

We propose:

19. the strengthening of the United Nations role in monitoring how countries live up to their commitments to conventions and declarations concerning human rights and democracy, recognizing that democracy can develop only through popular internal will;
20. the strengthening of independent international institutions that offer to monitor countries' observance of democratic rules and principles, in particular at time of elections, respecting the constitutional order of each country.

GLOBAL GOVERNANCE

We propose:

21. that the United Nations takes on a broadened mandate at the Security Council level, following the wider understanding of security which has developed, and that its composition and the use of the veto be reviewed;
22. that the Secretary-General be given a stronger position and the means to exercise authority, and that the method of appointment of the Secretary-General and of higher-level staff be reviewed;
23. that the system-wide responsibilities and authority of the Secretary-General concerning interagency coordination and cooperation should be firmly established;
24. that the financing system of the United Nations be reviewed, and that countries who do not adhere to the financial rules be deprived of the right to vote;
25. that the activities of the United Nations in the economic and social fields be strengthened and rationalized;
26. that the International Monetary Fund and the World Bank be coordinated, among themselves and with the United Nations system and GATT, with the aim of a clearer division of labour, better harmony and full universality in their work;
27. that a World Summit on Global Governance be called, similar to the meetings in San Francisco and at Bretton Woods in the 1940's;
28. as a matter of priority, the establishment of an independent International Commission on Global Governance.

OPINION

Despite the new relevance gained by its role in the Gulf, the UN badly needs structural change to create a strong, coherent, credible policy-making body

The Hydra-Headed UN

By John C. Whitehead and Jeffrey Laurenti

THE United Nations emerged from the Kuwait crisis with its reputation considerably enhanced. Long faulted for impotence and indecision, on Iraq the organization demonstrated resolve and effectiveness. But the UN's seeming new relevance is showing some limits, as the General Assembly demonstrated this month in a frustrating session called to consider the governance of the UN's economic and social activities.

The backdrop for the session was the uneven performance of UN social and humanitarian agencies – numerous but on shoestring budgets all – in coping with problems of environmental destruction, refugee relief, and economic devastation in the aftermath of the Gulf war. It was a bracing reminder that the UN has become a Janus-like system of two faces – the UN of peace and security, relatively purposeful and effective, to which influential governments pay active and growing attention; and the UN of economic and social affairs, halting, hortatory, and often ignored by powers great and small.

The Security Council, at the center of the security system, has proved it can move with a dispatch and effectiveness that the US Congress might envy. On pressing political issues, it can draw foreign ministers from their capitals for top-level decisions. But on economic, humanitarian, and social issues, which account for some 80 percent of UN spending, the management and policy process is tortuously slow. The sprawling collection of agencies and governing bodies has no real central authority. UN meetings directly involving Cabinet-level ministers on a global economic or social policy agenda are virtually unknown.

Meetings do go on at such levels. They just don't go on in the UN. On the eve of the the resumed Assembly session, finance ministers of the Group of Seven major industrialized countries met to thrash out common policy on interest rates and related economic issues that will affect the entire global economy. Even though any decisions on these issues would have dramatic impacts on, say, the debt burdens of the third world, not a single developing country is involved in them.

It has not escaped the notice of developing countries that international economic policy is made without them. Their repeated passage of plaintive UN resolutions advocating debt relief has had no impact on events. Their representatives understand that the UN resolutions they painstakingly craft on economic and social problems get filed unread not only in Washington and Bonn, but their own capitals as well.

THE system's fragmentation has frustrated the the industrialized countries as well. Urgent threats to the world environment are a case in point. There is no place in the UN system where a common policy on environment can be established to guide the actions of the many UN agencies involved in agricultural and industrial development, trade, health, education, and science. Likewise, while the UN sometimes does a very credible job at delivering relief to refugees, it has been unable to set an agenda addressing the social problems that cause many refugee emergencies.

Yet the UN's crisis in relevance has not led to any agreement on its restructuring. Since ambitious designs for reform have foundered on political inertia in the past, hopes for the recent session were focused modestly on setting a new direction for a single oversight body, the Economic and Social Council. This was originally established as an 18-member counterpart to the Security Council, though with neither veto nor coercive power. Today it has 54 member states, meets at the level of junior diplomats who have no political authority to commit anyone to anything, rarely draws even UN agency heads to its meetings, and rehearses speeches that will be recycled in the General Assembly. It is not a place where discussion of urgent issues involving many agencies and governments can be converted to serious commitments for action.

WHAT the far-flung UN system needs is a powerful nerve center, a role the Economic and Social Council clearly does not fill. In the absence of a nerve center, any other organism would be declared brain-dead. Yet some developing country representatives diagnose the source of the UN's marginalization as its not having enough poor, weak countries involved in the council.

Their prescription – adding *more* developing country governments to the council – has stalled progress on fundamental reform. By pushing a shopworn notion of governments' "equality" that is manifestly contradicted by world realities, these representatives display telling indifference to the structural causes contributing to the UN's sideline role.

There are, however, hopeful signs. Developing countries themselves are calling for UN meetings on major problem areas at the level of government ministers. They have also proposed joint top-level meetings between a few of their number and the Group of Seven – though most of them strangely resist institutionalizing such a group as a UN nerve center. For their part, the Nordic countries are proposing thoughtful and far-reaching reforms to establish a credible center of UN authority. The larger Western powers are at least amenable to substantive reform, even if some stand-patters whisper they are better off with a weak UN.

Ten days after the resumed session recessed, weary negotiators reached belated agreement on a package of modest procedural reforms, but left the system's fundamental weaknesses untouched. For the future, nations must press for a sharpening of this clouded vision of renewed UN relevance.

■ *John C. Whitehead is chairman of the United Nations Association of the USA. Jeffrey Laurenti is executive director of UNA's multilateral studies program.*

132

OPINION

Humanitarianism Across Borders

■ *Many officials view as a watershed the assertion by the United Nations – the world's preeminent security organ – that humanitarian assistance and human rights are themselves of overriding importance.*

By Larry Minear and Thomas G. Weiss

THE plight of the Kurds and other Iraqis displaced by the Gulf war has exposed the strengths and weaknesses of the world's humanitarian safety net. Like the war itself, the world's response to the victims demonstrates both new potential for collective action and serious structural inadequacies in responding to human need.

The appearance of some 2 million refugees in a matter of days, say aid professionals, is unprecedented. While they concede they could have done more to avoid the tragedy, it is difficult to envision standby machinery that could deal overnight with a crisis of this magnitude. It is like having enough plows to remove a foot of snow that falls in 12 hours, only to be faced with a blizzard that drops twice as much in six hours.

Extenuating factors notwithstanding, the world's inability to respond more effectively to Iraqi suffering has cost innocent lives numbering probably in the tens of thousands. There are currently more than 15 million other people around the planet who, fearing for their lives, have crossed international borders in search of refuge. An even larger number are displaced within their countries of origin.

With the international community opposed to the repatriation of people against their will, the choice of some Iraqi Kurds to return home on their own stands as a judgment against the lifeline available to them. Their decision to coexist with an enemy who gassed their relatives rather than trust the world to provide for their needs would be understood by Cambodians languishing in wretched refugee camps along the Thai border and Palestinians similarly encamped in the occupied territories.

But international legal norms related to humanitarian aid may be changing. Over the years, the shibboleth of "sovereignty" has subjected aid to the needy to government consent. Normal diplomatic niceties were set aside, however, when the UN Security Council, labeling the mass upheaval a threat to international peace and security, insisted that "Iraq allow immediate access by international humanitarian organizations to all those in need of assistance in all parts of Iraq."

Many officials view as a watershed the assertion by the world's preeminent security organ that humanitarian assistance and human rights are themselves of overriding importance. "Soon it will no longer be acceptable," writes Bernard Koucher, France's minister of humanitarian action, "to cross a border to wage war but not to do the same to make peace and save lives."

Yet it is hard to imagine a more attractive case for humanitarian intervention than Iraq, given Saddam Hussein's behavior and the prior UN decision to remove Iraq from Kuwait, using military force if necessary. Will the world community feel equally compelled to intervene the next time lives are on the line – for example, in Liberia or Somalia?

The use of American, French, British, and Dutch marines inside Iraq without Iraqi government approval and the allied ultimatums to Iraqi troops to withdraw from areas which then become safe havens may indeed represent a turning point in the evolution of humanitarian ethics. At the same time, current lifesaving efforts in the Gulf crisis raise complex questions.

Lofty rhetoric about the right and even the duty to intervene in humanitarian emergencies is one thing. The institutional capacity of aid agencies to fulfill such obligations is quite another.

Can multilateral institutions be strengthened so that future preemptive action by the United States and others will be unnecessary? Do those requiring succor and those seeking to provide it need protection of a sort that only military force can provide? Does the scale and complexity of the humanitarian tragedy in the Gulf suggest that the international community should be less willing to resort to military force and more patient with sanctions?

Current suffering will be in some small measure redeemed if it hastens the establishment of more effective and consistent international responses favoring humanity over sovereignty. Sovereignty must be faithful to humane values.

■ *Larry Minear is a visiting fellow at the Overseas Development Council and Brown University. Thomas G. Weiss is associate director of Brown University's Watson Institute for International Studies.*

■ COVER STORY

COMPETING FOR CHARITY

A catalog of miseries meets 'compassion fatigue'

In Bangladesh, a cyclone kills at least 125,000 people and leaves millions more prey to starvation and plague. In the Middle East, civil war drives an estimated 1.5 million Kurds from their homes, causing countless thousands to die of hunger, cold, and sickness. In South America, a cholera epidemic claims at least 1,300 lives before the onset of the southern winter. And beyond those disasters looms the specter of mass famine in Africa, which, relief experts say,

could kill between 20 million and 30 million people. Taken together, the underdeveloped world currently presents a picture of natural and man-assisted catastrophe rarely equaled in the 20th century. But in the recession-plagued industrialized countries, that catalog of Third World miseries arouses conflicting emotions. Although there is an unmistakable urge to help,

Maclean's

relatively affluent Westerners face counter-claims for sympathy from their own countries' hungry and homeless. And that, combined with a pervading sense that the Third World's problems are insoluble, creates what international relief workers call "compassion fatigue."

The Kurdish tragedy, even allowing for the belated U.S. reaction to it, attracted the greatest Western response, because it was a consequence of the Western-led war to liberate Kuwait. International pop-music stars in nine Western cities performed for free to raise money for the Kurds. But there were no recent concerts for Bangladesh. And many relief agencies are openly pessimistic about the likely Western response to the famine disaster now brewing in the Sudan and Ethiopia. Western nations gave massively to defeat famine in those two countries six years ago, only to see it recur.

In fact, aid officials say that if more effort had been put into long-range development, the threat of African famine might indeed have gone away—or at least receded. Bruce Moore, executive director of the Canadian Hunger Foundation, asks, "Can we keep responding to all of these emergencies? When will we address the larger agenda?"

So far, world governments, non-governmental relief agencies, and other international organizations have donated a total of $236 million for Kurdish relief, $18.6 million of which came from the Canadian government. The Bangladeshi government appealed in late May for $1.6 billion. Officials said that they have received pledges of about $234 million, $115 million of which came from Saudi Arabia.

Meanwhile, in eastern Africa, attempts to cope with famine have been complicated by civil war. The Ethiopian Marxist regime had long battled Eritrean nationalists and Tigrean rebels, while Sudan's Moslem fundamentalist regime is fighting a savage war against predominantly Christian rebels. International relief workers have accused both the Sudanese government and the recently ousted Ethiopian regime of obstructing their attempts to send aid to rebel-held areas. In Europe, too, relief workers say that Sudan and Ethiopia constitute the area most prone to the effects of compassion fatigue. "On a scale of magnitude," said Luc Trouillard, spokesman for the French branch of the international Roman Catholic charity CARITAS, "the East African famine beats all of the others combined, but we are receiving next to nothing for its victims." He added that of the money donated in France for relief recently, 89 percent went to Bangladesh, 10 percent went to the Kurds, and only 1 percent went to Africa.

The perception that some Third World governments are not doing their best to help may also discourage potential Western donors. Bangladesh desperately needed more helicopters to distribute the food aid that was flowing in. The country's armed forces have only 30 helicopters, and fewer than half are operational. In Kurdistan, private aid efforts were obstructed by overzealous Iranian officials—even though the fundamentalist Teheran government had complained that Western relief was inadequate for the massive influx of Iraqi Kurds into Iran. The U.S. charity Americares withdrew a seven-member medical team, abandoning a $575,000 clinic and $2.2 million worth of medicines and food, after Iranian officials accused them of spying. And a 30-member medical team from the French organization Médecins Du Monde (Doctors of the World) left another refugee camp for similar reasons.


Daher/Gamma-Liaison

Such outright obstructionism as Iran's is rare. But Third World failure to prepare for predictable disasters is clearly not. François Arsenault, director of international humanitarian assistance for the Canadian International Development Agency, has stressed the need for Third World countries to make better use of development programs. In particular, he said, "disaster-prone countries must more and more look to disaster-preparedness programs." That was apparently a reference to Bangladesh, where, although cyclones are common, successive governments have failed to introduce a proper warning system.

Obviously, cyclones cannot be prevented, adequate rainfall cannot be assured, and oppressive governments cannot constantly be removed by outside intervention. But poor environmental policies, which contribute to such Third World disasters as crop failure due to drought and flooding, can be corrected. Conservationists say that the deforestation of the lower slopes of the Himalayas has added greatly to the flow of water over low-lying Bangladesh. Population increases, deforestation, and overgrazing have accelerated the pace at which once-arable land is becoming desert in Africa.

Still, statistics indicate that, over the long term, the Third World's problems are not insoluble. For example, as one indication of progress, the U.S. Agency for International Development recently pointed out that infant-mortality rates in Third World countries had been cut 10 percent in the past five years.

Although continued Western aid cannot avert Third World disasters, it might make them significantly less severe if combined with a determined effort to prevent further environmental degradation. And that success might in turn help the wealthier industrialized countries to overcome the demands of recession and compassion fatigue—and to go on giving. ■

By John Bierman; from the newsmagazine "Maclean's" of Toronto.

The Insoluble Problems of Absolute Poverty

BY TAWHID ALI

Over 400 million people live in the 42 nations categorized as Least Developed Countries (LDCs). The LDCs present a unique problem of economic development. Their case is distinct not only because their economies are relatively backward, but also because their peculiar structural and natural characteristics impede efforts toward integration with the rest of the world economy. To combat their special problems, the international community adopted in 1981 a Substantial New Program of Action for the Least Developed Countries (SNPA) at the first UN conference for LDCs in Paris. The Program set guidelines for leading these fragile economies toward self-sustaining growth. The program's major goals were for the LDCs to attain minimum standards of nutrition, health and transport. Officials from about 150 countries adopted a similar plan of action at the beginning of the 1990s, and produced a thorough review of the advances made over the previous decade. Yet despite persistent international and domestic efforts, the LDCs continue to face problems in many areas of their development. Bad policies and a lack of a feasible infrastructure to implement policy improvements plague development efforts LDCs are disadvantaged in trade and lack the resources for efficient internal markets. Adding to these problems, the governments of the LDCs have shown little initiative in solving their own problems. The LDCs' economies have actually shrunk during the last decade when the SNPA was to have promoted at least minimal economic growth.

The international economic climate was particularly unfavorable to LDCs in the past decade and actual growth during the 1980s was far lower than expected. Despite national and international efforts to promote economic growth, Gross Domestic Product (GDP) grew by 2.3 percent annually in the 1980s. This was down from 3.4 percent in the 1970s. More alarming, GDP growth rates were lower than the average annual population growth rate of 2.4 percent. This figure indicates a deterioration in GNP per capita. But, the statistics conceal the wide variations that exist among countries. Six LDCs—Benin, Bhutan, Gambia, Guinea Bissau, Laos and Burma—recorded growth rates of 5-7 percent annually, a figure that was higher than their population growth rates. This figure surpassed even SNPA targets. Five other countries—Central African Republic, Niger, Mozambique, Samoa, Sao Tome and Principe—had negative growth during the same period.

> *Domestic policies must have affected the economic outcome but no underlying trends are evident...leaving policy planners puzzled over the seemingly random success of their plans.*

Agricultural performance was especially worrying since the average annual growth in total food and agricultural output averaged about 1.7 percent—far short of the figure projected in the 1981 SNPA, and below the rate of population increase. But again, statistics do not tell the entire story. They often obscure fluctuations in net production over the relevant period. Agricultural production in many LDCs surged in 1981 and 1985 but slackened from 1982 to 1984 and from 1986 to 1987. These periods of reduced production coincide with natural disasters in some of the LDCs. There were also some variations: Benin, Bhutan, Burkina Faso, Cape Verde, Guinea Bisseau and Yemen registered agricultural output growth of over 4 percent.

Domestic policies must have affected the economic outcome but no underlying trends are evident. Some policies worked in one country but were disastrous in another, leaving policy planners puzzled over the seemingly random success of their plans. The capacity to generate foreign exchange through exports other than the traditional commodities is the only factor common to the six successful LDCs but one might question whether that is the cause or effect of growth. Each of these countries, which registered GDP growth rates of over 6 percent in the 1980s, have non-traditional goods as their main source of export earnings: hydro-electric power in Bhutan, diamonds in Bhutan, tourism in the Maldives. But otherwise there are no common factors. This correlation suggests that export-oriented growth is the way to economic prosperity.

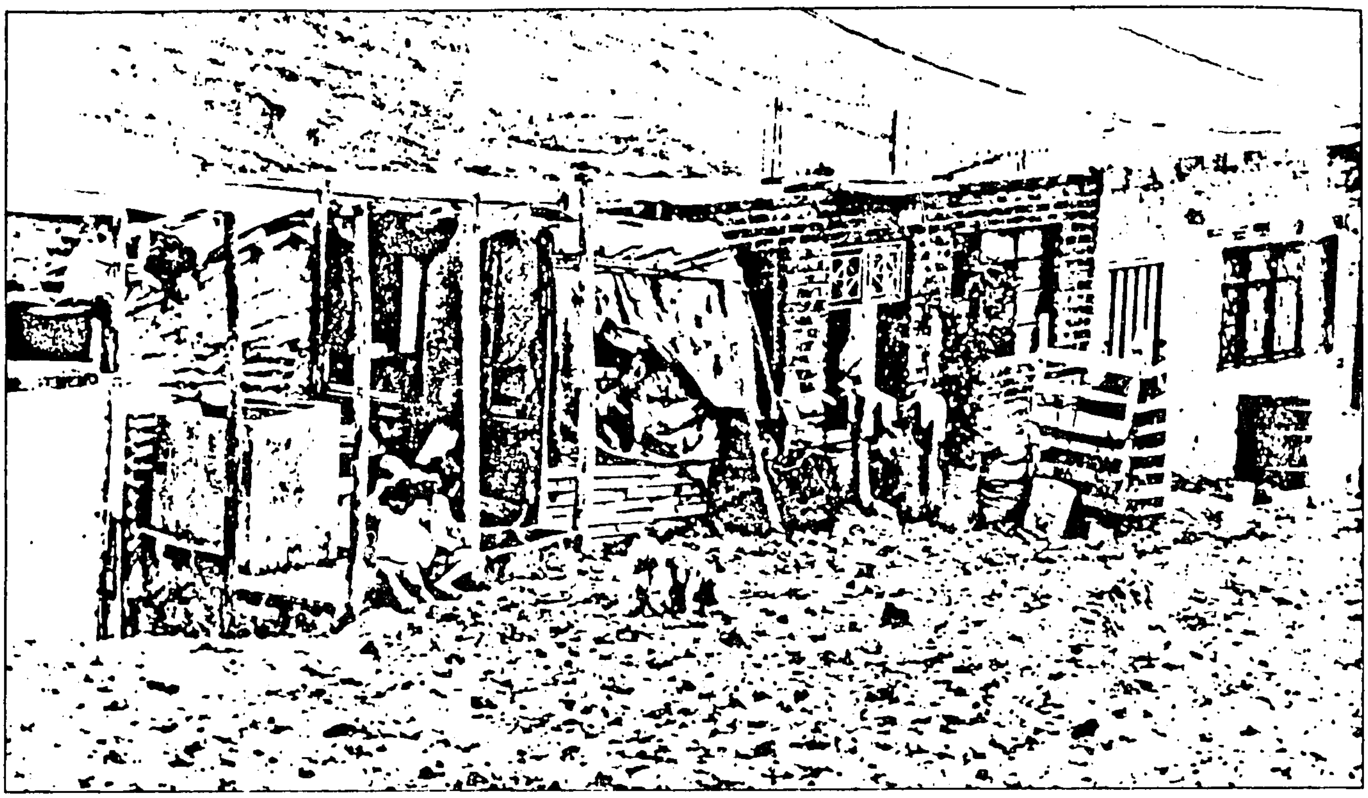
If one had to point out an underlying cause of failure in the countries whose production decreased, it would be natural calamities, which obviously cannot be countered with any policy. Recent floods have caused much damage in Bangladesh and Sudan. Locust infestations have destroyed crops in Ethiopia, Sudan and other African countries. Armed conflicts and political instability have also stymied growth. Price fluctuations in many LDC agricultural commodities have compounded LDC problems. The sugar price index, for example, fell 90 percent between 1980 and 1985, and cut the income of many sugar exporting LDCs.

According to UN planners, three major factors have contributed significantly to the dismal performance of the LDCs in the 1980s: basic structural contraints, domestic policy shortcomings and adverse trends in the world economy.

Structural Constraints

Many LDCs suffer from severe geographical and ecological handicaps. Of the 42 LDCs', 15 are landlocked and another nine are small island nations with fragile eco-systems and high levels of environmental degradation. Small natural resource bases limit their capacity to export primary

Tawhid Ali is a staff writer for the Harvard International Review.



Political Instability in LDCs complicates the development process.

products. These natural constraints are compounded by devastated economies and extreme poverty. The lack of skilled manpower and indigenous industries is a major hurdle to development. Domestic industries produce a limited quantity of goods for small domestic markets thus increasing the dependence on imports. The absence of rural and urban infrastructures leads directly to the inability to convert foreign aid into feasible projects. Aid is therefore not fully utilized further constraining growth. All these problems lead to small local markets, low to almost nonexistent savings and heavy dependence on foreign aid for even basic needs like food. These handicaps perpetuate the vicious cycle in which poverty breeds poverty.

Adverse Global Trends

LDCs are heavily dependent on raw materials exports for foreign currency earnings. Each country typically exports only one or two major commodities which are often in excess supply on world-markets. Market price fluctuations are common, making any investment in the production of these materials a risky venture. Many LDCs also face barriers to export goods such as textiles and garments. High interest rates coupled with these weak export markets force LDCs to use much of their foreign currency earnings to finance their large debts. LDCs now face a debt service burden whose real value was not anticipated at the time the debt was contracted. Continued borrowing in the 1980s has elevated the debt-servie ratio from 20 percent in 1982 to an incredible 27 percent in 1987. Because of this debt, the LDCs have trouble in gaining access to foreign capital markets and thus cannot finance trade-deals with the developed countries. Technological changes at the international level often do not extend to the LDCs, because the LDCs lack the capacity to import or borrow them. This alarming trend risks the further economic marginalization of the LDCs. Although the LDCs face these difficulties along with all the other developing countries, their case is special because of the extreme nature of their problems. As yet, they are not recognized by many as needing special consideration.

The third major impediment to growth has been the LDCs' domestic policies which have not addressed the challenges faced by the LDCs. Many ill-conceived ideas have caused great damage when implemented while potentially beneficial plans remain on paper because they lack adequate supporting. Planners have often forgotten rural development and rapid urbanization has resulted—a process that has strained the urban infrastructure. LDC governments continue to view income redistribution, land reform and decentralization of power as social and political issues, and not as conditions for economic development. Governments often fail to develop the private sector on a national scale and continue to fund unprofitable government ventures like national airlines, utilities and heavy industry. Efforts to stimulate private investment and savings have failed miserably except in a few cases, and has deprived the countries of much needed capital. Women continue to play largely traditional roles and their exclusion from the talent pool means a significant loss of human potential. The exodus of qualified personnel to developed countries is yet another loss, while unpopular governments, military strife and civil unrest continuallycomplicate domestic policy-making.

Structural Adjustment

Throughout the 1980s, the LDCs faced the double-edged problem of developing under such adverse conditions and dealing with their debt burdens. The worsening external environment has not helped matters. The rest of the world had become in-

131

creasingly closed to imports and less willing to negotiate terms of trade favorable to the LDCs. In the 1980s, the LDCs launched several programs to combat the problems they faced in all economic sectors. Yet many of the problems remain unsolved. In the 1980s, 27 LDCs implemented programs with International Monetary Fund support, but it is difficult to judge their impact. The World Bank now concludes that domestic problems—such as poor policies, structural rigidities and weak institutions—are the biggest hindrances to progress while the LDCs claim that the policies themselves are definitely ineffective. These conflicts have frustrated both sides.

One cannot place all the blame on the LDCs since many of them have invested much effort into development. UN analyses show that the performances of the twelve LDCs which have implemented development programs continually throughout the 1980s have not differed significantly from the LDCs as a whole. The absence of any correlation between the adjustment programs and respective national performances raises questions regarding the adequacy of these programs. Many multilateral institutions have only recently begun to review their policy approaches and have become aware of many of the shortcomings of their policies. The World Bank, in its 10-year review of adjustment lending, admits that adjustment is a longer process than was originally anticipated. Reform packages now pay closer attention to the time needed for adjustments to take effect.

Growth in LDCs' trade has lagged well behind the growth of world trade for several decades. While the LDC share of world population grew from 7 percent to 8 percent between 1970 and 1987, their share of world exports steadily declined from 1.4 percent in the late 1960s to a minute 0.3 percent in 1987. Among other causes, domestic policies have restricted export development. Exchange rate policies, public sector trading monopolies, price distortions, subsidies to uneconomic ventures, and neglect of the private sector have discouraged new initiatives and investments in the export sector.

The decline in prices of raw materials severely hurt the value of LDCs' exports. Commodity trade has indeed been the major determinant of the poor. As noted, many countries specialize in only one to three commodities and have been at the mercy of the world market. For example, between 1980 and 1988, international prices for coffee fell by 37 percent, cocoa by 51 percent and cotton by 33 percent. Tariffs and non-tariff barriers on processed commodities have also hampered trade. In addition, agricultural subsidies in developed countries take away any cost advantages that the LDCs might have in producing food.

An International Solution?

At the international level, developed countries must recognize that a favorable external environment is essential for sustained growth. Industrialized nations should recognize that certain conditions—like stability in international commodity markets, international support in terms of Official Development Assistance (ODA), debt relief and free access to world markets—are requirements for an international environment favorable for growth. International action to combat the decline of the LDCs needs to enhance LDCs' access to markets. The developed countries need to make an effort to remove non-tariff barriers faced by the LDCs. Protectionist policies have been the most severe impediment to LDCs' access to world markets. The developed countries should also pursue policies that cushion the LDCs from major price fluctuations in the commodities markets and compensate them for large export earnings shortfalls because of these price fluctuations. These compensatory measures could come in the form of grants or loans, from individual developed countries or international organizations, and should be negotiated on a country-by-country basis. As the LDCs' debt problem has become such a stumbling block to growth, the international community should actively attempt to reduce the burden by writing off some of the debt (as has France with some of its loans to the LDCs) or converting it into grants. This should not be done without extracting promises for financial discipline in the form of reduction of defense expenditures and curbing of unproductive operations. Shanta Devarajan, of Harvard's Kennedy School of Government, says that "eventually, some of the debt to low income countries should be written off, but the problem of incentive will remain." A policy of cooperation would help the Least Developed Countries achieve a degree of economic stability.

There will not be any significant alleviation of LDCs' problems in the near future.

On the other side, the LDCs' governments need to place primary importance on the implementation of policies which stress continuity and consistence. Sectors like rural development, agriculture and training require priority. The LDCs' government should establish links between manufacturing and service sectors and try to harmonize all foreign-exchange-earning projects with the rest of the national economy. They need to diversify exports and become more competitive internationally. Socio-economic development requiring equitable redistribution of income and inclusion of the entire population in national activities must be stressed.

On the whole, prospects for the future hardly seem sanguine for the LDCs. Their problems seem insurmountable and international efforts to aid them are dwindling. Recent developments in Eastern Europe and in the Persian Gulf have diverted much needed attention away from the LDCs. Although there are a few encouraging signs, the overall picture indicates that there will not be any significant alleviation of LDCs' problems in the near future. It will not suffice to say that LDCs have the primary responsibility for their development. Their problem cannot be tackled alone. A strengthened partnership between the LDCs and their development partners is essential for progress to occur. The international community must recognize that the problem of the LDCs is not a localized one but rather a source of general concern. The development of the LDCs should not be thought of as a humanitarian issue either. Their development will lead to a stronger world economy and gains for all nations. If a concerted effort is not taken by both sides, the world's least developed economies could easily deteriorate to dangerous conditions, a prospect which should not be accepted by the global community.•

American Enterprise Institute for Public Policy Research

AEI

On the Issues

Wisdom from the Pope

By Michael Novak

The pope's splendid new encyclical, "Centesimus Annus" (dated May 1, 1991), adds a new characteristic to his defense of liberty. It has been clear for many years that Pope John Paul II supports democratic institutions more than any previous pope and sees them as the best way to secure human rights. It has also been clear to some that he supports a type of "reformed capitalism." But this new encyclical makes clear beyond a shadow of a doubt that the pope endorses the "business economy," the "market economy," or simply the "free economy" as the goal he now proposes for formerly Communist and Third World societies. This support, even though limited, is very important for his native Poland and many other suffering peoples.

The institutional limitations on capitalism on which the pope insists are two: first, a juridical framework that protects other fundamental liberties besides economic liberty; and, second, a grounding of all liberties in a moral and religious core. In short, the economic system must be limited by a democratic polity and by a strong set of moral and cultural institutions (families, unions, associations, universities, media, churches, etc.). Only in this way will it, better than other systems, meet basic needs and constantly raise the level of the common good of peoples.

Jacques Maritain and Reinhold Niebuhr refer to such a mixed system as "capitalistic democracy." America's founders used the term "commercial republic." Some of us prefer (on the model of "political economy") "democratic capitalism." The name does not matter; it is the political and moral checks and balances that count.

"Centesimus Annus" is 113 pages long in its Vatican edition. Its main purpose is to mark the centenary of the first of all modern papal social encyclicals, Leo XIII's "Rerum Novarum" (May 15, 1891). Whereas Leo XIII warned against the coming scourge of socialism, John Paul II now vividly describes the collapse of "real existing socialism." His chapter three, "The Year 1989," is a particularly brilliant commentary; it was, after all, the year this pope himself did so much to make possible.

There is much that is new and fresh in this encyclical. The pope is a professional philosopher with a very concrete turn of mind. Thus page after page is filled with sustained, complex, nuanced argument, noting the specific differences between Latin America and Africa, Eastern Europe and Western Europe, etc. Regularly, he cuts through slogans. He tries to see the whole human reality true—in its glory and in its self-betrayals.

Yet for readers alert to the main debates of the last twenty years, two contributions of this encyclical stand out. First, the collapse of socialism suggests to him that much in "liberation theology" has been bypassed by events, and in section 42 he proposes as the goal for for-

1150 Seventeenth Street, N.W., Washington, D.C. 20036, 202/862 5800

merly Communist nations and the Third World a new ideal for "integral liberation": democracy and, in the appropriately limited sense, capitalism. This analysis, subtle and nuanced, is little short of brilliant. It has more than fulfilled the dreams (and prayers) of many of us. The market, the pope sees, is an important but limited tool of integral human liberation. Through it surges the creativity that God has endowed in every woman and man.

Second, chapter five, "State and Culture," offers the papacy's strongest language ever about limitations on state power. It includes a trenchant but fair criticism of the human losses involved in the "welfare state" and even more in the "social assistance state." No neo-liberal or neo-conservative ever made the case more profoundly and with so resounding a ring of truth. The pope emphasizes the human side—or better, the anti-human side—of bureaucratic "social assistance." He all but uses the phrase "the little platoons" of society.

The pope's greatest originality, however, may lie in going beyond questions of politics and economics to questions of morality and culture. In a sense, the political argument of the twentieth century has been resolved in favor of democracy; and the economic argument has been resolved in favor of capitalism. Thinking of the chief battleground of the next century, the pope turns to the disappointing use that existing free societies are now making of their freedom. He turns to the inadequacies of modern culture and morals.

Pope John Paul II is a humanist through-and-through. The legacy he wants to leave to Catholic social thought, he says, is that it is made for humans, not humans for it. He places Catholic social thought at the service of the high vocation that the Creator gives to every woman and every man. It is a vocation that we each often fail. The pope describes humans as highly endowed by nature, gifted by grace, and yet, nonetheless, tending often to turn against God and his gifts. His anthropology may be summarized as: "humans simultaneously graced and sinners."

Each society (John Paul II observes) has its own ecology—its own culture, ethos, distinctive shape, and story. Sometimes a culture disfigures the human character of its citizens, pollutes their minds, warps their wills, twists their instincts. Human beings can be made into monsters by their culture. The pope calls for a new science of "human ecology." This means a protracted public inquiry into human nature and destiny. Wrong answers in this inquiry can mean social suicide. Wrong answers always entail the disfigurement of human beings.

You can tell the quality and depth of a nation's culture, the pope trenchantly states, by observing what it produces and consumes. This simple remark imposes a new moral accountability on capitalist firms, advertisers, and media. In this century, the pope thinks free peoples have neglected their responsibilities to the quality of the moral atmosphere, the cultural ecology in which they try to raise their children and to be faithful to their destiny as free citizens.

This is a great encyclical. It will release enormous energies in Eastern Europe, the Third World, and advanced societies. It should read as well in 2091 as Leo XIII's accurate predictions about socialism in 1891 still read today. No other world leader could have produced such a profound *tour d'horizon*. Get a copy and see for yourself. You will be glad you did.

[from the *Washington Post*, May 7, 1991]

Michael Novak is George Frederick Jewett Scholar and director of social and political studies at the American Enterprise Institute. His latest book is *This Hemisphere of Liberty: A Philosophy of the Americas* (AEI Press, 1990).

1991 - # 26

The Changing Role of the State in Development

A leaner, specialized, and more effective public sector is needed to support a healthy private sector

Arturo Israel

A remarkable change seems to have occurred in thinking about the role of government in economic development across the globe during the past decade. Less is now considered better. In other words, increasingly countries of all political hues have been moving to policies that favor a reduced role for the public sector and greater reliance on the private sector. This movement has been so strong that, at times, it has been able to overcome resistance from powerful political and economic interests. There are many reasons for this change in strategy: the growing complexity and international integration of economies makes overly centralized decision-making practically impossible; the proven inability of the public sector to perform well, if at all, the myriad functions associated with an interventionist state; and the excessive politicization and corruption generated by overextended and overbearing public sectors.

But the will to change has not always been matched by the ability to effect a change. As the search goes on for the best ways, particularly in developing countries, to marry the functions of the public and private sectors, so does the controversy over the appropriate role of the state in the economy. At one end of the spectrum are proponents of an almost entirely laissez faire state; at the other end are those who favor a promotional role for the state in private sector-led development strategies.

This article does not take sides in this debate. Rather, its central thesis is that a greatly modernized, efficient, and supportive public sector is key to the success of a development strategy that rests on a larger role for the private sector.

Quality of the state's role

In the pursuit of economic and social development, one can identify the major areas in which changes need to be made to improve the quality of the state's intervention. These include (1) the functions of the public sector; (2) the administrative structures; (3) the procedures followed; and (4) the skills and management systems required.

Functions. Five important functions performed by the public sector need to be identified and improved:

- *The capacity to design, monitor, and implement a consistent set of macroeconomic and sectoral policies.* A consistent and stable set of carefully crafted macroeconomic and sectoral policies is the *sine qua non* of sound development strategies and yields the highest returns. Unfortunately, the developing world is littered with cases of badly thought through and meandering policies, with glaring costs. A preliminary analysis of the successful cases of policy formulation and implementation in developing countries (for example, in Botswana, Chile, Mauritius, and the Republic of Korea) suggests the need for highly qualified staff in key agencies (no more than 200 persons perhaps in larger countries), well versed not only in economic analysis and specialized subject areas but also in communicating across governmental bodies and, crucially, with the political establishment. Such staff are needed, for example, in the ministry of finance, the central bank, the trade agencies, and the main sectoral ministries. Such persons have to be brought to the right posts (with appropriate benefits and status) and then allowed to function.
- *To provide an enabling environment for the functioning of competitive markets.* This can be best begun by dismantling the "disabling" environment through the enactment of the liberalizing policies propounded in recent years, the privatization and liquidation of public sector activities that compete unfairly with private sector ones or are simply nonperforming, and the elimination of restrictions on competition. Legal changes and, perhaps more important, modifications in the functions of the state need to be made. These include the elimination of many controlling and licensing functions—for example, foreign exchange and financial controls, and industrial and transport licensing. Public sector agencies performing such functions have to be dismantled or reoriented. In practice, this has not been easy. In some countries, entrenched bureaucracies with considerable political power have managed to neutralize or greatly reduce the impact of policy reforms. Powerful interest groups sometimes have acted against the adoption or implementation of, for example, reforms to liberalize quantitative restrictions. Yet, in other cases, powerful central leaders have managed to push for such policy changes in spite of bureaucratic opposition. For example, Mexico dismantled quantitative restrictions over the objections of its Ministry of Trade and Industry, and Tunisia abolished the requirement that firms obtain clearance from the Agence des Promotion des Investissements before entering the market.

Another aspect of the enabling environment is the provision of fair and transparent rules and other operating conditions that would allow the smooth operation of the private sector and competitive markets. Such regulation includes not only the overseeing role (e.g., antitrust, prevention of collusion, or

This article is based on a longer paper, "The Changing Role of the State: Institutional Dimensions," available as PRE Working Paper No. 495 (August 1990) from Zeny Kranzer, Room N-9051, World Bank, Washington, DC 20433 USA.

\41\

monopoly) but also the enforcement of financial and technical standards, as needed. It requires a high level of skills (for example, to monitor the banking system), high ethical standards, and consistent political support. Regulatory failure is perhaps the highest risk of a private sector-led development strategy.

Many governmental functions have to be strengthened, and others created, to foster a liberal economic system. These include, as a minimum, the enforcement of technical standards (often a key ingredient for promoting exports), the streamlining of procedures to register property and protect property rights, the enforcement of contractual obligations and disclosure laws, and effective bankruptcy and foreclosure proceedings. In addition, some regulation of externalities is also required (for example, environmental protection), along with establishing mechanisms to assure adequate and accessible information for consumers, producers, investors, and regulators, through disclosure rules and other mechanisms.

Finally, the public sector can play an active or promotional role by creating "positive distortions," or incentives, to promote exports or particular activities in the domestic economy. Some Asian economies (Korea, Singapore, and Taiwan Province of China) have been quite successful in this direction. Such an activist policy, however, requires a delicate balance, both institutionally and politically, which is very difficult to achieve. This is a tall order for any country. The potential for big mistakes is huge; even the best performers have made them.

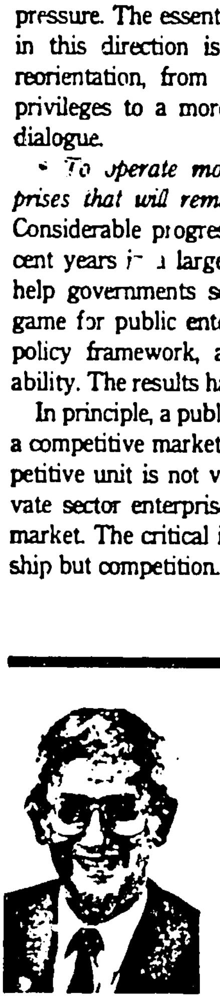
• *To privatize wisely and effectively.* The state has a difficult role to play in the process of privatization. Aside from the political issues, an important factor slowing down the privatization process in many developing countries has been the lack of technical capacity in the public sector to prepare the units that are going to be privatized and then to negotiate their sale, lease, or divestiture. This capacity could reside in a small unit with a few highly qualified professionals possessing technical and political independence. The extensive privatization process in Mexico, for instance, was "masterminded" by a small team at the Ministry of Finance. Once privatization has been effected, the public sector needs persons with the skills to monitor and often regulate the privatized units to ensure that the expected efficiency gains from privatization will materialize.

• *To conduct an effective dialogue with the private sector.* An essential ingredient of the new development strategies is a better dialogue between the public and private sectors, involving a simple and unfettered exchange of information, demands, concerns, and points of view. But this collaborative approach should not produce collusion and the negotiation of privileges on either side. This dialogue is particularly culture-bound and will vary from country to country. It must take place at all levels, but in many countries, the institutions required to facilitate it in both the private and public sectors have to be created or reoriented. Most public sector agencies are not attuned to looking at the private sector as their client, with needs and preferences and with a voice that has to be taken into account. This reflects the traditional top-down orientation of most public sectors.

In the private sector, there is an even wider disparity. At one extreme, the small and powerless private firms, including those in the informal sector, are not organized enough to make their views heard by government agencies. At the other extreme, there are powerful private sector associations (e.g., Chambers of Commerce) grouping the largest productive units, which maintain a strong position vis-à-vis the public sector and have often managed to obtain important privileges for themselves. Many public sector agencies dealing with these groups are weak and yield easily to pressure. The essential ingredient for success in this direction is a substantive political reorientation, from an excessive pursuit of privileges to a more open and constructive dialogue.

• *To operate more effectively the enterprises that will remain in the public sector.* Considerable progress has been made in recent years in a large number of countries to help governments set up clear rules of the game for public enterprises, governing their policy framework, autonomy, and accountability. The results have been promising.

In principle, a public enterprise operating in a competitive market and behaving as a competitive unit is not very different from a private sector enterprise operating in the same market. The critical issue is often not ownership but competition. Indeed, many public enterprises operating in relatively high technology and "hard" activities (e.g., telecommunications, electric power, and airlines) have been able to maintain a relatively reasonable level of operational performance even under unfavorable general conditions. But their performance has been less satisfactory in "soft" activities, such as education or the provision of services in agriculture or health. The largest gains from privatization might come from the soft activities, especially if they can be made to operate in competitive environments.



Arturo Israel
Chilean, is Senior Advisor, Infrastructure and Urban Development Department of the Bank. He holds a PhD from the London School of Economics and has written extensively on the public sector.

Structures. The reorientation of functions discussed above requires a "restructuring" of the public sector. As indicated earlier, a number of agencies directly controlling economic activities (e.g., industrial licensing, foreign exchange and import controls, and price controls) will need to be eliminated or reoriented. However, new agencies or units within agencies will have to be established; for example, regulatory agencies (to oversee the privatized financial sector, capital markets, and technical standards), or those capable of undertaking policy analysis and management. Depending on the circumstances, some regulations could come from the private sector itself. For example, the accounting, auditing, legal, and medical professions may have sufficiently strong internal standards so that the role of the state in their regulation could be minimal.

Because of the nature of their work (mainly economic and technical analysis, instead of the previous processing of paperwork and monitoring of controls in great detail), the new regulatory agencies should be smaller and much more efficient than their earlier counterparts. This is closer to the operation of a think tank and should be managed as such.

Procedures. The proposed reorientation also requires different procedures. Two major changes underline the importance of streamlining decision-making systems. First, the top-down orientation fostered by the public sector cum planning orientation of past development strategies needs to be replaced by an approach that includes beneficiaries ("clients") at all levels. This would reduce the distance between the state and the public. The specific mechanisms for this more open approach are country-specific, and the process is undoubtedly helped by a democratic setting, but several measures could be borrowed from developed countries. For example, procedures should be adopted that permit prior comment by all affected individuals or groups—not just those with vested interests—on regulations or even policy changes. Such procedures should be transparent to minimize the risk of collusion and should inform the public about decisions in a language that ordinary people can understand. Another crucial element is the provision of appeal by interested parties.

The essence of the argument behind these changes is that individuals and private enterprises are willing to take risks, in part, because they have a reasonable assurance that the state will act in a predictable, open, and systematic fashion, treat them fairly, give them a voice, and inform them of results.

The second, closely related issue is the need for efficient points of contact between public sector agencies and private sector operators. This covers, for example, the tax collection system, technical licensing and control, or credit processing, all of which are often appallingly incompetent. The de-bureaucratization program in Brazil of a decade ago, along these lines, had an important measure of success and other countries followed that experience, albeit only partially.

Skills and incentives. The functions, structures, and procedures described above demand a different kind of civil servant and a changed set of incentives for public sector employees. The staff should have sufficient professional stature and integrity not only to conduct a dialogue with the private sector but also to withstand its pressures. They should also be able to speak effectively with politicians. This kind of staff might be available in the country, but often is not attracted or retained by the public sector. Some countries (e.g., Brazil, Chile, India, Mexico, and Turkey) could achieve this objective with relative ease. Others have relatively less "stock" of the type of skills required, particularly in the public sector.

The quality of politics

In discussions about the changed role of the state, there has been surprisingly little analysis of the "quality" or effectiveness of the political process, an essential ingredient of sustained development. An effective political process includes a number of ingredients: a long-term perspective in policy design, instead of a concentration on immediate gains; stable policies; a low level of corruption; and a recognition that political control does not necessarily imply public ownership or operation. Contradictory and excessive political interference in the operations of the public and often the private sectors produces unintended negative results. For example, price controls for public enterprises aimed at reducing inflation result in higher inflation through increased budget deficits, and political appointments of incompetent staff lead to the bankruptcy or discrediting of agencies that were the sponsoring politicians' power centers. Equally important, the political establishment has to understand that saddling central agencies or public enterprises with an excessive number of often contradictory economic, political, and social objectives makes their effective management practically impossible.

Countries should look for additional approaches beyond the obvious answers of improving the democratic process and accountability of the political system. Strengthening the policy-making technocracy (inside and outside the government) could make it a countervailing force against political pressure, as is the case in many developed countries. In general, the more politicians and parliamentarians can be educated and trained to understand the process and objectives of economic policy and decisionmaking, through seminars and visits, and by retaining specialist staff to guide them, the better the political process will be for development. ■

World Bank News, May 2, 1991

World Bank to Shift Urban Development Strategy

Projecting that two-thirds of the world's population growth expected by the end of the decade will be in cities and towns, the World Bank announced a shift in its approach to urban development in a policy paper released April 29. The new report, "Urban Policy and Economic Development: An Agenda for the 1990s," redefines the urban challenge in developing countries and calls for a change in approach "to put development assistance in the urban sector in the context of broader objectives of economic development and macroeconomic performance."

Because 20 of the 25 largest cities in the world will be in developing countries by the year 2000, said Michael Cohen, the principal author of the policy paper, "it is critical that increased attention be paid to urban productivity and its linkage to macroeconomic performance, environmental deterioration and growing urban poverty."

The new report was developed in the midst of increased concern over the growth of urban centers. "With more than half of the people in the developing world living in cities," said Cohen, "the World Bank recognizes the need for a new policy framework and strategy that links assistance in urban areas to the broader objectives of economic development."

"The policy paper identifies four major gaps in addressing pressing urban problems," according to Mr. Cohen, World Bank Division Chief for Urban Development. "Emerging urban priorities include increasing productivity, attacking urban poverty, addressing a growing urban environmental crisis, and filling a serious research gap in current understanding of the urban development process."

The paper lays out a policy framework and strategy to address the Bank's priority issues in future urban development:

- The Bank will move toward a broader view of urban development that emphasizes the productivity of the urban economy and the need to reduce the constraints on productivity.
- Because of the growth of urban poverty, the Bank will help enhance the productivity of the urban poor by increasing the demand for their labor and improving their access to basic infrastructure and social services.
- The Bank will devote more attention to reversing the increased deterioration of the urban environment.
- A serious gap in the understanding of urban issues must be closed, with priority on the linkages between the urban economy, the macroeconomic framework, the internal efficiencies of cities, urban poverty, and the role of government in the urban development process and the urban environment.

More attention should be devoted to reversing the deterioration of the urban environment.

Cohen observed that, "Better management of the growth of cities is particularly important to developing countries because urban activities are making an increasingly significant contribution to national economic output."

More than 60 percent of most developing countries' gross domestic product, according to the Bank report, is produced in urban centers, and the importance of cities in national economies is expected to grow. "In many Latin American countries, the future urban share of gross domestic product is projected to be as high as 80 percent."

In addition to productivity, the Bank's policy paper includes urban poverty and a "growing urban environmental crisis" as priority issues. The report states that "In 1988, some 300 million urban residents--about a quarter of the total urban population--lived in poverty." The new policy paper echoes the concern of the World Bank's "World Development Report 1990," which concluded that "urban poverty will become the most significant and politically explosive problem in the next century."

Urban environmental concerns are another important focus of the policy paper, which urges that "more attention should be devoted to reversing the deterioration of the urban environment, an issue receiving short shrift in the face of global environmental problems."

Copies of the paper are available free to journalists by writing, on company stationery, to the World Bank Information and Public Affairs Division, Room T-8028, Washington, D.C. 20433, U.S.A.

LOS ANGELES TIMES, June 7, 1991

World Gets More to Eat, Africa Gets Less Than Ever

■ **Hunger:** Agricultural fertility can't keep up with human fertility; the entire continent now subsists on handouts.

By JONATHAN POWER

HELSINGOR, Denmark—War in Africa has been a primary cause and exacerbater of famine. But don't make the mistake of thinking that, because in the last few days the wars in Angola and Ethiopia have been wrapped up, the great hunger stories are over. Africa's agricultural problems are just too severe, its climate too harsh and erratic, its soils too poor, its governments too mismanaged and its population growth out of control, for any imminent solution to be on the horizon, or even over it.

This weekend, here in Hamlet's home town, agricultural ministers from most of the world's countries are holding their annual get-together under the auspices of the United Nations' World Food Council.

The report they have been given on the state of agriculture in Africa was the most devastatingly pessimistic document I've heard or read for a long time. Anyone who was dreaming, as I was, that there are hopeful signs got a rude shock. Yes, I've seen how Zimbabwe has geared up its peasant small-holders to the point where they produce sizeable export surpluses year after year. I've watched, and been inspired by, the technical wizardry of anti-pest programs sponsored by the International Fund for Agricultural Development; they have knocked down the screw worm, which threatens livestock, and the mealy bug, which was eating its way through the continent's main food staple, cassava. None of this—or all the other bits and pieces of progress—seems to have made a dent in the macro-statistics.

The last 20 years have shown beyond a shadow of doubt that Africa has the highest average increase in population in the world and the least productive growth in food output. While it's true that the number of poor and hungry is rising in all Third World countries, in Asia the increase in numbers—an extra 10 million since 1970—is minuscule compared with the successful feeding of the hundreds of millions of extra mouths that weren't around 20 years ago. In Africa, a much less heavily populated continent, the number of hungry has increased in that time from 92 million to more than 140 million.

But it is the outlook for the future that really startles. Today, Africa's food production shortfall is about 8 million tons. Much of it is made up with food aid. By century's end, the need will climb to 50 million, and by the year 2020 to a staggering, unimaginable, 245 million tons.

Even this is a benign estimate. It assumes that food production grows at 2% a year. The recent average is 1.7%. To keep food imports from rising to the sky would mean a modern miracle—increasing home-grown production by 4% a year, combined with a sharp decline in fertility rates.

In the rest of the Third World, the overwhelming majority of people are getting more food every year. In Africa, at least half eat less than they did in 1970. This year, drought has returned with a vengeance to Ethiopia and all of the countries bordering the Sahara. The emergency need for food aid is larger than during the great famine years of 1984, '85 and '86 when Bob Geldof and Harry Belafonte pushed us to be generous in a style we haven't been accustomed to, before or since.

Africa is not like Bangladesh, with its torrential storms and floods, or Guatemala, with its earthquakes, hit hard every 10 years. In Africa, disaster is the melancholy wheel of everyday life, forever turning.

The likelihood of introducing dramatic improvements in African agriculture on a wide enough scale to make a real impression is slim.

Comparison with the Asian Green Revolution highlights the difficulties. Irrigation was one of the secrets of Asia's success. But in Africa, dam-based systems have cost astronomical sums and given low returns. Research on yield improvement of crops traditional to Africa is still in its early stages. Meanwhile, soil fertility is worsening and the growth rate in fertilizer use is actually declining. As for aid programs, we have to be brutally honest—they have, in the main, a dismal record of failure.

If governments and aid agencies cannot resolve the problem, nature has its own way—at worst, tens of millions of people dying of hunger, at best living on meager handouts from U.N. and Red Cross food trucks. Africa will become a continent-wide Bronx, living on welfare. What we've seen already on our television screens is minor compared with what is to come.

Hamlet-like, we can go on being indecisive about what to do, discussing the options interminably. Or we can move on the problem immediately, casting aside the multitude of badly coordinated, often competing, incredibly duplicating and time-consuming individual efforts. We need a High Commission for Africa for 20 years, running development programs like Gen. Douglas MacArthur ran Japan. But this can't happen in a continent so proud of its recent independence. Perhaps there is a middle way if African leaders themselves are clever enough to come up with it. They must hurry. "The slings and arrows of outrageous fortune" give little time.

Jonathan Power is a London-based contributor to the International Herald Tribune.

147

Time To Turbo-Charge East European Development

by Holger C. Wolf

An M.I.T. Economist Highlights the Pitfalls of Fine-Tuned Incrementalism

ONLY A YEAR AGO PUNDITS TOUTED Eastern Europe as the new frontier, the land of opportunity. But low wages and the skills of yesteryear are apparently not enough: the investment trickle has not swollen into the anticipated flood. East Germany, arguably the healthiest among the stricken, has managed to privatize a scant 1000 of its 8000 firms. What has gone wrong?

Less than fully appealing fundamentals form part of the answer. Miracles are not created out of thin air. They require a solid supply-side underpinning: stable money, attractive tax rates, secure property rights and a government attentive to the needs of investors. Ludwig Erhard, Germany's miracle doctor of 1948, understood this. His medicine combined a drastic reduction in tax rates with a conservative monetary policy. It was administered by a government credibly committed to eliminating obstacles to investment. Of course, government policy is not sufficient. A long-term responsible union wage policy can do wonders for investment. The willingness of West German unions to accept real wage increases falling short of productivity growth for a decade after the war played a crucial role in the so-called German "economic miracle."

The emerging market economies of Eastern Europe have yet to learn from history. Real wage increases outrunning productivity growth, muddled property rights, hostility towards foreign investors and the occasional monetary overhang discourage capital inflows. As of now, investors have not lost interest. Yet sooner or later Eastern Europe will have to deliver or risk discovering to its detriment that foreign investment is a suppliers' market. Portugal and Spain present attractive alternatives, as do liberalized Mexico and much of Asia.

The grace period for the East European reformers is drawing to a close. The fate of free marketeers in 1980s Latin America illustrates the limits of public patience in fragile new democracies. Populism lurks in the shadows of pro-market reforms, ready to pounce if not checked by visible, sustained successes.

Foreign direct investment will be crucial if reforms are to survive the initial critical phase in which most of the costs are bunched but few of the eventual benefits of restructuring are already realized. On the political front, visible investment projects provide a welcome confirmation that the painful reform pro-

Dr. Wolf is a Professor of Economics at M.I.T.

146

cess is bearing fruit. On the economic front, foreign investment starts the urgently required transfer of technology and management skills. In economies used to treating service and consumer satisfaction as alien concepts, managerial know-how assumes a decisive role. West German firms rapidly captured dominant market shares in East Germany even for so standardized a product as butter.

Rapid privatization of enterprises thus forms the linchpin of successful reform. If a "critical mass" of investment can be attracted, the visible success of the reform program generates the public support necessary for the continuation of pro-investment policies and thus a speedy recovery from the present doldrums. If not, the East European Wunderkinder of today will turn into the problem children of tomorrow.

Why is investment so sluggish? Waiting pays. Paraphrasing Keynes, it is better for reputation to fail conventionally than to succeed unconventionally. But where is the downside risk of the apparently so tantalizing investment opportunities? At bottom, uncertainty about the permanence of pro-investor policies in combination with the irreversible nature of physical investments is to blame. The sturdiness of the commitment to low profit taxes and real wage constraint in turn depends fundamentally on their perceived success. In other words, it depends precisely on their ability to attract investors.

The mutual dependence leads to self-justifying waves of optimism and pessimism. If sufficient investment comes in, the resulting rapid growth provides a compelling argument for continuing pro-market policies, validating the initial investment decision. Ludwig Erhard was able to maintain his pro-market policies against the resistance of a large fraction of the population (and the Allied Powers) precisely because he could point to their evident success. Pessimism likewise is self-validating. If investment remains a trickle, the lure of populism, finding its expression in high capital income taxes and excessive real wage growth, may well carry the day, justifying the initial decision to stay out. The developments in Poland and East Germany over the last few months illustrate the reality of this option.

The trick then is to attract a "critical mass" of investment and to do it fast before public support for the market evaporates. Once sufficient capital has been committed, the investment process will become self-reinforcing and irreversible. How to attract the early investors? Moral suasion (arm twisting?) is the easy way; Germany has applied it with some success.

East Germany is a special case, however. None of the other post-socialist economies of Eastern Europe can rely on a financially strong partner to provide the booster funding. The answer here is enticements. The early investor improves the chances of successful reform by sending a signal to other, still vacillating investors. The benefits from his decision accrue partly to the host government, partly to future investors. A strong case for compensation can be made. Discounts on state-owned assets for "early birds" and bonuses against future tax liabilities are sensible options.

To date, East European governments have failed to appreciate the crucial interdependence linking individual investment decisions. Privatization strategies resemble those successfully used in the OECD over the last decade, aiming to extract a "fair" price for each enterprise and proceeding one firm at a time. The strategy is self-defeating.

Privatization in the OECD took place at the margin, permitting a reliable valuation of assets and prospects. In contrast, privatization in Eastern Europe is wholesale; it takes place in an economic desert providing precious few guideposts. Determining a "fair" price for an individual enterprise independently of the privatization prospects for the remaining firms becomes a dubious exercise at best. Setting non-contingent minimum prices in these circumstances is a sure-fire way of perpetuating the monolithic state sector. Early investors have to be compensated for the higher risk of failure, latecomers may be willing to pay a premium for entering a successful market.

In the end, the market itself provides the best mechanism to price firms. The sensible strategy ensures broad access to the bidding process for all interested parties and accepts the highest offer, however low it may be. To argue that such "firebrand" sales imply a sell-out of national wealth is to miss the point: privatization has become necessary because management has persistently failed to achieve even minimum levels of economic efficiency. Any loss in privatization revenues now may well be dwarfed by the losses of inefficient, directionless monoliths lumbering on while awaiting the elusive "fair" bid.

The emphasis right now must be squarely on speed. Maintaining public support for the reform program requires early successes. Fine-tuning the privatization process is self-defeating; the pro-market mood will not persist if results are not achieved. A relapse into populism is the unavoidable consequence. ◆

1471

What Eastern Europe Can Learn from Mexico

by Jose Angel Gurria

One of Mexico's Most Senior Strategists Lists the Key Steps to An Economic Turnaround

IN MANY WAYS, THE CHALLENGES confronting Eastern European nations today in their struggle to implement profound structural reforms parallels the situation faced by many Latin American countries since the mid-1980s. In the case of Mexico, a truly far-reaching program of reorientation and adjustment has been implemented since 1982, touching upon problems such as the straightening out of public finances, the execution of a privatization program, dealing with an external debt overhang, plus more fundamental aspects involving a change in economic agents' perceptions regarding the country's economic health and its future prospects. These are also principal areas of concern for evolving Eastern and Central European countries today.

By virtue of having an eight-year head start in some of these matters, I think that the Mexican experience offers certain insights which, despite the vast differences in underlying conditions, may benefit other countries. What follows are four key areas of economic policy which may have a bearing on the Eastern European situation: (1) stabilization policy, (2) privatization policy, (3) external debt management, and (4) the opening up of the economy.

I. Stabilization Policy

Stabilization of the economy, taken here to be represented by such indicators as relatively low, stable inflation, orderly financial markets, a sound currency and the establishment of policy credibility, will depend in the first instance on sound public finances. The size of the effort which needs to be made is usually extraordinarily and politically difficult. In Mexico, the public sector's financial deficit has been reduced from 16.9% of GDP in 1982 to a projected 1.9% of GDP for 1991, though the latter figure could easily end up being even lower if one-time gains from privatizations are counted. At the same time, the amount of total public sector expenditure has been reduced from 44.5% of GDP in 1982 to current levels of about 30%. More impressively, non-financial expenditures have been reduced by half over the same period from 36.3% of GDP to 18.5%.

The costs of putting public finances on a sounder footing have been undeniably high, in terms of the contractionary effect that this had on the economy in the initial stages. However, the payoffs are now becoming

---

Mr. Gurria is Undersecretary for International Financial Affairs in Mexico.

\\45

evident. For instance, the reduced pressure on domestic debt markets brought about by lower deficits, together with the perceived sustainability and credibility of fiscal policy, and the confidence generated by successfully concluding a decisive debt renegotiation in 1989 (itself due in great part to Mexico's coherent economic policies) have led to a dramatic drop in real interest rates from a peak of 45% in 1989 to current levels of about 7%. This, in turn, has provided the government with the room to switch the direction of expenditures from debt service to more productive activities such as health, infrastructure and education while maintaining strict control on total expenditures. Thus, in 1991 social expenditures will rise by 15.7% in real terms, even though the financial deficit will decrease from 3.5% of GDP to 1.9% or less.

These results are only possible if a government gains the public's trust by being credible, which itself can only be achieved through the consistency of its policies. The crucial point here is that once a coherent strategy has been mapped out and targets set, there should be no wavering, especially for reasons of political expediency. Wavering will quickly lead to a loss of credibility and make a second attempt doubly difficult. The implementation of painful economic measures, we have learned, is made successful as well as politically palatable when the policies are agreed upon by consensus. In other words, a successful stabilization program will be one in which the costs of adjustment are seen to be borne fairly. In this context, "fairly" does not necessarily mean "equally." It is primarily because economic policy was arrived at and carried out through a tripartite agreement between labor, business and government that Mexico was able to reduce inflation from a peak of 160% in 1987 to the current annualized rates of less than 20%. Success in this respect is impossible if the government is seen to be "waging war" on the business or labor sectors.

It is better and more efficient to declare a bankruptcy than to maintain a firm which is bleeding the Treasury's coffers.

II. Privatization Policy

Mexico has pursued a large-scale privatization program since 1983, accelerated in 1987, under which the number of firms remaining in the public sector has been reduced from 1,155 in 1982 to 280 in 1990. Even now, 137 are in the process of being privatized. The firms privatized have ranged from small enterprises to the largest concerns in the country, such as the telephone company, mines, the airlines and, currently, the commercial banks. This has been a formidable effort, but will probably stand small in relation to the magnitude of what needs to be done in Eastern Europe. There are four points that need to be made with respect to privatizations.

First, there is an important justification for embarking on a privatization program when the State is in control of a substantial portion of a country's productive apparatus: economic efficiency. Because a state-run enterprise will not necessarily respond to market forces, the public will typically encounter lower quality services than would otherwise be the case. At the same time, the central government will over time end up providing subsidies, as these firms tend to experience losses. Economic efficiency argues for privatization.

In Mexico, we have also pursued privatization assiduously for a second fundamental reason. Underpinning both the restructuring of public finances and the privatization program is a reorientation, or rather, an affirmation of the State's priorities. For example, in the case of the national telephone company, Telmex, we have an exception to the rule of the inefficient state enterprise. Immediately prior to its privatization, Telmex, though lacking modernization, was earning over one billion dollars per year. Telmex was privatized primarily because it competed for the government's scarce investment resources which could otherwise be destined for urgent social services. In other words, in the face of pressing demands for more and better schools, roads and hospitals, it is practically unjustifiable for the State to be concerning itself with optical fibre technology, or similar concerns in banks, mines, or airlines. Only by extricating itself from its web of non-strategic parastatal enterprises can the central government concentrate and make efficient use of scarce resources in priority areas which are in its natural purview.

Third, not all enterprises under state control are, or can be, going concerns. It is better and more efficient to declare a bankruptcy than to maintain a firm which is bleeding the Treasury's coffers and is unlikely to be viable in the private sector. When necessary, bankruptcies send a clear signal to society that the government knows and is committed to what it is doing, and that it is ready to do whatever is needed to permanently correct inefficiencies that adversely affect the public as a whole.

Fourth, a privatization program should be pursued gradually, making the most of market opportunities as they arise, in order to maximize the government's proceeds. A fire sale is clearly in nobody's interest. We have found that the government has maximized its revenues by selling the right firms at the right time to the right buyer. In the initial stages of the process, it was appropriate to sell smaller concerns both to test the market as well as to gain the necessary administrative expertise needed to hand over public concerns. As Mexico's structural reform program took hold and public confidence increased, it became opportune to sell larger concerns and at a higher price than would have been the case a few years earlier.

The burden of debt is not only financial but also psychological.

III. External Debt Management

As has been the case for many Latin American countries, including Mexico, there are a number of Central and Eastern European countries suffering from an external debt overhang. Unlike the former situation, however, the external debt of the latter countries is predominantly official debt as opposed to commercial bank debt. An excessive level of net resource transfers abroad will impede the ultimate success of any economic reform program, by hindering growth and presenting an obstacle to the elimination of inflation. The burden of debt is not only financial but also psychological. It weighs heavily on the public's perceptions of the viability of the economic program, creating uncertainty, while foreign investors are daunted by the political and economic risks posed by an unsustainable level of transfers abroad.

A successful renegotiation of a country's external debt, whether commercial or official, can only occur once it has been made manifest to all creditors that despite profound structural reforms, the country still suffers from excessive external indebtedness. Moreover, it is difficult to know by how much the country's debt needs to be reduced until all internal efforts have been exhausted. Once a renegotiation is concluded, however, it will have a catalytic effect that leads to a virtuous circle of increasing confidence, reflected in the domestic financial markets in higher domestic and foreign investment, capital repatriation, voluntary access to the international capital markets and further consolidation of public finances and inflation control.

The Mexican experience highlights this process very clearly. Prior to 1989, Mexico had already effected drastic reforms in both the external and internal sectors of the economy, a sharp turnaround in public finances. We had made strong headway in beating inflation. However, due partly to lags between lower inflation figures and lower nominal interest rates, but mostly to a stubbornly high level of perceived risk, real interest rates on government instruments were extremely high at 45%, as mentioned previously. This situation coincided with the negotiations between Mexico and its commercial banks during the early part of 1989, when the outcome of these was still far from being clear. In the same week that an agreement in principle was concluded, domestic interest rates dropped by 22 percent. This was followed by a partial rebound and then a gradual decline to current levels of just over 20 percent, with real interest rates hovering around 7 percent. As mentioned previously, this has been a tremendous boon to public finances and has helped consolidate and build on our stabilization efforts. At the same time, between January 1989 and March 1991 more than 4.8 billion dollars of capital have been repatriated, 6.9 billion dollars of foreign investment have been disbursed and a further 2.5 billion dollars have entered in the form of portfolio investment in the Mexican stock market, which has been one of the world's leading performers in the past two years. In view of the lower risk perceived by international investors since Mexico's external debt was renegotiated and the debt overhang eliminated, Mexico has been able to return gradually to the international capital markets with nearly $3 billion of public and private offerings over the last two years.

Finally, with regard to external debt management, note that achieving a solid, comprehensive agreement that puts to rest any fears regarding possible future renegotiations is even more important than achieving a large discount on the debt. The deal must be such that economic agents cease bringing up external debt as a topic of discussion, i.e., "permanency" must be established. Ultimately, the success of a deal will hinge not just on such factors as whether there should be a few more points of discount or a certain number of basis points less in interest paid. Instead, it rests on many other issues as well, such as the amount of debt being restructured, the maturity, the defeasance of principal payments through matching zero coupon bonds, and clear support by the international financial system for what is being done.

IV. Trade and Investment Liberalization

Trade and investment liberalization are fundamental elements of structural reform for inducing microeconomic efficiency and for consolidating macroeconomic stability. Mexico's experience has been that it is better to introduce these liberalization reforms quickly, but at the right moment. By implementing rapid liberalization, economic agents are better assured of their irreversibility, which might otherwise occur if the measures are adopted gradually. Such quickness also clarifies the regime for investors and removes any uncertainties as to the timing of further reforms. However, certain preconditions should be established before embarking on a rapid trade liberalization. The most important include a relatively high level of international reserves, a moderately undervalued currency and a moderate rate of expansion for domestic demand. The initial response of the private sector to a commercial opening will be an import boom, especially of consumption goods, which is followed by a boom in the import of capital goods as the irreversibility of the policy becomes apparent. A trade opening will have further beneficial effects on the stabilization of inflation by keeping the prices of goods and services down as domestic producers face increased competition. This can only occur, however, once the fundamental cause of inflation, a high public sector deficit, has been removed.

An indispensable condition for development is to have positive or at least neutral external resource transfers. In a post-debt world, private investment flows take on increased significance as a non-debt-creating complement to internal savings and investment. Besides affording the recipient country the benefits of improved technology, foreign exchange availability and employment creation, foreign investment has a positive psychological impact on potential domestic investors. One of the dilemmas posed by a rapid reform process which almost inevitably leads to transitional costs in terms of growth is that during the adjustment process itself the country may not seem attractive to foreign investors. This can be the case, despite recognition that the reforms, including those which deregulate foreign investment, will eventually make the country a good investment bet. It is for this reason that foreign investment flows may be sluggish at first, and accelerate towards the end of the structural reform process. The pitfall to be avoided is to overestimate these flows in the early stages, a problem which may currently be affecting evolving Eastern European countries.

The initial stages of reform are the most trying. But the appearance of positive results will make further efforts more palatable and easier to accept.

In conclusion, we Mexicans are convinced that we have chosen the right path since 1982, but it has been a hard lesson. The ultimate success of our program lies, as it will in other countries, in the solidarity and hard work of the people. Designing the optimum economic policies is a relatively easy task. Making them succeed requires a tremendous will involving all sectors to ensure that the goals set are achieved. It is clear, though, that the government must take the lead and set an example. I also believe that the clear support of the international financial institutions, especially of the multilaterals, is of fundamental importance in the initial stages of an economic reordering. Once a country is better able to stand on its feet, it can continue its recovery with less and less assistance. The learning process over this period is slow. The initial stages of reform are the most trying. But the appearance of positive results will make further efforts more palatable and easier to accept. There are still many challenges facing our economy, as in Central and Eastern Europe, but we are confident that what has been learned in Mexico in the past decade will be of great use in easing the road, both for us and for other countries. ◆

151

Managing Director's Address . . .

Camdessus Outlines Multilateral Strategy for Economic Recovery in the Middle East

Following are excerpts from remarks by Michel Camdessus, Managing Director of the IMF, delivered before the Conference Board of Canada in Toronto, Ontario, on March 19:

I would like to offer you some comments on the prospects for the developing countries, with particular emphasis on the basic conditions for sustainable economic progress in the Middle East.

For it was there, of course, that the impact of the crisis that began last August was the most extensive and damaging. I need not dwell on the great human suffering and losses that fell on those directly affected, nor on the widespread physical destruction in Kuwait and Iraq, and the damage to the environment. Normal economic activity in those two countries, and in Jordan, was suspended. Other countries in the region, notably Egypt and Turkey, also suffered severe losses, including the loss of export earnings, including workers' remittances and tourist receipts. These losses are estimated at approximately $3 billion for 1990, and almost three times that amount in 1991. The oil exporting countries in that region also experienced adverse consequences, on balance, because the benefits of higher oil revenues were more than offset by substantially higher expenditures associated with the war, including military and economic assistance to other countries.

A Kuwaiti oil field burns out of control: rapid progress is needed in the urgent work of reconstruction and repair of war damage.

Looking ahead, it is obviously difficult to comment on the outlook for the Middle East countries. But I would hope to see a gradual recovery in activity in the region *provided* rapid progress is made in the urgent work of reconstruction and repairing the war damage, re-establishing the trade and labor market links, and pursuing sound economic policies.

Clearly, the period of reconstruction, and more broadly of economic and financial restructuring of the region, will be uneven and demanding. The economic challenges will be inextricably connected to the resolution of political questions, on which I will not comment. But I am sure that the prospects for reconciliation and for a lasting peace in the region will be stronger, if conditions for sustainable economic progress are created, and vice versa.

Without attempting to be exhaustive, let me briefly mention five basic ingredients of a postwar economic strategy to help the economic recovery of the Middle East, in a truly multilateral framework;

• first, and most important, recognition of the need for sound economic policies in each of the countries, supported by effective international cooperation, to deal with long-standing problems resulting from weaknesses of past policies. It is clear that no solution will be found to the persistence of great poverty if the countries do not correct these shortcomings;.

• second, a reinvigorated effort to implement structural reforms aimed at strengthening the economies. Some of these countries had embarked on such reforms, before the crisis, but much more needs to be done; in particular, they need to simplify, and make more transparent and even-handed, the regulatory environment (so that it is, among other things, conducive to private foreign investment); to promote efficiency by liberalizing prices; and to open their economy to international trade.

• third, an adequate availability and effective utilization of financing, in some cases on concessional terms, to support well-designed economic policies. This should include a readiness of the wealthier countries in the Middle East to step up their contributions to multilateral efforts to bring about strong economic recovery.

• fourth, there will have to be an exceptional effort of debt reduction for several countries to help get rid of the legacy of past mistakes, and remove serious obstacle to growth, provided they implement strong and credible adjustment efforts.

• fifth, it is essential for these countries to concentrate domestic resources on productive investment, which will be a key factor for sustainable development and peace in the region. There is, therefore, also a need, preferably within the framework of a global political arrangement, for an imaginative international effort to reduce the need for—and the provision of—arms in the area. To stick only to the economic aspects of this, think of the harmful consequences of excessive spending on arms for the budgets, balances of payments, and debt situation of many developing countries (and not only those in the Middle East).

On this topic, let me pay tribute to the recent initiative by Prime Minister Mulroney in raising for discussion this important question of limitations on arms sales. Indeed, as a clear signal of the determination by the international community to create a strong framework for reduced tensions in the Middle East, why shouldn't the arms exporting countries impose on themselves a common discipline that would effectively support the efforts that are expected from the countries themselves? To be more precise, couldn't they study carefully the possibility of a ban on export credits for arms sales to the Middle East? I am truly mindful of the difficulties in the way of such an arrangement. But the objective is important enough to warrant the effort.

These are five possible elements of the sort of framework that comes to mind that would help establish a solid basis for postwar financial stability and economic progress in the Middle East. Clearly the list is not exhaustive. What is essential is that these issues are considered urgently, and action taken soon . . . .

* * * * *

The most striking feature of the reczent performance of the developing countries remains the contrast between the situation of those countries that did, and those that did not, show determination in implementing far-reaching structural reforms to enhance the role of market forces in the allocation of resources, and to open up the economy to international trade. More developing countries are now following this strategy, in order to establish the foundation for the sort of sustained economic expansion that was achieved over the past twenty years by several Asian countries. These structural reforms are, in many cases, complemented by monetary and fiscal policies designed to correct large macroeconomic imbalances. Indeed, a number of developing countries have successfully implemented such programs, and the prospect now is for continued growth in these countries. In many other developing countries, unfortunately, the macroeconomic imbalances are expected to continue to affect adversely their economic performance . . . .

It is against this background that I would like now to focus on three aspects of the financing problems of the developing countries and then on three elements of the industrial countries' responsibilities.

First, and most basic, the developing countries face an economic environment characterized by a severe shortage of savings, at a time when worldwide investment needs are rising sharply. The savings performance of both the industrial and many developing countries has been disappointing for some time, and shows no immediate signs of recovery. The reasons are pretty obvious—they include the large fiscal deficits of many governments, as well as disincentives to private saving in many countries, including high inflation and other manifestations of unsettled economic conditions. On the investment side, the rising needs of the industrial and developing countries have recently been augmented by some special situations. In particular, it is clear that the transformation of the Eastern European countries, [and] the Soviet Union, and the reconstruction of the economies most severely damaged in the Middle East war, will require large exceptional investments in the coming years.

"The savings performance of both the industrial and many developing countries has been disappointing for some time . . ."

A *second* point, related to the first, is that many of the developing countries face a difficult situation as regards their traditional sources of external finance. In particular, the last DAC [Development Assistance Committee] report forecasts only a modest nominal increase in ODA [official development assistance], at best, in the next few years. This is not encouraging. In addition, the countries with debt difficulties are, for the most part, unlikely to resume borrowing from commercial banks, and certainly not on the scale of the period before the debt crisis. Some countries, especially Chile, Colombia, Mexico, and Venezuela, have been able to secure market borrowing, but others, including some countries that had avoided debt difficulties, are finding their access to bank finance limited. This is in part because of the move, in the industrial countries, toward a financial strengthening of the banks, through increased capital/asset ratios and more adequate provisioning requirements. This leads me to two conclusions: that the developing countries must pay close attention to improving the *quality* of investment; and that they will need to rely increasingly both on domestic resource mobilization, to meet their investment needs, and on nonbank forms of foreign financing.

Third, it is apparent that the most practicable way to improve significantly the medium-term growth prospects of the majority of developing countries is by a determined effort both to raise domestic saving and to eliminate market distortions, and thus to give priority to investments with high rates of return, as integral parts of a balanced, growth-oriented adjustment strategy. In practice, this requires a combination of macroeconomic and structural policies to lay the basis for a sustained and sound growth.

A destroyed jewelry store in Kuwait City: widespread physical destruction and great human suffering and losses.

* * * * *

This brings me to my last major subject for this evening, the contributions that the industrial countries can make to development. For them, also, I will stress a three-point agenda.

In view of the shortage of global savings, which I mentioned a moment ago, you will not be surprised if I stress *first* that one of the most useful contributions that the industrial countries could make, would be *to strengthen their own fiscal performance*. This is particularly true of those countries that have been running large budget deficits, and thereby making sizeble demands on global savings. Decisive action to reduce these deficits would free up resources for the developing countries, and easing the burdens on monetary policy would make possible a significant reduction of interest rates, to the benefit of all.

Trade liberalization is another key area of global interdependence where the industrial countries can make an essential and very important contribution to the prospects for the developing world. It is commonplace to say that trade is more important than aid, but it is true nonetheless. The importance of maintaining open markets, and indeed broadening the access to industrial country markets of imports from the developing countries, cannot be emphasized often enough.

Third, although I regret that we cannot project a substantial increase in *official development assistance*, this makes it all the more important that the industrial countries do everything in their power to ensure that the scarce development resources are channeled in ways that best contribute to genuine growth. One way they can help this is by ensuring that their assistance is directed to countries that have good policies, and another is by streamlining their disbursement procedures. Also, they could increase the proportion of grants in their assistance, and improve the terms and conditions of their loans. And there is undoubtedly scope for further actions by bilateral creditors in the area of debt relief through the Paris Club.

DEVELOPMENT CONNECTIONS

NEWSLETTER OF THE WASHINGTON CHAPTER OF THE SOCIETY FOR INTERNATIONAL DEVELOPMENT

Vol.XI , No. 8
May 1991

HUMAN RIGHTS AND DEVELOPMENT: TWO HALVES OF THE SAME WALNUT

by Marah de Meulė

"The indivisible union of human rights and development" was the subject of the March 21 chapter dinner. Although inextricably bound, human rights and development have evolved along "different paths," and presently are considered disparate entities. The result of such an evolution, according to one of the two speakers at this event, SID Board Member Goler Butcher, is the pressing need for a "fundamental reassessment of the cooperative efforts" of development workers and human rights activists, and the beginning of "joint strategizing." Yet this separation has proven an effective route for human rights groups. The other speaker at the dinner, Amnesty International's Kurt Goering, noted that his organization's success stems from its assumption of "a very specific role in the overall spectrum of human rights work." Their concern with civil and political rights, through the focus on imprisonment, is necessary for the evolution of a society "where each person's dignity is respected and realized." Such a society, according to Butcher, is the common goal of human rights and development work. Civil and political rights constitute only half of the solution; social and economic rights — "the concern of development" — represent the second half of the equation. "Any debate on the priority of emphasis between civil and political rights, and economic and social rights confuses the issue and is myopic," warned Butcher, "for each set of rights is both dependant upon, and ultimately meaningless without, the other."

Civil and political rights constitute only half of the solution; social and economic rights — "the concern of development" — represent the second half of the equation.

Drawing upon her field experience as the assistant administrator for Africa at USAID, and her legal expertise — she is a professor of law at Howard University — Butcher offered several explanations for the divergence of the human rights and development fields. An underlying cause has been "the historical development of human rights law." Such law has been predicated on the "concept of an individual having certain rights against his own government;" thus "these kinds of rights are basically limitations upon the scope of one's own government's freedom of action." Development concerns, such as social and economic rights, "proceed from a different view of government, of the citizen's relation to government, and of the role of government." The goals of development require a more activist government, one that will help "secure for the individual not only dignity under the traditional western view of human rights, but certain of his basic needs." Butcher cited the Universal Charter on Human Rights as a document that has been able to successfully assimilate the two types of law into "a common standard of achievement for all peoples and all nations."

A second reason for the divergence is "the cost of including development and social and economic rights in our concept of human rights duties, since acknowledging these rights would incur great financial, economic, and political costs." A crucial step to integrating such concerns would en-

See HUMAN RIGHTS page 2

HUMAN RIGHTS

Continued from page 1

tail "conceiving of aid on a need basis, not a political one." The politicizing of aid, exemplified by "shibboleths such as 'we are conditioning our aid on progress towards democratization'" has the unfortunate effect of "cutting the poorest people — even though they may have despotic governments — out of the aid pot." Amnesty International (AI) can cite a plethora of facts regarding the detrimental effects of politics on human rights efforts. Essential to the mission of AI has been a standard of impartiality: "Amnesty tries to oppose the abuses that it opposes in every situation where it has the information; we try to uphold governments to a single standard." Conversely, a second "part of what we try to do is to hold our own government to a single standard of human rights. At this particular moment, we feel that this is very important."

The response, or more accurately, lack of response, of the US government and the international community to the documented human rights violations occurring in Iraq over the previous decade constitutes "one of the examples of (the) really appalling hypocrisy that we face," stated Goering, deputy executive director for programs of Amnesty International-USA. AI "had been producing report after report on Iraq for more than ten years." But it was only when "the victims happened to be Kuwaiti rather than Iraqi or Kurd," and criticism of the Iraqi government was more politically expedient, that "it became an issue that this administration and many in government became rightfully very concerned about." The UN has been equally remiss. According to Goering, "After Saddam Hussein had twice used chemical weapons against his own population, and after he had engaged in a widespread pattern of torture and execution, ...the UN Human Rights Commission voted to remove Iraq from the list of countries that were subject to confidential scrutiny of their human rights records."

The goals of development require a more activist government, one that will help "secure...not only dignity...but certain basic needs."

Further impeding the integration of human rights and development efforts are what Butcher termed "the single-minded focus of development workers" and "the muddled thinking of human rights activists regarding the rights of development." She attributed the rather narrow vision of development workers to the overwhelming nature of their task. Butcher said, "The challenge of underdevelopment is so enormous that the preoccupation of development workers with the conundrum of development is perfectly understandable." Equally problematic has been the inability of human rights activists to clearly articulate the "right to development." "Its human rights proponents," chiefly those active at the UN, have attempted to get formal recognition from the international community of the right to development. But they offer a too "broad, almost incomprehensible, concept" of such a right. "A more workable definition," declared Butcher, "would be a more limited one — namely, the right of each human being to be free from a certain level of poverty."

Despite the polarization of the human rights and development fields, and the obstacles impeding the assimilation of efforts in both fields, both speakers offered optimism for future. Amnesty International has noted "very encouraging developments in virtually all of the so-called Third World" where local chapters have been forming and becoming quite active, participating in letter writing campaigns and embassy protests. Butcher found the very fact that the dinner focused on the "indivisible union of human rights and development" very encouraging and hoped it was the first step towards opening dialogue between the two fields.□

156

Human Security and the Gender Perspective

Wendy Harcourt

Wendy Harcourt looks at the gender perspective of security issues in a changing world order. She suggests that the recent Gulf crisis must not distract our attention from the on-going development concerns of global human security, food security, social security and human rights.

War affects all: men and women. Can we therefore have a women's position? What is evident is that we did have a call for solidarity by women in the region to all women in the global peace movement. One which was eagerly responded to. However what was equally clear is that there was a diversity of views and reactions among women as among men. Perhaps then we should not seek out a special women's view but rather seek in this crucial post-Gulf War period to contribute a gender analysis which will broaden the debate from a focus on "women and peace" activities to the issue of the basic human rights to a safe and secure life.

Within the Middle East the post war phase has to be determined by the actors in the region though of course we need to follow the debates and be willing to work with those who ask for our support. International NGO support, such as SID can provide, a clear media focus and information on what the people of the region want will be important in ensuring positive change.

The international response to the Gulf crisis should be to take a hard look at some of the tougher political issues which we have ignored; well-meaning development which does not take on board "difficult" issues such as the number of arms being sold to the Third World by the West is, as recent events have shown, not only naïve but dangerous. Perhaps one of the most immediate outcomes of the war for European development issues is a growing movement of peoples from the region to Europe of diverse religions and ethnic mix, and an increasing tension for those immigrants already in Europe. And thirdly we have to recognize that the historical creation of countries as the result of past conflicts (colonial and global) leaves a cultural inheritance we cannot afford to ignore in our present development effort.

But perhaps more than ever before, SID has to keep public awareness focused on development issues other than those of the Gulf. During the war the plight of the Baltic peoples, Liberians, Palestinians and the Somalians, to name just four examples, was all but forgotten in the horror of the Gulf War. And, in the blitz of war twenty four hours on our screens, the approaching horror of the potential famine in Africa dropped completely from the popular media and the public's conscience.

SID's network has to keep a critical focus on development issues by continually bringing home the importance of current events for the men and women of developing regions. Global collective security, the key to the peace initiatives, has to be considered on a personal as well as international level. As many are saying, stronger international and regional institutions are necessary and welcome with the proviso that NGOs play an even more careful monitoring role of multilateral institutions. The point though, is that security is not just about balancing numbers of armies and bombs nor just about accords between super powers; it also means food security, social security, human rights, in short, men and women's reach for dignity, freedom and a decent quality of life.

Another important security issue is environment. As we saw only too graphically in the last months, conflict in today's world is based on an imbalance between resources and people's needs, as many have argued, the Gulf War could be interpreted as the need to protect the world's capital and energy resource - oil. With the growing pressure of the population in the South, wasteful living in the North and using up of environmental resources globally, the demand for coveted resources particularly in the Third World will only increase dramatically by the end of the century. As population and pollution pressure mount we will be facing a growing tension among a largely un-

\S'

employed youth, economic and environmental refugees, unhygienic and unsafe cities (look at the recent cholera epidemics in Peru and Indonesia) and chronic food shortages. And we will have, whatever the outcome of the peace talks in the Middle East, and even if the Soviet Union and the USA remain friends, an unmanageable, desperately insecure situation where women will, as usual, be bearing the brunt of the burden.

At the heart of development security issues are questions about how we are to ensure a basic quality of life for all the world's population. This means a drastic rethinking about present world trends. Access to decision making, food, employment, choice about family size, education, proper medication, sanitation and housing are all basic security issues which would lead to safer lives for women and men.

When examining personal security issues we need to be aware of the different gender roles, issues and questions we must ask to bring out women's particular needs.

In both peace and war it is often women's "invisible" roles which are forgotten. They are the mothers, wives, social carers, the guaranteers of social and cultural continuity. They are the ones who, apparently regardless, can be relied on to pick up the pieces of family and home in times of crisis and dire need. Family, community, national and global security depend on this special role of women, often as lone heads of households, and sole family providers.

Indeed, the Gulf War has seen women experience not only the violence of war in the Gulf, but also we now have the phenomenon of women soldiers. Highly advanced technologies produce wars where women can also fight raising important questions about "equal participation" and women's roles as utilizers.

Here it is not only that we may wish to question the "right" to participate in war for both men and women, but also how the double role of women as primary carer and wage earner clashed as women soldiers, primarily from the poor black female headed households in the US, left children parentless.

Our major concern here however, cannot be with these more thorny questions of the new role of women and war but with how we need to be aware of these types of issues as we re-think development strategies and policy.

The development community must be sensitive to this double role of women as reproducer and producer and recognize their knowledge and skill in survival. More importantly, we need to be aware that there are decisions and choices which women themselves must determine for long term security — we need to value their work in the recovery period even if it is unpaid and unrecorded — women's work remains an integral part of social and economic development. Perhaps even more acutely, especially as we face the devastation of the Gulf War, we have to see that women's work as mother and wage earner is not infinitely elastic. Women in the Gulf, and in most developing regions, are bearing an enormous burden and personal cost which the development community should appropriately acknowledge and compensate in future policies.

As we look to the heralded new phase in global development we need to be aware that equitable development and human security is based on the protection of the human resource base which is largely in the hands of women.

March 8, 1991

Wendy Harcourt *is Associate Editor and Coordinator of SID Women in Development Programme.*

155

United Nations Children's Fund

THE STATE OF THE WORLD'S CHILDREN 1991

A Summary

The following is a summary of the State of the World's Children report for 1991, issued by the Executive Director of UNICEF, James P. Grant. For details of the full report, please see back cover.

On Sunday, September 30th, 1990, a great promise was made to the children of the 1990s. On that day, 71 Presidents and Prime Ministers came together for the first World Summit for Children. It was the largest gathering of heads of state and government in history. And the outcome was an extraordinary new commitment - a decision to try to end child deaths and child malnutrition on today's scale by the year 2000 - and to provide basic protection for the normal physical and mental development of all the world's children.

This overall goal was broken down into more than 20 specific targets listed in the Plan of Action agreed on by the 159 nations represented at the Summit. All governments will review their plans and budgets and decide on national programmes of action before the end of 1991.

"We are prepared to make available the resources to meet these commitments", said the final Declaration. All national and international organizations have been asked to participate. In particular, the worlds of religion, education, the communications media, business, and the non-governmental organizations in every country are invited to join this decade-long effort.

As the Summit met, the world was nearing the deadline set just over 10 years ago for reaching another great human goal - 80% immunization coverage for the children of the developing world. At the time, approximately 15% were being immunized. Today, despite all the difficulties of the last decade, the 80% goal is expected to have been reached when the latest figures become available early in 1991.

* The goal of immunizing 80% of children under the age of one is expected to have been reached for the developing world as a whole on the basis of the percentage of infants who have received the necessary three shots of DPT vaccine (considered by WHO and UNICEF to be a good indicator of the effectiveness of the immunization system as a whole). For BCG, the target has already been surpassed. For Polio (three shots) overall coverage of 78% by 1989 is expected to rise beyond the 80% target by the end of 1990. Measles immunization, which is not normally given before the age of nine months and which began the decade at very low levels, reached 71% in 1989 and may still lag a few percentage points behind as 1990 ends.

The diseases which vaccines prevent are also major causes of child malnutrition; the immunization effort of the last decade has therefore also kept uncounted millions of children from the downward spiral of frequent illness, poor growth and early death.

159

The year 2000: what can be achieved?

The following is the full list of goals, to be attained by the year 2000, which were adopted by the World Summit for Children on September 30th 1990. After widespread consultation among governments and the agencies of the United Nations, these targets were considered to be feasible and financially affordable over the course of the decade ahead.

Overall goals 1990-2000

- A one-third reduction in under-five death rates (or a reduction to below 70 per 1,000 live births - whichever is less).
- A halving of maternal mortality rates.
- A halving of severe and moderate malnutrition among the world's under-fives.
- Safe water and sanitation for all families.
- Basic education for all children and completion of primary education by at least 80%.
- A halving of the adult illiteracy rate and the achievement of equal educational opportunity for males and females.
- Protection for the many millions of children in especially difficult circumstances and the acceptance and observance, in all countries, of the recently adopted *Convention on the Rights of the Child*. In particular, the 1990s should see rapidly growing acceptance of the idea of special protection for children in time of war.

Protection for girls and women

- Family planning education and services to be made available to all couples to empower them to prevent unwanted pregnancies and births which are 'too many and too close' and to women who are 'too young or too old'.
- All women to have access to pr natal care, a trained attendant during childbirth and referral for high-risk pregnancies and obstetric emergencies.
- Universal recognition of the special health and nutritional needs of females during early childhood, adolescence, pregnancy and lactation.

Nutrition

- A reduction in the incidence of low birth weight (2.5 kg. or less) to less than 10%.
- A one-third reduction in iron deficiency anaemia among women.
- Virtual elimination of vitamin A deficiency and iodine deficiency disorders.
- All families to know the importance of supporting women in the task of exclusive breast-feeding for the first four to six months of a child's life and of meeting the special feeding needs of a young child through the vulnerable years.
- Growth monitoring and promotion to be institutionalised in all countries.
- Dissemination of knowledge to enable all families to ensure household food security.

Child health

- The eradication of polio.
- The elimination of neonatal tetanus (by 1995).
- A 90% reduction in measles cases and a 95% reduction in measles deaths, compared to pre-immunization levels.
- Achievement and maintenance of at least 85% immunization coverage of one-year-old children and universal tetanus immunization for women in the child-bearing years.
- A halving of child deaths caused by diarrhoea and a 25% reduction in the incidence of diarrhoeal diseases.
- A one-third reduction in child deaths caused by acute respiratory infections.
- The elimination of guinea worm disease.

Education

- In addition to the expansion of primary school education and its equivalents, today's essential knowledge and life skills could be put at the disposal of all families by mobilizing today's vastly increased communications capacity.

165

U.S. AND GLOBAL MACROECONOMIC TRENDS

Nathan, Robert R. and Edwin L. Dale Jr. "Is The U.S. Really on The Decline as an Economic Power?" Comos, The Cosmos Club, Washington, 1991.

Heinemann, H. Erich. "A Year Older and Deeper in Debt," The Journal of Commerce, April 3, 1991.

Roberts, Paul Craig. "Forget Taxes; When in Debt, Stop Spending," The Los Angeles Times, April 1, 1991.

Hager, George. "Congress Approves Blueprint for Fiscal 1992 Spending," Congressional Quarterly, May 25, 1991.

Rosen, Gerald R. "U.S. Economy Will Soon Rebound, Says OECD," IMF Survey, June 24, 1991.

Bryant, Ralph C. "World Interest Rates," The Brookings Review, The Brooking Institution, Summer 1991.

Schlesinger, Helmut. "The Credit Squeeze, Is it a Myth?" On The World Agenda: The Capital Crunch, Volume 4, Number 3, May/June 1991.

Henning, C. Randall. "The G-7 Dilemma: Agreeing on Cost Sharing," Economic Insights, May/June 1991.

"Capital Market Integration Has Benefits, but May Have Created New Risks," IMF Survey, April 15, 1991.

Powell, Jerome H. Statement before the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, Treasury News, June 18, 1991.

Bryan, Lowell. "Two Enemies of Sound Banking," The Wall Street Journal, April 29, 1991.

Cranford, John R. "Seidman Seeks Up to $80 Billion to Complete Thrift Bailout," Congressional Quarterly, June 22, 1991.

Mulford, David C. Statement before the House Committee on Banking, Finance and Urban Affairs, Treasury News, June 11, 1991.

IS THE U.S. REALLY ON THE DECLINE AS AN ECONOMIC POWER?

YES The U.S. "Has Lost Considerable Ground Over the Past Decade"

Robert R. Nathan

The end of the Cold War. Dramatic and as yet unstable political and economic changes in the Soviet Union and East Europe. Turmoil in the Mideast. The economic integration of Western Europe. Huge amounts of Third-World debt. Failure of industrial countries to make further progress toward lower trade barriers.

This brief inventory of major challenges underscores the need for strong American leadership at a time when signs are spreading of trouble in the U.S. economy and its capacity as a world economic power. There is more to world leadership than economic strength, as events in the Persian Gulf demonstrated, but without a strong and expanding economic base, leadership is difficult to provide. And the United States has lost considerable ground relative to many industrial and industrializing nations over the past decade. It is in danger of failing to mobilize the resources needed to play a constructive role in the pursuit of peace, prosperity and freedom.

Among the signs of a nation in danger of decline as an economic power:

- Persistent budget deficits have set peacetime records.
- The national debt has more than tripled in the last 10 years.
- After more than a half century of trade surpluses, the 1980s brought huge trade deficits.
- From being the largest net creditor nation a decade ago we are now, by unprecedented margins, the world's largest debtor nation.
- Savings rates are inadequate to finance levels of investment essential for vigorous economic growth, let alone finance the federal deficits.
- The savings and loan debacle has lessened confidence in our financial institutions and will cost taxpayers over half a trillion dollars.
- Competitiveness has been weakened and bankruptcies have increased due to diminished antitrust

Continued on next page

Robert R. Nathan ('56) is chairman of Nathan Associates, consulting economists, and a former National Chairman of Americans For Democratic Action. He was chief of the Planning Committee of the War Production Board during World War II.

NO The U.S. "Remains the World's Supreme Economic Giant"

Edwin L. Dale Jr.

The question before the house is a good and valid one. Before attempting an answer, however, it is necessary to tackle some rather formidable semantic underbrush which has bedeviled discourse on the matter.

What is the meaning of "economic power" in the context of a nation, and how is it measured? Does it mean large gold reserves or a large gross national product or perhaps per capita GNP? Does being an economic superpower require a favorable balance of trade? Does it have something to do with the domestic budget-deficit or -surplus?

Does it turn on a nation's international debtor-creditor status? Or require a strong currency? Does it have something to do with international competitiveness, whatever that may mean? Is it a function of a nation's productivity? Does it mean being able to push other nations around or induce desirable behavior through foreign aid? Does it involve the international ranking of a nation's big banks, or heavy research and development outlays, or the performance of a nation's students in math and science?

The mere listing should show, at the least, that the definition or measurement of economic power is not a simple matter. Consider a few anomalies:

- Per capita GNP is one important measure of economic power. It reveals standard of living and, indirectly, productivity. But if this were the only measure, then the United Arab Emirates would be at the top of the world economic power table because of the high value of oil production spread over a very small population.
- If possession of natural resources were an important element, Switzerland would be weak and poor. But, in fact, it is widely and correctly recognized as having considerable economic strength.
- The Soviet Union has the world's second largest GNP, very large gold reserves and an ample endowment of natural resources. Yet it would be an absurdity to consider the Soviet Union an economic super-

Continued on page 79

Edwin L. Dale Jr. ('85) is counselor to the director of the Office of Management and Budget and director of OMB's external affairs. He was formerly a chief economic writer for **The New York Times**.

162

regulation and a surge of speculative mergers and acquisitions financed with junk bonds.

- Inadequate infrastructure funding has brought deterioration to our streets, highways, bridges, ports and other public facilities.
- Income distribution has become more skewed with widened gaps between low- and high-income groups.
- Pride in quality of performance seems to have diminished in private and public service.
- The latest recession, severe or not, will make it more difficult to shape policies that effectively address the nation's deep-rooted problems.

The odds are very high that the federal debt will grow through most of the 1990s.

These manifestations of lagging and destabilizing economic performance have evolved over the last 20 to 25 years, but with much increased gravity in the past decade.

From the middle of 1965 to 1980 there was considerable economic turmoil associated with a serious pace of inflation that accelerated over most of the 15 years until the 1980-82 recession. The start of the inflation could be attributed to the concurrence of the Vietnam War, a couple of poor crop years and ill-timed expansive fiscal policies. One of the most serious factors that intensified the pace of inflation was the role of the OPEC cartel. In 1973 an embargo imposed by OPEC led to an approximately fivefold increase in petroleum prices. The further doubling of petroleum prices in 1979-80 was attributable to the cartel's production constraints.

THE TROUBLESOME 1980s

The most serious economic difficulties occurred in the 1980s. In 1981 President Reagan proposed a 30 percent income-tax reduction over a three-year period. Counter-cyclical fiscal policy calls for tax cuts in recessions and tax increases in boom times, usually on a year-to-year basis. Congress did enact a 25 percent cut over three years. President Reagan simultaneously called for substantially higher defense expenditures. The ensuing huge budget deficits did not precipitate severe inflation only because of a marked increase in industrial imports. Largely because of this competition from abroad, wage rates of factory workers in the United States, adjusted for inflation, declined during much of the decade.

The adverse consequences of the large, persistent budget deficits will be difficult to overcome. Big deficits in peacetime reflect poor fiscal management. As the national debt climbed from well under a trillion dollars in 1980 to more than $3 trillion now, interest on the debt has quadrupled. The odds are very high that the federal debt will grow through most of the 1990s, tending to result in higher interest charges.

At the same time, private savings in the U.S. fell sharply in the 1980s as a percent of disposable income—from 7.5 percent in 1981 to 3.2 percent in 1987. It climbed back to 5.5 percent in 1989 but remained well below historic levels. One would have expected personal savings to rise when the top personal income tax rate was cut from 70 to 50 percent in the 1981 tax legislation and to 28 percent in the 1986 tax bill. Consumers seem to be following the federal government policy of "borrow and spend" rather than "save for a rainy day."

In trade balances, too, the 1980s brought a drastic turnaround. From a near balance between exports and imports in 1980, by mid-decade the excess of imports over exports reached $170 billion a year. The trade deficit has been dropping since but was still near the $100 billion level in 1990. Many of our financiers and industrialists have been more interested in get-rich-quick buyouts and mergers than in restoring our competitive posture.

The phenomenal rise of federal debt coupled with the low level of private savings led to heavy reliance on foreign capital to finance a sizable portion of our federal deficits and private capital formation. Even with improvements in our trade balance and increases in private savings, foreign ownership of American assets will grow unless budget deficits are reduced significantly.

In 1981 the residents of the United States owned about $140 billion more of foreign assets than foreigners owned of American assets. As of the end of 1990 foreign owners of assets exceeded assets owned abroad by U.S. citizens by more than three-quarters of a trillion dollars. The trillion-dollar level will surely be exceeded within the next year or two. We will need to attract more and more foreign capital just to service the existing holdings of United States assets by people abroad, let alone help finance the continuing large deficits.

On the expenditure side of the Federal budget, reductions have occurred, especially in revenue sharing with state and local governments, some social programs, funding for infrastructure projects, non-security-related foreign economic assistance and staff curtailments in some regulatory agencies. A heavier tax burden has been placed on state and local governments where highly regressive property and sales tax rates have had to be enacted.

Shifts in tax burdens, curtailed public services and a deterioration in family relationships have brought relatively greater affluence to the upper and upper-middle classes and relatively more unmet needs for the lower and lower-middle classes. A hard core of homeless, poorly-paid minority workers and the unemployed are plaguing our large cities. Fewer federal financial resources are being made available to reverse this worsening situation.

One manifestation of the "Let the market solve everything" philosophy is that it tends to ignore reality. A neglected infrastructure hurts efficiency. Productivity performance dwindles. The marketplace cannot solve many problems. The savings and loan fiasco, which is having an effect on confidence in the commercial banking system, is due in part to deregulation, the urge to reduce federal regulatory staffs. The staffs of the Antitrust Division of the Justice Department and of the Federal Trade Commission have been cut so deeply that no serious guardians now exist in the federal government against monopolies.

A hard core of homeless, poorly-paid minority workers and the unemployed are plaguing our large cities.

Because of its domestic economic problems, the constructive role of the United States in the world is highly uncertain. World leadership requires a range of political, moral and humanitarian commitments as well as economic strength. A brief review of the overall performance of the United States during World War II and afterward can help one better understand the opportunities for the United States in a shrinking world.

AN ERA OF U.S. GREATNESS

Until World War I the United States played a relatively modest role in international affairs. Even its contribution to the victory in World War I came relatively late. It was not until World War II that the United States came to be recognized as the major power and the principal leader among the family of nations. Clearly, the United States played a decisive role in the victory over Germany, Italy and Japan. It was not only the contribution of American fighting men that brought victory. The vast flow of American matériel to the United Kingdom and the Soviet Union was an important factor in their successful military operations.

The United States emerged from World War II much stronger. The war brought no destruction of any of its productive facilities. Its capacity to produce was greatly enhanced by new facilities and new technologies derived from the intensive and highly successful mobilization effort of the United States. In fact, the war led to the expanded role of the United States in world affairs because both friendly and enemy nations in Europe and Asia suffered from severely curtailed productive capacities.

Between 1945 and 1965, U.S. income per capita, adjusted for inflation, doubled. America's wealth flowed out in the form of investment capital, expanded purchases of foreign goods—and in aid to needier countries. The international role of the United States in the postwar years was unprecedented in scope, constructive impact, generosity and good will. Of utmost importance was the part the United States played in the practical end to colonialism in the world, except in Eastern Europe. Unprecedented, too, was the role the United States played through the Marshall Plan in the restoration of the economies not only of its allies but also of its enemies.

In the postwar years, the United States provided the initiative for a major and continuing effort to help the less developed nations of the world achieve and enjoy rising productivity and higher standards of living. Most of these countries had been colonies of major powers. The "Point Four" concept articulated by President Truman was designed to provide technical assistance from the industrialized countries and international and regional institutions to help build up the economic capabilities of the lagging nations. The United States can look back with pride on its leadership in bringing higher living standards to many nations in Africa, Asia and Latin America.

These brief observations indicate how significant was the leadership of the United States in world matters during and after World War II. That past performance far outshines the current role of the United States when the need for world leadership continues to be critical.

It was more than money and technology that brought leadership status to the United States. Adherence to democratic principles, commitment to human rights and the recognition that extremes between affluence and poverty were not tenable were important factors in the leadership status of the United States. But its influence outside the military sphere has declined from what it was two or three decades ago. In considerable measure it has been the relatively weaker economic performance of the United States that has diminished its prestige and influence. The United States now provides a substantially reduced share of aid to the developing countries and in support of regional and international institutions than it did in the past. The Vietnam War, larger defense outlays, huge budget deficits, reliance on foreign capital inflows, lagging productivity, all add up to concerns about the degree to which the world can rely on the economic strength of the United States to spur effective trade and development policies.

RESTORING ECONOMIC POWER

A critical review of the economic performance of the United States does not justify the conclusion that it is poor and cannot afford to improve the well-being of its own people, to provide more help to the developing countries and to play a key role in preserving and expanding the prospects for peace around the world. The United States is not on a path toward the

\166

economic weakness of the Soviet Union and many of the Warsaw Pact nations. It has the resources to contribute a great deal more toward world peace and prosperity than it is currently. But many recent economic policies will need to be reversed. Large military commitments, as in the Persian Gulf, alone will not suffice.

A recession of even limited depth and duration will make it difficult to reverse the economic trends of the 1980s rapidly and without political turmoil. There will need to be evidence of steady progress on many domestic issues if the world is to once again look to the United States for the kind of leadership it provided in the 1940s, through the 1950s and much of the 1960s. The following issues require serious attention:

- Until the economic recovery is well underway, expansive fiscal policies—even at the risk of temporary larger budget deficits—and monetary policies must be pursued.
- As recovery evolves, budget deficits must be reduced through both tax increases, especially income taxes, and carefully-considered expenditure cuts.
- New taxes on oil should be part of an effort to reduce our growing reliance on petroleum exports, as well as to raise new revenues. Half of our oil comes from abroad, and imports will account for two-thirds of our consumption before the end of the 1990s. Aggressive pursuit of energy conservation and research into renewable energy sources should receive top priority.
- Taxing a larger portion of Social Security benefits on middle- and higher-income recipients should be considered.
- A larger Internal Revenue Service staff for monitoring and strictly enforcing tax payments should get a very high priority. Only a few years ago, an IRS study showed $11 more in tax collections for every extra dollar spent on enforcement.
- Among targets for expenditure reduction are some farm price supports; new approaches to cut medical care costs; encouragement of later retirement years for older workers, thus slowing the rise in Social Security outlays—and when the dust settles in the Mideast, a reduction in defense spending.
- Budget-cutting should take into careful account the need for better education; more research and development; incentives for savings and for new and modernizing investments; infrastructure projects and such social issues as the homeless, crime, drugs and discriminatory practices. These are priorities that warrant tax increases, but implementation can and must be more efficient and requires more federal, state and local cooperation.
- The impact of federal policies on state and local governments must be more fully considered in federal policy decisions. We must also get more tax revenues from the highest income classes and the richest states and suburbs and direct more public programs to the poorest states, cities and people. If we do not do this, the gap between the affluent and the poor will grow.
- Stricter regulation of antitrust activities is needed, with beefed-up staffs to do the job.
- Guarantees of deposit insurance must be associated with careful monitoring of financial institutions to prevent the S & L abuses from recurring or spreading. Deposit insurance guarantees should be reduced and deposit insurance rates raised.

Budget deficits must be reduced through both tax increases, especially income taxes, and carefully-considered expenditure cuts.

- Continuing efforts to achieve freer trade are desirable, but the principles of reciprocity must also be pursued. Pressure must be exerted on those who believe in free trade where they sell but restrict access to their home market.
- Resources should be made available for more foreign assistance. We can afford to continue and increase aid to developing countries and to facilitate desirable change in East Europe and the Soviet Union.

Clearly there is at present no country, international or regional institution in a position to provide successfully the leadership role that the U.S. held in World War II and the postwar years. The United Nations can continue to have some but not major impacts on economics, living standards or competitiveness between and among countries in the foreseeable future. Japan is a country with a strong economy and a huge level of foreign exchange reserves. But the role of Japan is not going to be similar to that of the United States after World War II for a variety of reasons, including a reluctance to take on a global responsibility. The same is true for Germany, which has also achieved a strong economic posture. Germany is faced with the costly problem of absorbing a much less prosperous East Germany. Germany has given indications of playing a significant role in helping the Soviet Union and the Warsaw Pact countries in overcoming their serious economic problems.

The need for leadership in the world is urgent, but there is concern whether the United States can build on its victory in the Gulf war to reestablish its leadership status. Though the U.S. is now not prepared to undertake many of the commitments and responsibilities associated with world economic leadership, it has the resources, talents and adherence to principles that could, with strong internal leadership, again provide the leadership role in the pursuit of peace, freedom and progress in the world. ■

167

NO *Continued from page 75*
power. Given its current condition domestically, there is reason to doubt it can be considered an economic power at all.

The fact is, there is no definition of "economic power" nor even a clear concept of what the term means. That is why the discourse on the subject has been so diffuse and confusing. To judge by commentary in the press during much of 1990, for example, the inability of the United States government to come to grips with its budget deficit was a glaring example of economic "weakness." In fact, it was an illustration of a poorly functioning governmental/political process—and may have affected foreign perceptions of the U.S.—but it had little to do with economic strength or weakness.

Those who say the United States is on the skids as an economic power are missing the forest for the trees.

Even if there is no good definition of economic strength, there does exist a set of perceptions which are based more or less on facts and statistics. As we shall see, a nation—and in particular the United States—can display a weakening trend in one or more of the measures cited above while still retaining overwhelming "economic power." To cite an old and useful aphorism, those who say the United States is on the skids as an economic power are missing the forest for the trees.

A technical note is necessary before examining some of the indicators of economic strength. International comparisons are often complicated by the problem of currency exchange rates. At the unadjusted exchange rates of early 1991, for example, Japan or Germany or even a country like Finland may seem to be "richer" on a per capita basis than the U.S. when that is not really the case. This problem can be solved by using an adjusted exchange rate called "purchasing-power parity." It seeks to determine the exchange rate between the dollar and, say, the mark, that makes the price of bread, or a hotel room, or a man's shirt—a broad "market basket" of goods and services—about the same in Germany and the United States. This is indispensable in making meaningful international comparisons. Insofar as possible, what follows in this article will be based on adjusted, or purchasing-power, exchange rates.

A LOOK AT GNP

The most important measure of economic power is the one that common sense would point to—the total output of a nation, its gross national product. Here there is no doubt at all who is number one, and who will stay number one for as far as the eye can see. It is the United States. What is more, by this measure there has been remarkably little erosion of U.S. dominance in the past several decades, despite the very rapid growth of Germany, Japan, France, Italy and others. Using purchasing-power-parity exchange rates, the CIA estimates that the U.S. share of world GNP (including the Soviet Union, China and the former communist bloc) was 29 percent in 1960, 27 percent in 1970, 25 percent in 1980 and 26 percent in 1989. The next largest economies are far behind. In 1989, the Soviet Union was in second place, with 13 percent of world GNP, and Japan was third with 9 percent. Economist Herbert Stein has calculated that even if the differential in growth rates of GNP between Japan and the United States of the last six years were to persist, it would take 189 years before the Japanese economy would be as large as that of the U.S.

This simple matter of size is of great importance. It means, among other things, that the U.S. can field a very large military establishment at a comparatively small cost (about 5.5 percent of GNP in 1990). No other nation can come close to our military power without an enormous burden of taxes or other drains on the standard of living.

As the CIA figures disclose, there has been a small slippage in the U.S. dominance based on size alone—a natural consequence of the growth of the other industrial economies. But the dominance remains so overwhelming that the slippage in relative share can properly be viewed as normal and of little significance. What is more, the huge U.S. GNP of $5.5 trillion is continuing to grow—not as fast as some other countries, but still growing in real terms in all but the occasional recession years. Growth has averaged 2.7 percent a year for the past 20 years. Manufacturing output, in which the U.S. is often alleged to be slipping, grew by 41 percent in the decade of the 1970s and 38 percent in the 1980s and remains by far the world's largest. The U.S. economy remains incomparably the world's largest and is growing.

But size alone is not everything. The U.S. is a big country with a large population, which alone would help account for the size of GNP. An important measure of the strength of an economy is GNP per capita, which is a good proxy for productivity and the standard of living of the people. Here, too—with the exception of the aforementioned aberration of the small oil-producing countries—the U.S. remains in first place by a good margin. United States GNP per capita in 1989 was still a third higher than that of Japan and Germany despite their gains in recent years. Only Canada among the advanced industrial countries comes close to the U.S. in per capita GNP, but it is a small country in population and total GNP.

On a per capita GNP basis, the U.S. lead is indeed slipping. Stein calculates that it will take "only" 32 years for Japan to catch up to the U.S. by this measure if the trend of the past six years continues. This slippage in the U.S. lead is almost entirely because our productivity performance—the annual improvement in our overall efficiency—has been weak since the early 1970s while that of other nations has been better. Here we begin to get to the heart of the case of the doomsayers that the U.S. is, indeed, "on the skids" as a world economic power. How good is that case?

INTERNATIONAL COMPETITIVENESS

The case, when closely examined, comes down primarily to a cluster of measures or criteria that can be grouped under the general heading "competitiveness." They include the U.S. productivity performance, its foreign trade performance (and consequent international "indebtedness") and its educational performance. These are the very types of criteria cited by Paul Kennedy, the author of *The Rise and Fall of the Great Powers*, in describing the decline of British power starting early this century. In a recent article in the London *Times*, Kennedy referred to the impressive projection of British military power at the time of the Boer War in South Africa and then added: "It was easy to forget the other part of the story—the inadequate educational system, the meager levels of investment, industry's growing uncompetitiveness, the vast trade deficit in manufactured goods. Those weaknesses would one day cause the collapse of British power."

In the present situation, there is something to the argument, centered on competitiveness, that American power is slipping. But whatever conclusions are reached, the basic facts on U.S. economic strength noted above—the forest—are not changed.

Productivity is probably the most important test of all. It determines not only a nation's growth but its living standards. William J. Baumol, Sue Anne Batey Blackman and Edward Wolff, in their recent book entitled *Productivity and American Leadership: The Long View*, note that a lag in Britain's annual productivity improvement, compared with other industrial countries, averaging only about 1 percent but lasting for a century, transformed that country from the undisputed leading economic power to "the third-rate economy that it is today."

Productivity growth in the United States, which was impressive in most of the century before World War II and the early decades after the war, began to slow in the late 1960s and dropped markedly beginning about 1973. Compared to annual productivity growth for the nonfarm economy as a whole of as much as 3 percent in the early postwar period, the figure dropped to 1.1 percent in the 1970s and 1.3 percent in the 1980s.

Despite all the presumed advances in economic knowledge, no one knows exactly why this happened. U.S. fixed nonresidential investment (new machinery and the like) as a share of GNP, while consistently lower than in some other industrial countries such as Japan, has not been weak in the 1970s and 1980s relative to the U.S. investment performance in the earlier postwar period. There are various partial theories for the poorer productivity performance but no comprehensive explanation. In any case, what is not so widely realized is that the same thing was happening in nearly all the other industrial countries. Manufacturing output per-hour-worked in Japan, for example, rose by an average of 10.8 percent a year in the 1960s but less than half that—5.3 percent a year—in the 1980s. Productivity growth in France and Germany was also only about half as rapid in the 1980s as in the 1960s.

What is more, there is a distinction between manufacturing, where productivity can be measured with some degree of accuracy, and the service economy (from health care to banking) where productivity measurement is difficult, to say the least. In manufacturing, U.S. productivity growth rebounded in the 1980s, rising to an average annual improvement of 3.5 percent compared with 2.4 percent in the 1970s.

Real GNP: How Major Nations Stack Up

Gross National Product in billions of 1989 U.S. dollars—

	1960	1970	1980	1989	Gain, 1960-89
United States	2,050	2,986	3,916	5,198	154%
USSR	1,012	1,727	2,257	2,664	163%
Japan	314	848	1,335	1,913	509%
West Germany	390	607	792	943	142%
France	286	492	681	819	186%
United Kingdom	402	533	643	818	103%
Italy	259	452	654	801	209%
Canada	148	248	382	513	247%
China	n.a.	93	190	427	n.a.
Spain	109	221	310	397	264%

Note: GNPs of noncommunist developed countries are converted to U.S. dollars by use of purchasing-power parities to offset distortions caused by currency exchange rates.

Source: CIA

This was due in part no doubt to the impact of much greater foreign competition, which forced both modernization and labor force reduction. In any case, in the manufacturing sector, the U.S. productivity performance in the 1980s remained a little behind that of Japan but was about the same as the average for the leading European countries. This is not the portrait of a serious laggard.

IMPACT OF THE TRADE DEFICIT

The foreign trade story is one of anecdotes, perceptions and some misconceptions, as well as some solid facts and statistics. We all know that foreign producers have taken over more than a quarter of the automobile market; that there is only one remaining U.S.-owned producer of color television sets; that American companies have been completely shut out of other consumer electronic markets, such as that for VCRs; that the "quality" of American goods has declined (at least until some recent improvement). It is also true that the U.S., once the superpower among manufacturing nations, now imports more manufactured goods than it exports, accounting for the bulk of the large overall trade deficit. These are important facts and perceptions. But they are not the whole story. Consider the following:

- The Census Bureau publishes a series on exports and imports of "advanced technology products." In 1988 and 1989, United States exports of these products were about 50 percent higher than imports, with an annual export surplus averaging about $27 billion, and in 1990, the surplus rose to $34 billion. This does not fit very well with the image of the U.S. as falling badly behind in the "high-tech" world of the future. In fact, there are numerous areas, from medical devices and scientific instruments to aircraft, where the U.S. is the undisputed leader.
- Although the total trade balance in manufactured goods is negative, it is now clear that the most important factor in bringing this about was the huge rise in the dollar's exchange rate against other currencies in the first half of the 1980s, which drove up the price of American goods to foreign purchasers. The effects were dramatic. The United States had a surplus in trade in manufactured goods of $19.5 billion in 1975 and $20.3 billion in 1980. During the ensuing five years of almost uninterrupted appreciation of the dollar's exchange rate, trade in manufactured goods swung into deficit, reaching a peak deficit of $137.3 billion in 1986. Then, as the dollar's exchange rate began to decline, exports rose and the trade balance soon improved though not enough to swing back into surplus. By 1990, the deficit had dropped to $90 billion. Exports of manufactured goods have risen 70 percent since 1985, which hardly indicates a weak and non-competitive manufacturing sector. There is no disputing that the trade figures show some fundamental deterioration, apart from the exchange rate, but it is not at all certain that deficits are permanent.
- After briefly losing its lead to Germany, the U.S. is again the world's leading exporter. Total exports in 1990 were nearly $400 billion, which surely suggests that this country's producers must be doing something right.

NO. 1 DEBTOR NATION?

But what of the "fact" that the trade deficits of the past decade have turned the U.S. into the world's largest debtor nation? The first thing to be said is that the term "debtor" has a rather special meaning for the United States. Unlike Brazil or Argentina, which owe their debt not in their own currencies but in dollars, the debts of the U.S. are in its own currency. If a foreigner keeps dollar deposits in a bank in New York, that counts as a U.S. debt. The same is true for foreign decisions to buy U.S. stocks, or Treasury (or private) bonds, or manufacturing companies, or real estate. It is a matter of how the international ledgers

There are numerous areas, from medical devices and scientific instruments to aircraft, where the U.S. is the undisputed leader.

are constructed rather than being a debt in the usual sense of the term—something that the United States as a nation has to "repay."

The United States does not go out and borrow money as Brazil does. Instead, foreigners, on their initiative, invest or hold funds here. What has happened is that, as a counterpart to the large trade deficits of the 1980s, total foreign investment in the U.S. has risen faster than U.S. investment abroad, and now has surpassed it. Only in this sense is the United States a "debtor" nation, and it is not something to be greatly concerned about, for several reasons.

- In no sector of the U.S. economy is foreign ownership troublesomely large. In manufacturing, for example, foreign ownership—which, as foreign direct investment is defined, includes companies that are owned as little as 10 percent by foreigners—amounts to about 8.5 percent measured by employment and 12.2 percent measured by sales. Spectacular Japanese acquisitions of such well-known U.S. entities as MCA and Rockefeller Center understandably lead to public bewilderment and concern. However, it is easy to forget that U.S. acquisitions of *foreign* companies led not long ago to a popular and alarmist book by the Frenchman, Jean-Jacques Servan-Schreiber, called *The American Challenge*, which incorrectly predicted American economic dominance of Western Europe. Such alarms are no longer expressed. The U.S. is not in danger of foreign takeover though investments in both directions will continue.

One sector that has received much attention is U.S. government debt—Treasury bonds and notes and bills. Here foreign ownership is about 18 percent of the debt held by the public. But this fairly high figure simply signifies that foreigners, like some Americans, have chosen to invest rather heavily in risk-free Treasuries. It does not mean that the Treasury needs foreign purchasers to sell its bonds. In fact, foreign purchases of Treasury securities fell off sharply in the first three quarters of 1990—to $3.2 billion from $24.3 billion in the same period of 1989—with no effect at all on the Treasury's ability to borrow money to finance the budget deficit, and no discernible impact on the interest rates at which the securities were sold.

• The "debtor" position of the United States is exaggerated by the way the figures are calculated. This is particularly true of direct investment—the ownership by foreigners of factories, real estate and other non-portfolio investments. The figures are measured in "book value," which reflects the value of the investment when it was made. Since U.S. direct investments abroad are far older on average than foreign investments here, and since the value of the properties increases with time, the value of the U.S. investment is understated.

• There is nothing inherently bad about foreign ownership though there is a "cost" in the form of the annual payment to foreigners of interest, dividends and profits on their investments in the U.S. This cost is now about 3 percent of our national income and is matched by an equal amount of income from U.S. investment abroad. The net balance, positive for many years and now zero, will soon be negative and will continue to worsen slowly as long as the deficit in trade continues. This implies a consequent small drain on the American standard of living. But the Institute of International Economics, in a forthcoming study on "The United States as a Debtor Nation," estimates that even if our international current account deficit (whose largest component is the trade deficit) remains at its present annual level of around $100 billion indefinitely, the net payments to foreigners on their investments would level off at only about one half of 1 percent of U.S. GNP. In short, the burden of being a net "debtor" is not very large and will not become large.

A note is in order here about the dollar—its rise and fall. The dollar is a "hard" currency because it is accepted everywhere in exchange for other currencies. That is, the dollar is fully convertible. Indeed, the dollar is the medium of exchange for much trade and investment between third countries, not involving the United States. It is a true world currency, unlike any other. But though the dollar is "hard," of late it has also been "weak," to use the jargon, because its exchange rate has declined against most of the other leading currencies. The exchange rate can turn on a number of factors, from the trade balance to the level of U.S. interest rates relative to rates in other countries. A weak dollar—a declining exchange rate against other currencies—does not necessarily signify a weak U.S. economy though there is sometimes confusion on this point.

SOME DANGER SIGNS

Education. This is not the place to examine in detail the clearly deplorable situation in much of the United States public school system. The argument that the U.S. is performing poorly in this respect is accepted and the point is granted. If this situation continued long enough, it would eventually weaken the U.S. posture in the world economy, principally through the route of a poorly qualified labor force. But several points are worth noting:

The problem of public school education has serious future implications if not dealt with.

• The condition of American education is not quite as bad as the alarmists have painted it. Several million U.S. young people enter college every year, more than in any other country of the world. Many of them, *mirabile dictu*, are quite literate and some are even competent in math and science. The U.S. higher education system is in many respects the envy of the world. There are strengths in American education as well as weaknesses.

• The nation and its political leadership have become aware of the serious deficiencies in U.S. elementary and secondary education, and quite possibly something will be done about them. The decline in various student-testing measures has, at least, halted, and there are a few signs of modest improvement.

Research. Another measure of what might be called the "intellectual capital" of a nation is its research and development effort. Here again, the U.S. performance is impressive, though by some measures it is no longer number one.

• Total United States R & D expenditures, defense and nondefense, public and private, exceed $100 billion a year. The next largest effort, by this measure, is that of Japan, with about $40 billion.

• As a share of GNP, the total research expenditure of all the leading industrial countries is quite similar, ranging between 2.5 and 3 percent. Japan is a little ahead of the United States by this measure.

• Nondefense R & D again finds the United States far in the lead measured by total annual expenditures, but U.S. outlays are behind Japan and Germany as a share of GNP. In assessing this measure of research and development capability, it is important to remember that not all defense R & D is "wasted" in that there is some spinoff from defense-related research in the civilian economy.

Despite some grumbling in the scientific community, the United States retains an impressive scientific and technological capability. The federal government's outlays for basic research have been growing in real terms. The U.S. continues to win a disproportionate share of Nobel prizes in the scientific disciplines. Granted, U.S. strength in the broadest sense of intellectual capital, measured by indicators such as patents granted to U.S. nationals as well as test scores of high school students, is perhaps not what it used to be. As noted, the problem of public school education has serious future implications if not dealt with. No one can say where the longer-term trends in intellectual capital may lead, but nothing that has occurred to date warrants the conclusion that the United States is in an irreversible decline.

BUDGET DEFICITS: OVERRATED RISK?

Finally, what about the much-lamented large United States budget deficit and the seeming inability of the political system to deal with it? The first thing to be said on this matter is that there is no consensus among economists and other analysts on the nature and seriousness of the problem. For example, Robert Ortner, former Undersecretary of Commerce for Economic Affairs and an economic centrist, has written a book entitled *Voodoo Deficits* in which he argues that the harmful effects of both the budget and foreign trade deficits have been greatly exaggerated.

Others, of course, feel differently. A commonly held view is that the deficit is harmful because its financing, through borrowing by the Treasury, soaks up a sizable portion of private savings in the U.S., which are already low in comparison with other countries; this, in turn, reduces funds available for investment and eventually will adversely affect U.S. productivity and growth. Charles Schultze of the Brookings Institution, a former Director of the Budget and Chairman of the Council of Economic Advisers, likens the effects of the deficit to "creeping senility."

Whichever view is right, nothing that has happened thus far as a consequence of the budget deficit has noticeably impaired the U.S. position as an economic power. Private, fixed nonresidential investment, as a share of GNP, averaged about the same in the high-deficit 1980s as in the 1970s and was actually a little higher than in the 1960s. This was made possible in part by the heavy inflows of foreign capital cited above, but international mobility of capital is a feature of the modern global financial system that is to be welcomed, not lamented.

What's more, the federal budget deficit in the United States steadily declined after 1983, measured as a percent of GNP, until the savings-and-loan fiasco came along. Paying off depositors in insolvent thrift institutions and banks, or paying healthy financial institutions to absorb the insolvent institutions, does not create new purchasing power as does other spending, from social security checks to military procurement. In any event, the huge outlays associated with the savings-and-loan debacle will taper off and give way to modest *inflows* later in this decade as some of the assets acquired by the government are sold. The underlying budget deficit, not counting the deposit insurance outlays, continues to decline gradually as a percent of GNP and is not large by comparison with a number of other industrial countries. The deficit reduction package enacted in late 1990 will further reduce the magnitude of the problem.

> ***A weak dollar does not necessarily signify a weak U.S. economy.***

Still, there is no doubt that the apparent budgetary impotence of the U.S. political system has had an impact, at least on perceptions. A *Washington Post* headline in early October 1990, when the budget impasse between the Bush Administration and Congress was the center of attention, captured the presumed sentiment well: "Europe Views U.S. Crisis as Sign of Economic Ills." The lead paragraph stated, somewhat breathlessly, "For Europe's bankers and financiers, the federal budget crisis in Washington appears to be the latest symptom of a deeper disease that some fear could render the United States the sick man of the new world economic order."

A few weeks later the "crisis" was resolved with the budget agreement which, while hardly a triumph of fiscal courage, will reduce the deficit in the years to come. To judge by the *Post*, all was well again. A column proclaimed that the budget agreement has "a potential to reverberate around the world" and "announces quietly to those who will listen that in the best possible way America is back—as a society able to claim that it is finally buckling down to the central business of matching ends and means."

Of course, both viewpoints were exaggerated. The budget problem did not threaten to make the United States a "sick man," and the budget agreement did not signal the start of a new world. Given its low rate of private saving, the U.S. would be better off with a minimal budget deficit or a budget surplus, but beyond that, the issue is not nearly as urgent as the reader of the daily press would conclude.

We return, then, to the question before the house: "Is the United States on the decline as an economic power?" The answer, quite simply, is No. By some measures the U.S. relative standing has worsened or weakened in recent years; a few trends in the society, particularly the public education problem, are potentially menacing. But the United States remains the world's supreme economic giant by a wide margin and is likely to retain that status for as far ahead as it is useful to contemplate. ■

A Year Older and Deeper in Debt

By H. ERICH HEINEMANN

The United States earned dubious distinction as the world's largest debtor during the Reagan administration. Under George Bush, the nation has slipped deeper into red ink.

U.S. net foreign debt was $694 billion at the end of 1990. When President Reagan came to office in 1981, the United States had a net creditor position of $125 billion.

This accumulation of debt is likely to have several consequences. First, growth in the U.S. gross national product will be slower and real living standards will rise less quickly. Second, the debt burden will lead to a restructuring of the economy toward less consumption and more investment, fewer imports and more exports. Third, manufacturing firms are likely to be on the cutting edge for decades to come. The U.S. service economy may have reached high tide in the 1980s.

The good news was that the increase in U.S. foreign debt last year came to a mere $25 billion, the best performance in almost a decade. Foreign ownership in the United States will continue to rise, but almost certainly at a pace well below the 16.8% compound rate of gain typical during the 1980s.

The Reagan administration spent far more energy attacking the statistics on U.S. foreign debt than in dealing with its underlying causes. While Commerce Department figures on debt are riddled with inconsistencies, such failings are not true of the Federal Reserve's U.S. balance sheet, a treasure trove of valuable information.

Federal Reserve economists systematically adjust Commerce Department statistics, which are based on original costs, for changes in market value and in the relationship of U.S. and foreign currencies. Though the Fed's data are far from perfect (economic measurements never are), they provide a guide to the nation's true economic position.

On the domestic front, the Fed reported a whopping jump in corporate debt. Non-financial corporations had a debt-to-equity ratio of 89.5% last year, up from 87.5% in 1989 and 51.6% in 1980. Consumers have followed a similar pattern. Household debt was 22% of net worth last year, up from 20% in 1989 and 16% in 1980.

The leveraging of America will play a critical role in the 1990s. Foreign investors still are eager to lend and invest in the United States. In recent weeks central banks have been active in the foreign exchange market in an effort to put a lid on the surging dollar.

But over time the real cost of servicing U.S. international debt will rise. Moreover, the threat of a political backlash against the buildup of foreign assets in the United States is clear. Gross foreign-owned assets in the United States came to $1.64 trillion in 1990, up from $401 billion in 1980 and only $99 billion in 1970.

The data shows that U.S. investors consistently earn about one-third more on their overseas investments than foreigners earn on their assets here. This disparity has persisted for almost 50 years. Furthermore, the foreign rate of return tracks the yield on long-term U.S. government bonds with extraordinary fidelity.

This conclusion should be taken with a grain of salt. There is no evidence that U.S. investors are always smarter than those overseas. And the idea that foreign investors can't achieve a yield better than the risk-free return on long-term Treasuries is silly.

This means that the official figures understate the true economic cost of servicing the $1.6 trillion portfolio of assets held by foreign investors. The geometric expansion of foreign assets in the United States suggests that this distortion will become larger over time.

The Fed's analysis of the domestic U.S. corporate balance sheet was also disturbing. Based on replacement values, stockholder investment in U.S. corporations came to $3.9 trillion, or about 70% of GNP. Ten years ago, current-cost corporate equity equaled 100% of GNP.

Companies piled up record levels of debt, but failed to acquire earning assets needed to service that debt.

The drop in the quality of corporate debt was symptomatic of deeper problems. The rationale for increased leverage is to improve profitability. If the cost of borrowing is less than the rate of return on the assets acquired with those funds, then the earnings on investment will go up. This did not happen.

One of the iron laws of economics is that savings and investment are equal — not sometimes, but always. If profitability declines, then savings will decline. If savings decline, then investment will decline. If investment declines, the trade balance will not improve. In that case, both the dollar and U.S. living standards will gradually erode relative to other industrial nations.

H. Erich Heinemann is chief economist of Ladenburg, Thalmann & Co., investment bankers in New York.

COLUMN RIGHT/
PAUL CRAIG ROBERTS

Forget Taxes; When in Debt, Stop Spending

■ Today's deficit was built on wild miscalculation of revenues

When President Bush broke his word and hiked our taxes by $166 billion, he promised that it would help reduce the deficit. However, not only did the budget deficit rise by $803 billion over the next five years in place of the promised $500-billion decline, projected revenues fell by $297 billion. In effect, the hike lost nearly $2 for every projected $1 rise in revenue.

Of course, the government will blame this on the recession, but policy-makers knew that a recession was in the cards before they raised taxes. Yet they proceeded with a policy that every school of economics says is counterproductive.

Tax hikes take a toll on economic activity and reduce the growth of the revenue base. During an economic slowdown, revenues are falling automatically with the decline in sales, profits and incomes. In such a climate, a tax increase contributes to the economy's decline.

The recession of 1981-82, for example—during Paul Volcker's tenure as head of the Federal Reserve—cost the Treasury more in lost tax revenues during 1982 and 1983 than the Reagan tax cut did. The two-year static revenue cost of the tax cut totaled $118 billion. The recession, however, stopped all growth in federal tax receipts for two years and deprived the Treasury of about $140 billion in revenues.

In a miscue of policy control, the Reagan Administration added a major tax increase to this recessionary climate—the Tax Equity and Fiscal Responsibility Act of 1982. Its purpose was to reduce the revenue loss of the 1981 tax cut by repealing most of the business-tax reductions.

The Treasury estimated that the measure would raise $229 billion from 1983 to '87 and reduce the cumulative deficit from $636 billion to $407 billion. The tax increase passed, and by the end of the year the deficit estimate had tripled to $1,248 billion. The actual deficits for that five-year period totaled $976.2 billion—240% larger than the tax hike advocates had predicted.

Tax increases add to red ink for another reason. Governments always forecast more revenues from tax increases than materialize. These optimistic predictions encourage the continuation of spending, but because the revenues are "phantom receipts," the deficit persists and sometimes widens.

After cutting taxes in 1981, the government decided to regain the revenues through a series of tax increases. Every year saw a tax hike. Some were large, and some were small. Altogether, legislated and unlegislated (bracket creep) tax increases more than offset the 1981 tax cut by several hundred billions of dollars. The budget deficits, however, persisted, and today, after another large tax increase, the budget deficit has hit record highs.

'For the past decade, Washington has made the wrong budget choice every year.'

If the recession is lengthy or the recovery sluggish, the red ink will persist. Politicians will blame the economic doldrums on the deficit and promise better times if taxes are raised to balance the budget. The tax hikes will lead to more spending of phantom revenues and to slower growth of the tax base.

States are not immune to this process. The cessation of the long Reagan expansion has left gaping holes in the budgets of states that failed to plan for a rainy day. For example, California has a pit $13 billion deep. Judging from New Jersey Gov. James Florio's tribulations, a tax hike won't help. Last year, New Jersey enacted the largest tax increase in the history of the 50 states, but sales and income taxes are running far below projections and the state continues to sink in red ink.

Ultimately, the incidence of taxation falls on economic growth. Inflation and redistribution are the hallmarks of an economy with bad incentives. As the United States moves in this direction, capital will leave as long-term investments look for a more hospitable climate.

For the past decade, Washington has made the wrong budget choice every year. The budget went into imbalance when the Fed froze revenues for two years as the price of its anti-inflationary policy. Spending, however, did not slow down and proceeded as if the revenues were there. The obvious solution was to bring spending back in line with revenues. This would have required two one-year spending freezes, which could have occurred separately during the decade. Indeed, a near-freeze occurred in 1987, which knocked $72 billion off the deficit. One more would have done the trick.

Instead, Washington relied on tax hikes, and in 1991 the budget deficit is estimated to be $318 billion—$100 billion above Ronald Reagan's old record. It is fashionable to ridicule the "Laffer curve," but the real joke is on those who believed tax hikes were the path to a balanced budget.

Paul Craig Roberts is the William E. Simon professor of political economy at the Center for Strategic and International Studies in Washington.

172

THE BUDGET

Congress Approves Blueprint For Fiscal 1992 Spending

Congress finished an unusually friction-free budget process this year by approving the conference report on the fiscal 1992 budget resolution May 22 — the second earliest date that has happened since 1982.

But the House Appropriations Committee's subcommittee chairmen had already drafted their own spending plans a week earlier, fueling criticism that this year's resolution is largely irrelevant.

By the time the House and Senate voted largely along party lines to approve the $1.45 trillion budget, House appropriators were already making the real spending decisions. The appropriators tracked some of the budget drafters' recommendations but shifted priorities in several areas.

Critics say budget writers were so hemmed in by tight new spending restrictions from last fall's budget deal that they had little room to draft a meaningful expression of congressional priorities anyway. But House Budget Committee Chairman Leon E. Panetta, D-Calif., said the budget was important precisely because it reaffirmed Congress' commitment to stick by the new rules it had agreed to — despite the pain they have inflicted.

The conference report was approved 239-181 in the House and 57-41 in the Senate. *(House vote 112, p. 1408, Senate vote 75, p. 1411)*

The new budget resolution adheres to strict caps for discretionary spending for defense, international and domestic programs. It does not propose to raise or lower any tax or entitlement spending (programs such as Medicare and food stamps). And it insists that if such changes are made later, they be along pay-as-you-go guidelines, as required by the budget deal.

Democrats claimed that the budget laid out significant differences between their priorities and those of the Bush administration — increasing spending for a variety of education, health and job training programs while cutting b[illegible] on Bush proposals in areas such as [illegible]ce exploration.

Republicans [illegible] the differences were minimal, and they further criticized the Democrats for including $1.8 billion in unspecified spending reductions that allowed the majority to keep the numbers high for programs such as education without spelling out how to make the cuts to get there.

By George Hager

Budget '92

BOXSCORE

Bill: H Con Res 121 — H Rept 102-69 — Fiscal 1992 budget resolution.

Latest action: Conference report adopted May 22 — by the House 239-181 and by the Senate 57-41.

Background: The budget resolution is a set of guidelines for congressional spending; it is not enacted into law.

Reference: Tax fight, Weekly Report, p. 1183; Senate passage, p. 1040; House passage, Senate committee action, p. 962; House committee action, p. 903; Bush budget, p. 332.

The House and Senate budget resolutions differed little, and in most cases conferees made only minor changes to reach a compromise in the conference report.

The hottest single dispute in the budget conference turned into a fizzle on the Senate floor when Republicans largely passed up the opportunity to hold Democrats' feet to the fire on the issue of new taxes.

Republicans had managed to add a provision in the Senate Budget Committee to bar using tax increases to pay for new or expanded entitlement spending under pay-as-you-go rules.

But Senate Finance Committee Chairman Lloyd Bentsen, D-Texas, bitterly objected, charging that the restriction would hamstring his committee in trying to fashion critical new spending for health care, unemploy-

173

ment and other programs.

House Republicans staged a knock-down, drag-out debate on the issue May 9 when they tried and ultimately failed to instruct House conferees to support the provision in conference. Democratic conferees stripped the provision from the conference agreement, and Senate Republicans were expected to take advantage of floor debate to paint the Democrats as "tax and spenders," just as their House colleagues had done.

But Senate Republicans agreed to cut the 10 available hours of Senate debate to two, and while they attacked Democrats, they did so with little of the zeal evident in the House.

Amendment cosponsor Hank Brown, R-Colo., declined to speak for his provision, leaving it to Budget Committee ranking Republican Pete V. Domenici of New Mexico and fellow GOP Budget member Phil Gramm of Texas to argue that Democrats were looking for ways to raise taxes.

In the end, it appeared that Bentsen's fury and mixed signals from Minority Leader Bob Dole, R-Kan., took the fight out of the GOP.

"You're going up against the chairman of the Finance Committee," explained one key Senate aide. "He doesn't forget these things." And in contrast to the House's bare-knuckled debate on the issue, he added, "It's a much more clubbish environment over here."

Balanced Budget Amendment

Meanwhile, the Senate Judiciary Committee voted 11-3 on May 23 to approve a resolution (S J Res 18) that would amend the Constitution to require a balanced federal budget.

The resolution, sponsored by Paul Simon, D-Ill., would allow Congress to waive the amendment by a three-fifths vote of both houses. It could also be waived when a declaration of war was in effect or when the United States was engaged in a "military conflict" that threatened national security.

The panel rejected, 6-8, a competing resolution (S J Res 5) by Arlen Specter, R-Pa., that would also have called for a balanced budget amendment but would have required a three-fifths vote in both houses for a tax increase.

The House failed to pass a balanced budget amendment last year; the Senate narrowly rejected a similar amendment in 1986. If approved by both chambers, the amendment would have to be ratified by legislatures of three-fourths of the states within seven years. *(1990 Weekly Report, p. 2284)* ■

Fiscal 1992 Budget Resolution

(In billions of dollars; totals may not add due to rounding)

	Bush's Budget	House Passed	Senate Passed	Final
National Defense				
Budget Authority	$ 290.8	$ 290.8	$ 290.8	$ 290.8
Outlays	295.3	295.3	295.3	295.3
International Affairs				
Budget Authority	21.9	21.9	22.3	21.9
Outlays	17.8	17.9	17.9	17.9
Science and Space				
Budget Authority	18.9	17.7	16.5	17.1
Outlays	17.5	16.8	16.2	16.5
Energy				
Budget Authority	4.9	6.2	5.4	6.2
Outlays	4.3	4.5	4.5	4.5
Natural Resources				
Budget Authority	19.8	19.4	19.5	19.5
Outlays	20.0	19.4	19.7	19.4
Agriculture				
Budget Authority	22.1	22.3	22.6	22.[illegible]
Outlays	16.9	17.0	17.1	17.0
Commerce and Housing				
Budget Authority	107.2	107.5	107.7	107.7
Outlays	103.4	104.3	104.6	104.5
Transportation				
Budget Authority	34.3	34.6	33.8	34.6
Outlays	33.4	33.7	33.5	33.7
Community Development				
Budget Authority	5.6	6.1	5.9	6.1
Outlays	6.7	6.7	6.7	6.7
Education and Social Services				
Budget Authority	46.8	51.0	54.2	53.1
Outlays	45.0	47.4	48.2	47.9
Health				
Budget Authority	81.8	83.1	82.9	83.1
Outlays	82.7	83.4	83.3	83.3
Medicare				
Budget Authority	117.4	120.1	120.0	120.1
Outlays	114.1	116.9	116.8	116.9
Income Security				
Budget Authority	220.2	221.9	222.2	222.2
Outlays	179.8	180.1	180.9	180.3
Social Security				
Budget Authority	356.4	356.6	356.6	356.6
Outlays	287.1	286.9	286.7	286.9
Veterans' Benefits				
Budget Authority	32.9	34.4	34.3	34.3
Outlays	32.6	34.0	34.1	34.0
Justice				
Budget Authority	14.8	14.2	13.2	13.7
Outlays	14.8	14.2	13.5	13.6
General Government				
Budget Authority	12.5	11.6	12.7	11.6
Outlays	13.1	12.2	12.6	12.2
Net Interest				
Budget Authority	210.2	209.9	209.9	209.9
Outlays	210.2	209.9	209.9	209.9
Allowances				
Budget Authority	−0.2	−0.2	−1.4	−0.2
Outlays	−13.5	−13.5	−14.5	−13.2
Offsetting Receipts				
Budget Authority	−39.0	−39.1	−38.8	−40.6
Outlays	−39.0	−39.1	−38.8	−39.3
TOTALS				
Budget Authority	$ 1,579.3	$ 1,590.0	$ 1,590.2	$ 1,590.1
Outlays	1,442.2	1,448.0	1,448.0	1,448.0
Revenues	1,172.2	1,169.2	1,169.2	1,169.2
Deficit	270.0	278.8	278.8	278.8

NOTE: Numbers in this table reflect House Budget Committee adjustments. Totals in the House and Senate resolutions and the president's budget proposal have been readjusted to be comparable to the estimating assumptions used in the conference report. This makes it possible to view policy differences, rather than mechanical or estimating differences, between the various budgets. Totals for the Senate budget resolution and the conference agreement display total budget figures, instead of on-budget figures only.

SOURCES: Congressional Budget Office, House and Senate Budget committees

SELECTED TOPICS

U.S. Economy Will Soon Rebound, Says OECD

The Organization for Economic Cooperation and Development (OECD), comprising 24 industrial countries, forecasts that the U.S. economy will emerge from recession in the second half of 1991. The Paris-based organization says that the American economy will grow at an annual rate of 2.7 percent in the second half of 1991, following a drop of 1.8 percent in the first six months of the year.

For the year as a whole, the United States will show negative growth of 0.2 percent, according to the OECD. Next year, the U.S. economy will grow at a rate of 3.1 percent.

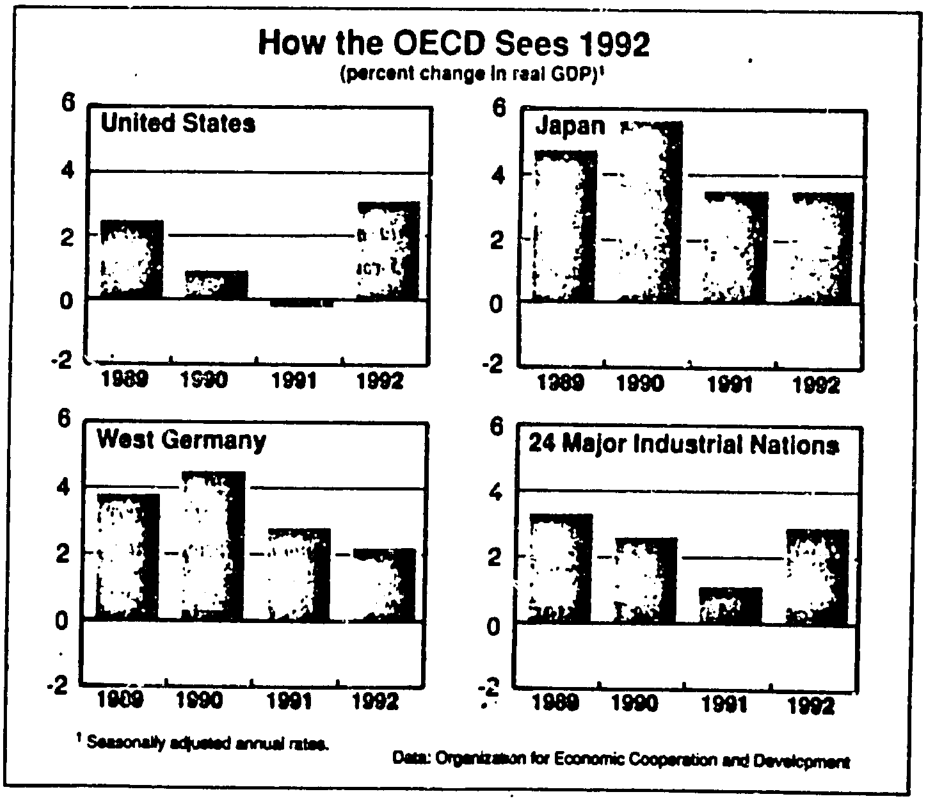
As for Germany and Japan, the world's other two bellwether economies, the OECD expects the former to experience growth of 2.8 percent in 1991 and 2.2 percent in 1992, while the latter should grow by 3.5 percent this year and by a similar rate in 1992. For its member nations the OECD projects an overall annual growth rate of 2.4 percent in the second half of 1991 and 2.9 percent next year, compared with growth of only 0.3 percent in the first half of this year.

OECD officials base their prediction of an economic rebound in the industrial world on lower interest rates in Canada, the United Kingdom, the United States, and some smaller European countries. In addition, the end of the Middle East conflict has helped raise consumer confidence. "From now to 1992," maintains one OECD official, "all the countries of the industrial world will be growing." However, growth will be relatively modest compared to the recovery from the 1981–82 downturn. "We don't expect a vigorous recovery," notes the OECD's Secretary General, Jean-Claude Paye, "notably because the slowdown wasn't profound and didn't last very long."

The OECD forecast is also optimistic about inflation in its member countries, where as a group, prices should rise by 4.4 percent this year, and then drop to 3.8 percent in 1992. Inflation in the United States is projected to decrease to 3.6 percent next year from 4 percent in 1991. Similarly, inflation in Japan should drop to 1.9 percent from 2.3 percent. On the other hand, Germany, which is committed to vast budgetary outlays to invigorate the moribund economy of the former German Democratic Republic, should experience a rise in inflation from this year's 4 percent to 4.2 percent in 1992.

Unfortunately, the relatively modest economic rebound will not make a dent in the unemployment rate in the industrial nations. For the OECD as a whole, the jobless rate will remain static at 7.1 percent for this year and next. It will rise slightly in both Germany (to 5.1 percent from 5 percent) and Japan (to 2.3 percent from 2.2 percent) and decline in the United States (to 6.3 percent from 6.7 percent).

Gerald R. Rosen,
Editor, *IMF Survey*



World Interest Rates

BY RALPH C. BRYANT

Ralph C. Bryant is a senior fellow in the Brookings Economic Studies program. He is the author of numerous books and articles on international economics, including Money and Monetary Policy in Interdependent Nations *(Brookings, 1980) and* International Financial Intermediation *(Brookings, 1987).*

Should other nations change their policies to make life easier for the United States? Yes, answers the U.S. government from time to time, appearing to equate international cooperation with the desired foreign response. Not surprisingly, U.S. efforts to "cooperate" in that spirit have been less than a brilliant success.

The most recent such effort was mounted this spring, when Germany and Japan were pressed to lower their interest rates. In public statements, and probably in numerous private meetings, U.S. officials stressed an urgent need for lower world interest rates, with the implicit or sometimes explicit assertion that the Bundesbank in Germany should take the lead. Lower interest rates in Germany and other foreign nations, it was presumed, would strengthen foreign economic activity and thus U.S. exports, thereby countering the U.S. recession with expansionary stimuli from abroad.

The Bundesbank disliked the U.S. advice. Germany, enmeshed in its struggle to reunify, has recently experienced robust growth amid signs that inflationary expectations are rising. Since the hyperinflationary trauma of the 1920s, Germans have had a strong aversion to inflation. Given that predisposition and given its assessment of the country's economic situation, the German government saw the U.S. request to lower interest rates as altogether inappropriate.

The American pressure on Germany might have sprung from a naive yearning to get someone else to change policies to help ease the U.S. recession. Less simplistically, but still naively, the U.S. administration may have been arguing that Germany puts too much stress on the goal of low inflation and too little on the goals of high employment and robust growth (translation: "Germans should have *our* priorities"). A third possibility is that U.S. officials analyzed the German economic situation differently, believing that German inflation was not threatening to increase and that growth would be insufficiently strong. Whichever attitude best describes the administrations's views, none represents a constructive approach to genuine international cooperation.

Inflation-adjusted ("real") interest rates in the world economy are still relatively high by historical standards, as they were for much of the 1980s. One explanation is that many governments have permitted budget deficits to grow excessively, thereby leaving themselves no choice but to rely unduly on tight monetary policies to curb unsustainably high growth in aggregate spending. The United States is a prime culprit, but Germany is also now in this predicament. (Recently both nations have taken some actions to reduce bloated fiscal deficits, but not enough.) The world economy would be better off with a changed "mix" of fiscal and monetary policies: more budgetary restraint and correspondingly easier monetary policies, with the combination of both policies set to maintain steady, noninflationary growth.

Over the next decade, additional demands for the world's savings are likely—for example, for investments in the East European and Soviet economies. These new circumstances make it even more plausible to argue that needed investments and vigorous growth in the world economy would be better assured if the major economies would alter their policy mixes, substituting fiscal restraint for monetary restraint, thereby lowering real interest rates below where they would otherwise be.

Did the U.S. administration have in mind such a change in the mix of fiscal and monetary policies as it pressured Germany to ease monetary policy? Probably not, to judge from the public statements. Nor would it have been credible to take such a position without proposing, first and foremost, a change in the mix of policies for the United States itself.

Increasing interdependence in the world economy does raise the potential value of intergovernmental cooperation. The essence of successful cooperation among sovereign nations, however, is a self-interested, mutual adjustment of behavior. Cooperating governments will typically not have common goals or even goals that are compatible. And to argue that other governments should give up their goals in deference to our goals is to undermine the potential for cooperation. Notwithstanding its position as the single most powerful nation in the world economy, the United States should forgo efforts to bully or lecture other governments to take actions that they perceive to be contrary to their own interests.

If the United States really wants to promote international cooperation, Americans themselves must be more forthcoming. Cooperation must begin at home. We should develop potential adjustments of U.S. policies to bring to the international bargaining table—for example, credible further progress in reducing the federal budget deficit combined with appropriate offsetting relaxation of U.S. monetary policy. Only when Americans can deliver—when we exert genuine leadership—does it make good sense to pound the table demanding actions by others. Even then, it makes more sense—and would probably be more effective—to pound it privately. ■

May/June 1991
Vol.4, No.3

The Credit Squeeze:

HELMUT SCHLESINGER
Deputy Governor
Deutsche Bundesbank

After joining the Bundesbank's predecessor in 1952, Helmut Schlesinger headed the Research and Statistics Department. He became a board member in 1972, and he is now in charge of the bank's credit area, including money market management.

We hear conflicting views today about the global liquidity squeeze. After rapid expansion in the 1980s, international net lending recently has declined, but only slightly (see table A). Nevertheless, there is a wide range of opinion about this topic, with some people believing there is a credit crunch or a liquidity squeeze, and still others that the credit crunch is a myth.

A key distinction in the debate is whether the problem is a regional or global one. It goes without saying that in today's highly integrated world financial markets, any regional problem has the potential of expanding to global proportions. But first, we must distinguish carefully between the different features and causes of this topic so that we can get a better understanding of what we are facing.

"Stopping bank loans to overexposed real estate projects, corporations and households will leave more room for better loans."

As early as 1989, the IMF pointed out in its World Economic Outlook that, in the years to come, we would face a declining trend in the savings ratio (i.e. the share of GNP used for savings) and an increasing need for capital. Private savings in the industrial countries decreased from an average of 21% of GNP in 1980 to about 19.5% last year (see Table B). Public savings did not fill the gap completely, so for many countries the rest had to come from foreign sources.

Much of the increased need for capital is the result of exogenous factors. These include the unification of Germany, the reforms in Central and Eastern Europe and the reconstruction of the Persian Gulf. Together, the trends toward reduced savings and higher capital needs have been reflected in higher real interest rates.

RECESSION AND THE BANKS

Some countries, including the US, are experiencing financial strains as a result of the end to an extended eight-year business cycle. To a large extent, this is the normal type of "cleansing" that occurs in most recessions. However, the strains have been aggravated by two additional factors. First, financial deregulation in the eighties resulted in a large number of so-called highly leveraged transactions as well as inflated asset values, especially in the US and Japan.

Second, some international banks are finding it difficult to meet the new BIS capital standards recommended by the central banks of the G-10 group of countries. As a result, these banks have reduced their international lending. They also have cut back on their sales of assets to other financial and non-financial institutions, and they have shifted into more high-quality investments, such as government securities.

There is another difference between the present recession, which is centered mostly in the English-speaking countries, and earlier boom-bust cycles. It can be argued that the recession is more or less self-inflicted because the countries involved are highly over-exposed to household, public and corporate debt. With the prevailing high interest rates and a grim business outlook, many debtors find it undesirable to pile up further debt. This seems to be healthy and, at any rate, unavoidable. It will leave more financing available for projects that have a sounder basis for earnings and debt servicing.

As a result of these strains, there is a shift to better quality lending. At the same time, some big international banks are losing market share to those banks – often strong US regional banks and European banks on the continent – that have a better balance-sheet mix. In addition, it is no longer fashionable for banks to buy market share at low margins.

One way out for overexposed banks might be to increase their capital base through issues of new shares, even if at present this proves to be costly. Of course, issuing banks must be well positioned to earn a good return on the added capital if they are to attract equity investors.

What does all of this mean for the real economy? Will there be a loss of economic growth due to a lack of bank credit for the corporate sector? This need not be the case, because stopping bank loans to overexposed real estate projects, corporations and households will, in fact, leave more room for better loans. Although some borrowers with sound projects may be crowded out in this process, I nevertheless think that the so-called credit crunch is largely a myth.

In addition to more sound lending, we also need to boost world savings. This can be achieved through policies that encourage greater private savings – or in some cases that simply remove

Fewer loans for unsound borrowers is good for the economy

Is It A Myth?

disincentives to saving. In some countries, measures to reduce government budget deficits are also essential to freeing up larger sums of private savings.

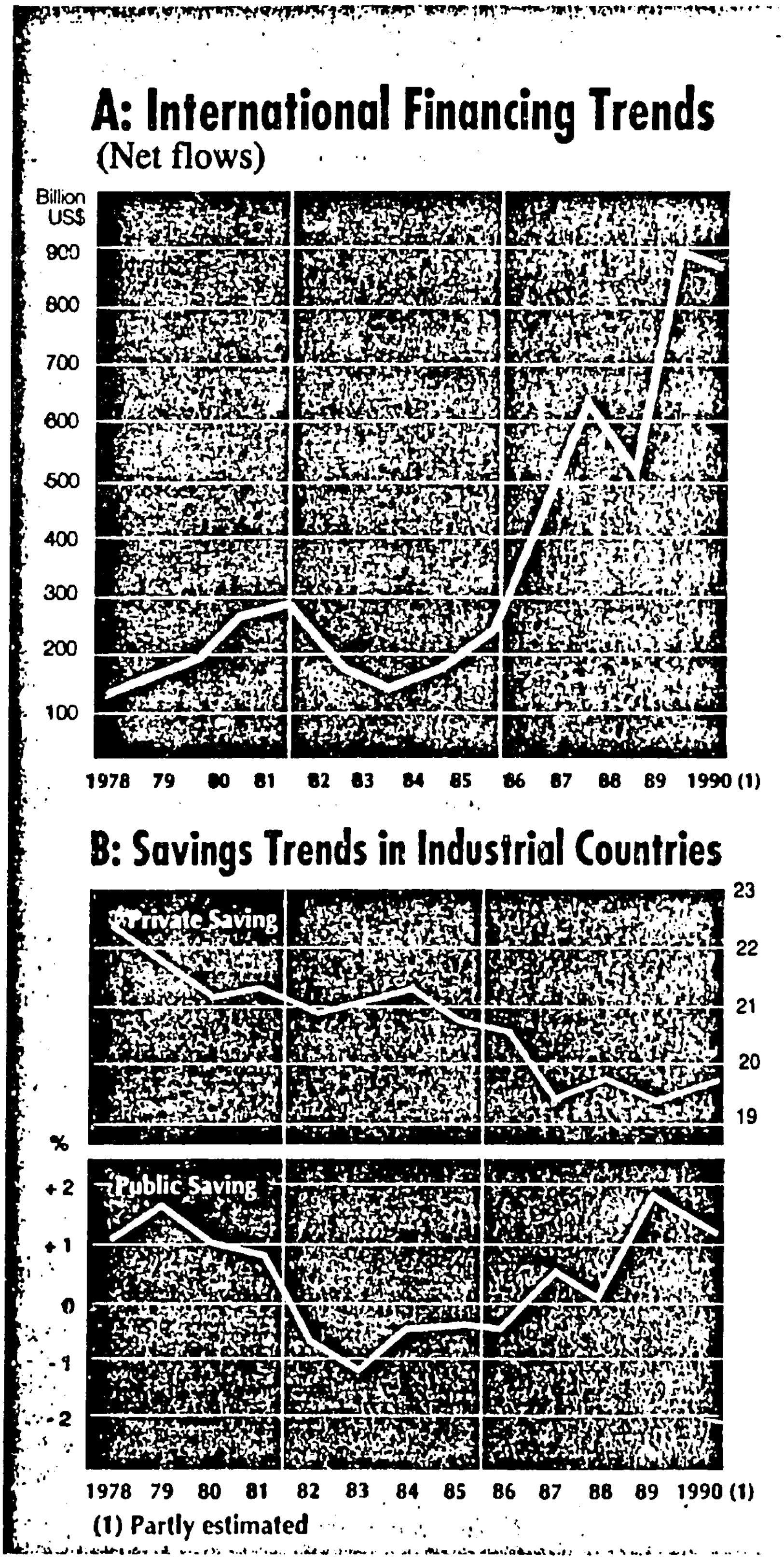
Germany, of course, has a history of being a net saver and a net provider of capital funds to the rest of the world. This has changed somewhat due to the country's reunification. Net capital exports to the rest of the world will be low in the current year. But the somewhat higher use of borrowed funds by the German government should last for only a few years, and it is scheduled to drop to pre-unification levels by 1994.

We are quite convinced that the impact of German monetary union, as well as the increased public borrowing requirements, have had only very limited effects on world financial markets. Those effects have to be balanced against the benefits that increasing German demand for imports and the reduction in our balance-of-payments surplus will have for those countries with sluggish domestic demand.

How, then, should central banks respond to the so-called global liquidity squeeze? Some of my central bank colleagues are faced with specific problems, which require specific solutions. In particular, they may come under pressure to ease their stance on monetary policy and to relax their capital adequacy standards for banks. But these measures could prove to be self-defeating because they would reduce market stability and confidence, which are important preconditions for increased private savings.

In addition, the internationalization of financial markets and the spread of electronic data communication make it impossible for different capital standards to coexist for an extended period of time. The markets have learned to evaluate financial quality, as is shown by the increased spreads in interbank, as well as in corporate, lending. I feel, therefore, that the markets will help to sort out the problems in credit quality.

On balance, then, we seem to be experiencing a shift in the patterns of international lending, rather than a drying-up of resources. The global impact of subdued lending in certain countries results from the fact that the internationalization of financial markets ensures that shock waves from one part of the world are transmitted to other parts. This underlines the importance of international monetary cooperation and coordination to the creation of a favorable environment for increased private and public savings. Such an environment will be essential to meeting the investment needs of the future. ■



The G-7 Dilemma: Agreeing On Cost Sharing

by C. Randall Henning

The United States, Europe and Japan should adopt as their essential task a system of comprehensive collective security, one which ensures economic as well as political well being, to capitalize on dramatic changes in the Soviet Union and Eastern Europe. Doing so, however, will require a fundamental renegotiation of their Cold War bargain. The successful expulsion of Iraq from Kuwait, and the sharing of the costs of the military operations, is a hopeful precedent for the post-Cold War period. But disagreements cropped up over the cost-sharing and loom as a potential stumbling block for any ongoing collective security arrangement.

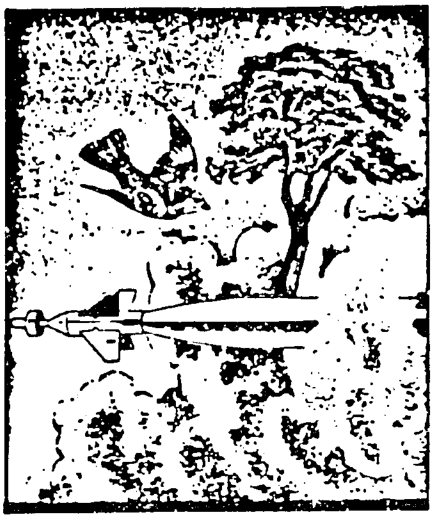
First, changes in the relative strengths of nations have produced a continuing debate over international roles, burdens, benefits and responsibilities. Second, disagreements during the Gulf operation over estimates of US budgetary costs, exchange rate losses on the payments, US arm twisting to secure them, and ignored contributions to other regions of international tension, such as Eastern Europe, created bitterness among the partners. These difficulties were kept within modest proportions because one half of the cost of the Gulf War was "self-financed" by increased oil revenues of frontline states; the cost-sharing in future crises is likely to be more complicated. Already, Europeans urge Americans to contribute more to Eastern Europe and the Soviet Union. Japan has opposed American debt reduction proposals, revoking a loan promised to Poland after its debt to foreign governments was cut by half.

Although collective security will involve other major powers, the Group of Seven countries must be primarily responsible for organizing its economic and financial underpinnings. This sharing of responsibilities will be an underlying theme of the July G-7 summit meeting in London. But several key issues must be clarified before cost-sharing can be addressed in a systematic way. First, over what domain are costs are to be shared? Second, what are the appropriate criteria to divide these costs into country shares? Third, in what form should national quotas be filled? Fourth, how should operational control over the collective task be assigned; does burdensharing necessarily entail power sharing?

International bargains can be struck across a variable domain. Governments might trade concessions solely within a single economic area, as during the current round of GATT negotiations. They can exchange concessions across different economic areas, such as at the Bonn summit of 1978, when Germany and Japan agreed to administer fiscal stimulus in exchange for the US decontrolling oil prices. Bargains also can be struck between economic and security matters, exemplified by Japanese foreign assistance to US third world allies (Turkey, Pakistan and the

Philippines).

As governments move from intra-issue to economic-security linkages, however, the complexity increases of calculating appropriate contributions, arriving at an agreement, and "ratifying" it domestically. The nexus of issues before the London summit is very broad and includes: financing Eastern European and Soviet reforms, the use of international financial institutions, Persian Gulf problems, energy, trade, immigration, environment and third world concerns. Aggregating national commitments in all of these would render any bargain unsustainable. How can cost-sharing agreements be limited to a manageable scope?



Burdensharing discussions should concentrate, first, on matters which have the character of a public good. An international public good is one in which use does not diminish availability to others and from which no country can be excluded. Prevention of global warming and ozone depletion, nuclear deterrence, deterrence of aggression in general, monetary and financial stability, and international regimes are all in some degree public goods.

Public goods tend to be undersupplied, as countries can benefit from them whether or not they bear their costs of supply—the free rider problem. Governments benefit from the exchange of private goods, as when swapping airline landing rights, bilateral market access and non-aggression guarantees, and those gains should be pursued. But, because the undersupply of public goods is greater than the risk of failure to provide private goods, special collective energy should be devoted to providing the former.

Second, governments should try to balance costs within each issue area before moving on to broader linkages. Bargains are best formed around issues that are linked functionally or technically. The world will clearly benefit from a Japanese concession on rice imports, for example. But that concession should not be "credited" to Japan's bill for the cost of Desert Storm because it is so tenuously linked to the Persian Gulf problem. The tenuousness of the functional linkage would render the political linkage tenuous as well, because of the strong perception within the United States and elsewhere that Japan is a free rider in trade matters. To sustain domestic political support for the bargain—a third major requirement—it is better to link difficult rice import liberalization to equally courageous EC and US decisions on agricultural trade.

This is not to deny the value of multiple-issue bargains. The burdensharing talks at the London summit should couple finance with security in Eastern Europe and the Soviet Union because Western assistance can help to consolidate democratic and market reforms there. Police actions outside Europe draw on the same G-7 military forces and budgets; European and out-of-area collective security are therefore linked. Savings, investment and macroeconomic policies within the G-7 bear on the capacity to meet huge capital needs in Eastern Europe, the Soviet Union and Persian Gulf, which could potentially crowd out Latin American borrowers.

These issues, therefore, define the appropriate domain over which cost-sharing negotiations should be conducted. Beyond this, for example, the European Community might be credited in multilateral negotiations for trade concessions granted to Eastern Europe and the Soviet Union. But in general the Uruguay Round, the environment and other unrelated issues should be discussed separately at the London summit and not as part of an overall cost-sharing package.

How should national shares be decided? The primary criterion in assigning a country's financial or budgetary responsibility should be the degree to which a country draws benefits from collective action.

Among the G-7, the best criteria might be population and economic size as measured by GNP. Narrower criteria might be appropriate in particular cases. If the economic and political reforms in Poland fail, for example, Germany (first) and Western Europe (second) would absorb Polish immigrants and forgo trade opportunities. When dividing up the share of financial support to Poland, trade linkages and vulnerability to migration are rough indicators of the extent to which countries might benefit from collective support. In the Persian Gulf contingency, national oil consumption is a relevant indicator. In both the Polish and Persian Gulf cases, however, narrow indicators would not be sufficient as more than trade and oil are at stake.

The distribution of costs within international organizations such as the United Nations, the World Bank and IMF can also be guides. One compelling advantage of using international organizations for collective action is that cost-sharing has long since been pre-negotiated in their quotas and budgets.

Finally, taxes could be used to assess each contributor proportionately to his benefits. A tax could be levied on oil imports to finance the Persian Gulf operation and continuing refugee problem, for example, or indirectly on international trade to support the maintenance of the open multilateral regime.

The principle of comparative advantage should apply to the form in which the contribution is made, military, political, economic, or financial. Europe, Japan and the United States have been endowed with different capabilities and world roles. They have benefitted greatly from specialization along the lines of their comparative advantage and exchange. In the new international environment, Japan and Germany have considered taking more active military or logistical roles outside their respective regions. But those roles should be limited, for example, to military forces in support of a multilateral venture or sending minesweepers to the Gulf. Going further by creating an active independent military policy would create more problems than would be resolved. The division-of-labor strategy—by which Germany and Japan contribute predominantly economic, financial and political resources for security objectives while the United States and others place greater emphasis on military contributions—has been beneficial in the past and should continue.

Some deride this strategy as relegating the United States to a mercenary role. But the Bush administration, with the coalition partners, defined the major objectives as well as the operations of the Persian Gulf War. Mercenaries sell their services to others who define war aims; their political interests are not engaged. Thus, the mercenary label does not apply.

Financial shares of a budgetary burden such as the cost of sending the US military to the Gulf, parenthetically, should be defined in the currency in which the costs are incurred. National budgetary authority and even actual payments can remain in local currency. But, governments should anticipate the possibility of exchange rate changes when formulating their budget proposals to maintain the value of their contribution. By following this sensible guideline—which should apply equally to US shares of foreign governments' costs in future contingencies—disputes over exchange rate risk can be avoided.

But if the G-7 is to systematize cost-sharing across multiple issues, how should a political or military contribution be weighed against an economic or financial contribution? How much would a promise to admit Poland, Czechoslovakia and Hungary into the European Community be worth in terms of lending to Eastern Europe? How much would a tightening of German export control laws and regulation be worth in terms of military spending for Gulf contingencies? Even more intractably, how much Japanese financing would be equivalent to Coalition casualties in the war?

There is no formula or blueprint for evaluating such qualitatively different contributions. The bargaining positions of governments—dictated by their international position and domestic political strength, given the particular set of issues on the agenda—will determine the "relative prices" of different contributions.

Finally, does sharing costs necessarily require sharing decisionmaking power? The answer is that the objectives of collective action must reflect the interests of the contributors. As long as that rule is satisfied, operational control can be centralized in an executive body; it need not be dispersed among the membership. The Bush administration persuaded other countries to subscribe to US objectives in the Persian Gulf while at the same time concentrating internationally legitimized authority through the United Nations Security Council. The Germans and Japanese, major financial contributors, had no voice on the Security Council, nor in the timing and details of the military operations. However, the operation itself was in their basic interests just as much as in the interests of the Permanent Members. Indeed, maintaining proportionality of rights and obligations in collective endeavors argues for those countries which contribute troops as well as money to have greater weight in decisionmaking than those contributing financing alone. As in private corporations, senior and subordinated classes of "shareholders" should exercise differentiated prerogatives.

A final word of caution is needed. The major powers will be tempted to solve the problem of burdensharing by resorting to regional hegemonies. Under this approach the European Community would assume responsibility for Eastern Europe, Japan for East Asia, and the United States for Latin America. The spheres-of-influence solution was disastrous historically, and it would be the wrong solution in the post-Cold War, post-Pax Americana world.

There are several reasons: the capital needs of each region vary greatly and not in proportion to the financial power of would-be regional hegemons; a spheres-of-influence approach would weaken the multilateral system and limit the choices of the recipient countries; Hungary, Malaysia and Mexico, for example, benefit from financing and trade outside their regions. Also, this approach would not ensure the optimal supply of public goods as there would be disputes between the regional hegemon and the lesser powers; and important countries and regions, such as the Persian Gulf, could fall between the boards. Though it requires a more complex political bargain among major economic powers, an open multilateral system characterized by division of labor remains the best solution.

Capital Market Integration Has Benefits, But May Have Created New Risks

The growing integration of major domestic and international offshore financial markets in the 1980s has increased the efficiency of international capital markets, according to IMF Occasional Paper No. 77, Determinants and Systemic Consequences of International Capital Flows. *But, the study notes that structural changes in financial markets may have altered the effectiveness of monetary and fiscal policies, created new systemic risks associated with increased asset price variability, and made developing country access to international capital markets less certain.*

In the first chapter of the study, Morris Goldstein, Donald Mathieson, and Timothy Lane examine the growth in net and gross capital flows, the determinants of these flows, and the systemic consequences of the increased integration of international capital markets. The following article highlights their findings.

Trends in Capital Flows

Four main trends in capital flows emerged during the 1970s and 1980s. First, the scale of net and gross capital flows expanded sharply, and the participation of foreign investors and foreign financial institutions in the major domestic markets increased markedly.

Second, the easing of capital controls and the broader liberalization of financial markets in the industrial countries stimulated competition and brought about a growing integration of domestic and offshore markets, thereby increasing efficiency.

A third main feature of capital flows in the 1970s and 1980s was the use of private capital flows to finance the large current account and fiscal imbalances of the industrial countries. For example, private capital flows financed about 75 percent of the U.S. current account deficit in 1983–88. Moreover, within these private capital flows, flows of securities increased sharply relative to banking flows.

Another aspect of capital flows in the 1980s was the curtailment of developing country access to international capital markets. These countries relied more on official capital flows, and the pattern of private and official financing for developing countries in the late 1980s was similar to that in the early 1970s. Net non-debt-creating flows—foreign direct investment, official transfers, and grants—nearly matched the cumulative current account deficit of indebted developing countries in 1987–89.

Determinants of Capital Flows

Net capital flows serve as the financial counterpart to the transfer of real resources through a trade or current account imbalance. They arise only when saving and investment are out of balance within countries. Gross capital flows allow individuals and firms to adjust the form of the financial claims they issue, and, therefore, can be important in improving the liquidity of portfolios and in diversifying risks. Because these flows can be offsetting across countries, they need not involve a transfer of real resources.

It has proven difficult to identify empirically the determinants of gross and net capital flows, largely because capital markets can respond to shocks through a combination of capital flows and changes in asset prices. Most econometric models have ceased to be based on capital flow equations and now rely on financial linkages via interest rate parity relationships.

Net International Capital Flows Increase
(period averages)

	Germany			Japan			United States		
	1970–72	1979–81	1985–88	1970–72	1979–81	1985–88	1970–72	1979–81	1985–88
Capital account balance[1] (billion U.S. dollars)	–0.98	7.57	–37.57	–4.79	4.77	–75.12	1.63	–2.36	128.71
Capital account balance (billion U.S. dollars deflated by U.S. GNP deflator (1985 = 100))	–2.45	9.76	–35.95	–12.00	6.15	–71.88	4.08	–3.04	123.15
Capital account balance as percent of GNP	–0.45	0.96	–3.77	–1.88	0.48	–3.59	0.13	–0.06	2.93

[1]This is taken as the counterpart to the current account imbalance. A positive value indicates a capital account surplus (inflow).

Data: International Monetary Fund, *Balance of Payments Statistics*

Nonetheless, experience during the past two decades has highlighted the role of particular economic fundamentals and distortions in explaining capital flows. For example, it would be hard to understand the large-scale outflows from Germany in 1987–89 without referring to the planned withholding tax on interest income, or the large capital inflow into the United States in 1981–85 without noting the differences in its monetary and fiscal mix from that in Germany and Japan. Similarly, uncompetitive interest rates, large fiscal deficits, and high external debt burdens contributed to large-scale capital flight from developing countries in 1977–84.

Systemic Consequences

The increasing integration of financial markets has facilitated net and gross capital flows and yielded important efficiency benefits across nations. But it may also have created new systemic risks.

For example, financial innovations and liberalizations have increased the ability of borrowers to seek alternative sources of credit and provided lenders with new opportunities to place funds in global markets. As a result, relationships between monetary instruments, money stock, and nominal income have become less predictable. Monetary policy now works more through changes in interest and exchange rates than through liquidity or credit constraints. Nonetheless, the experience of the 1980s suggests that the ability of governments to use monetary policy to promote price stability has not been impaired.

The availability of external funding can also potentially weaken fiscal disciplines. In theory, private markets can impose discipline on errant borrowers—either governments or pri-

Payment Systems, Foreign Investment, and Capital Flight

Determinants and Systemic Consequences of International Capital Flows, Occasional Paper No. 77, was prepared by an IMF staff team. The first chapter, by Morris Goldstein, Donald Mathieson, and Timothy Lane, examines the trends in, reasons for, and consequences of international capital flows.

In the second chapter, David Folkerts-Landau examines both the nature of systemic risks in payment systems and the policies the authorities in industrial countries are currently implementing to manage such risks. He notes that efficient and stable payment systems are of fundamental importance in maintaining an orderly international monetary system. Folkerts-Landau concludes that central bank cooperation in strengthening international payment systems should complement the cooperation already achieved in the area of bank supervision and monetary policy.

J. Saúl Lizondo finds that there is no consensus on the determinants of foreign direct investment. However, aspects of industrial organization—especially transaction costs and structural imperfections that give an organization market power—seem to explain better the pattern of investment across countries and across industries. It is generally agreed that the motivations for foreign direct investment are different from those for portfolio investment. As a result, a given pattern of foreign investment flows does not necessarily have to be associated with a similar pattern of overall capital flows.

Liliana Rojas-Suárez focuses on the reasons behind capital flight from developing countries in the 1970s and 1980s, which drained resources that might have been used to increase domestic investment and debt-servicing capacity. She contends that the major reasons were the fear of expropriation of domestic assets and the risk of substantial losses in the real value of domestic assets arising from inflation and large exchange rate devaluation.

Rojas-Suárez suggests that the different perceptions of foreigners and domestic residents about the risks of holding domestic claims explain the simultaneous inflows of foreign capital and capital flight from developing countries in the 1970s. Differences in these perceptions, she notes, have been reduced since the onset of the debt crisis in 1982.

To stem capital flight, Rojas-Suárez urges the adoption of sound macroeconomic policies and structural reforms aimed at reducing the risks that initially gave rise to it. Once such policies and reforms are in place, she says, debt-equity swaps and foreign currency deposits may be complementary measures to help stem capital flight.

Copies of *Determinants and Systemic Consequences of International Capital Flows* are available for US$10.00 each (US$7.50 for full-time faculty and students) from Publication Services, Box S-318, International Monetary Fund, Washington, D.C. 20431, U.S.A.

vate entities—by progressively widening interest rate differentials and then, if necessary, excluding them from financial markets. For market discipline to work, there must be no guarantees of an official bailout and no monetization of borrowers' debts through central bank purchases of these debts; full infomation about the debtor must be available to market participants; and the financial system must be strong enough that no institution be viewed as being "too big to fail." Experience suggests, however, that, in practice, these conditions are not always met.

The integration of international capital markets has increased incentives and pressures for greater coordination of macroeconomic and financial policies. The case for crisis coordination, especially among central banks, has been strengthened by the growing rapidity with which financial shocks—like the equity market crash of October 1987—can spread internationally.

At times during the 1980s, official capital flows constituted a significant portion of total capital flows to developing countries and between industrial countries. While some official flows were motivated by noneconomic objectives—such as military or humanitarian assistance—others were aimed at altering the distribution of global savings and investment or at influencing asset prices (especially exchange rates) produced by financial markets.

Official flows to developing countries have helped to cushion the sharply reduced access to private financial markets suffered by many indebted developing countries since 1982. Therefore, official credits are likely to continue playing an important role in capital flows to developing countries—even those countries pursuing strong adjustment measures.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

EMBARGOED UNTIL GIVEN
EXPECTED 10:00 A.M.

STATEMENT OF THE HONORABLE
JEROME H. POWELL
ASSISTANT SECRETARY OF THE TREASURY
(DOMESTIC FINANCE)
BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

June 18, 1991

Chairman Gonzalez, Congressman Wylie, and Members of the Committee:

It is a pleasure to have the opportunity to comment today on the companion concepts of the "core bank" and the "wholesale bank," two proposals suggested for incorporation into the comprehensive banking legislation your Committee is now considering. If adopted, these proposals would fundamentally alter the traditional business of banking in the United States in ways that are difficult to forecast but that are potentially destabilizing. We are particularly concerned that the core bank structure could create or aggravate future credit crunches and otherwise disrupt routine commercial lending activities.

Nevertheless, we recognize that these proposals, despite their potentially serious problems, are intended to achieve the same result as the Administration's legislative proposal -- safer, more competitive banks. Indeed, some aspects of the proposals are merely more extreme versions of proposals included in the Administration's bill. As discussed in more detail below, there may be elements of the core bank proposal that could be modified in a way that the Administration could support as improvements to the Committee Print.

Let me say at the outset that we have seen a preliminary draft of two alternative core bank amendments. The first would create core banks only, without providing for wholesale banks; the second would establish core banks and wholesale banks as complementary elements of a single banking system. We understand

NB-1332

136

the text of these drafts is not final, and our observations on these proposals might change depending on later changes.

In my comments today I will review what we see as the aims of these proposals; describe the basic structure of the "core bank" and the "wholesale bank" as we now understand them; and set out the concerns we believe should be given consideration in any further examination of this approach. I should add that our concerns are somewhat different depending on whether the core bank amendment is offered alone -- which raises serious concerns about the availability of credit -- or in combination with the wholesale bank, which raises different concerns about spreading the safety net to new institutions and new activities. It would also allow large banks to avoid paying insurance premiums despite continued access to the federal safety net.

Aims of the Proposals

The basic aims of the core bank and wholesale bank proposals are the same as those of the Administration's proposal for banking reform: to limit the taxpayer's exposure to losses through the overextended federal "safety net," and to bolster the safety, soundness, and competitiveness of the U.S. banking system.

The Administration's banking reform package addresses these objectives in seven different ways. These are (1) a reduction in the overextended scope of deposit insurance, which directly reduces the taxpayer's exposure and directly increases market discipline on bank risk; (2) a strengthened role for capital; (3) direct restrictions on risky bank activities; (4) risk-based deposit insurance; (5) improved supervision of bank risk, especially through a new system of prompt corrective action; (6) nationwide banking and branching, which diversifies geographic risk and reduces unnecessary costs; and (7) new financial activities for organizations with well-capitalized banks, which will improve the overall profitability and competitiveness of the banking franchise.

This integrated package works straightforwardly to achieve its goals, and its consequences are well understood. As you know, legislation reflecting this proposal is now well-advanced in the legislative process and has received careful consideration by the Administration, by regulators, and by a number of Congressional Committees.

The core bank and wholesale bank proposals, however, seek to achieve the same objectives through a much more radical approach. They are intended to reduce risk in the system both by using deposit interest rate controls to significantly limit the amount of insured funds available to banks, and by severely constraining the types of activities in which banks will find it practical to engage. This extreme approach, described in detail below, is considerably more speculative and experimental than the legislation reported out of the Subcommittee on Financial Institutions.

Core Bank/Wholesale Bank Structure

Both of the draft amendments we have reviewed begin by requiring all insured depository institutions to become "core banks," which are described in three simple provisions. First, interest rate regulation: no institution that accepts insured deposits would be permitted to pay a return on any of its deposits, insured or uninsured, greater than 105% of the effective interest rate paid by Treasury securities of comparable maturity. Second, restrictive lending limits: all insured institutions would become subject to greatly reduced limits on the amounts they could lend any one borrower. These limits are calculated on a sliding scale: 15 percent of a bank's first $100,000,000 of tier 1 capital, 4 percent of the next $100,000,000 and 3 percent of any capital over that amount. Third, trading exposure limits: no insured institution could incur an exposure in connection with any trading activity greater than 5% of the institution's tier 1 capital.

These provisions are designed to eliminate excessive risk-taking by banks. By restricting the interest payable on deposits, the proposal would at times reduce the supply of government-insured funds to banks -- an attempt to address the perception that deposit insurance allows too much money to chase too few good lending opportunities. By restricting each loan to such a small amount of capital, the proposal ensures that insured banks will abandon "big-ticket" loans, such as HLTs, real estate finance, and other large-scale commercial lending. By restricting trading exposure, the proposal would require the transfer of most foreign exchange and swap activities out of insured banks.

As a stand-alone amendment, the core bank represents a fundamental change in our financial system. It assumes that all of the activities transferred out of insured core banks -- large commercial and industrial loans, commercial real estate loans, foreign exchange and swaps trading, and other types of intermediation -- will be adequately provided for by financial firms that are completely outside the banking system. This is a very large assumption, especially in view of the fact that all major industrialized countries generally carry out these

\98

functions within banks. If the assumption is incorrect, the consequences for credit availability and economic growth could be profound, as set forth in more detail below.

On the other hand, the second amendment would pair the core bank with the wholesale bank, a new creature in our financial markets. This combination amendment creates a somewhat different set of concerns than does the core bank by itself. Specifically, the wholesale bank provision would permit large institutions to avoid paying a substantial amount of insurance premiums despite continued coverage by the federal safety net; it could spread the safety net to new kinds of financial institutions; and in the end, it could defeat the very purpose of the core bank by allowing institutions merely to shift "risky" activities from one part of the safety net to another part.

A wholesale bank, as described in the draft amendment we have reviewed, is essentially a "universal" bank -- based on European models -- which pays no deposit insurance premiums while engaging in securities activities and the "big ticket" bank lending and trading activities prohibited to the core bank. Its status as a wholesale bank is dependent on one condition: that it accept no deposits of less than $100,000 from the general public. A wholesale bank would be free of the core bank interest rate cap, lending limit, and trading exposure restrictions and exempt from much substantive regulation of its nonbanking activities. It would remain, however, a bank: it could be a member of the Federal Reserve System, and would have access to the full safety net support mechanisms and subsidy represented by the Federal Reserve's discount window and access to the payments system. As a result, the federal safety net would be explicitly expanded to cover securities activities for the first time.

It is our understanding that a core bank and a wholesale bank could be affiliated in a single corporate group, though they need not be. Nevertheless, under this alternative the core bank and the wholesale bank would be intended to work together, whether under one roof or not. The core banks would receive all retail, insured deposits and confine themselves to a small-scale lending business, making few or no commercial or real estate loans; the wholesale banks would receive only uninsured deposits of $100,000 or more and conduct all large-scale lending and trading activities.

The proponents of core and wholesale banking have given careful thought to these approaches and their ideas deserve -- and have received -- serious attention from the Treasury and other policy makers. These are, however, untried theories and put into practice they would launch our financial system into uncharted waters. No major nation has organized its banking industry under the core bank/wholesale bank model.

THE WALL STREET JOURNAL MONDAY, APRIL 29, 1991

Two Enemies of Sound Banking

By Lowell Bryan

At the heart of the problems with U.S. banks and thrifts are two great flaws in the marketplace, both caused by the federal government's decision to absorb risk that ought to be borne by participants in the marketplace. Both were created in 1980 when the federal government removed the ceilings on the maximum interest payable on bank and thrift deposits but did not simultaneously reform the deposit insurance system. By allowing the highest bidder to raise funds with government guarantees, the U.S. enabled banks and thrifts to give depositors returns that were too high relative to the risks they were running. This can be called the *deposit anomaly*.

This government subsidy of interest payments to depositors, in turn, enabled banks and thrifts to lend to borrowers on overly generous terms relative to risks. This can be called the *credit anomaly*.

Speculative Demand

Over generous credit is the bane of all financial markets because it feeds speculative demand. And when speculation begins to overwhelm fundamental demand and supply, the booms and busts that have long characterized the history of financial markets appear. It was just such a speculative boom that the U.S. went through in the 1980s. We now face the crash.

SAVING THE BANKS

As a result, the savings and loan deposit insurance fund has gone insolvent, and the bank insurance fund is now teetering on the brink of insolvency. The U.S. needs more capital in the banking system, but capital is just another name for profitability. The deposit anomaly, however, undercuts the ability of well run depositories to take deposits profitably, and the credit anomaly undercuts the ability of strong lenders to extend credit on prudent terms.

Some want to repair this situation with tighter regulation. But down that path is the government deciding who gets credit and who does not. In any event, the evidence of the past decade indicates that regulation is not very successful at controlling market forces.

Others want to cure the problem with market discipline. But the evidence of 600 years of banking history is that in banking, "market discipline" is another name for panics. It should not be beyond the talent of American society to provide its citizens and businesses with a secure place to keep their money.

The deposit anomaly undercuts the ability of depositories to take deposits profitably; the credit anomaly, the ability of lenders to extend credit on prudent terms.

Where instead should the U.S. go? The best answer is to reform, directly, the deposit and credit anomalies at the heart of the problem. Specifically, interest rate regulation on deposits should be reinstated for insured depositories.

Right now, the risk for federally insured deposits is basically the same as for U.S. Treasuries of equivalent maturity. Because it has less risk, a bank backed by the government's guarantee should be able to raise money more cheaply than an uninsured institution. Deposit insurance is a subsidy of the deposit taking function. Because of the credit anomaly, many institutions have used this subsidy to take on excessive risk. Troubled institutions overbid for funds to keep liquid and, in the process, erode the profits of even their strongest competitors, since everyone has to offer higher rates to keep depositors from switching.

The deposit anomaly can be eliminated by limiting the interest that insured banks can pay on deposits (and other borrowed funds) to the rates paid by the U.S. Treasury. In other words, if the six-month Treasury rate were 7½%, insured banks would be allowed to pay a maximum of 7½% for deposits or other borrowed funds.

Talk of reimposing an interest rate ceiling bothers many people. The ceiling that prevailed between 1934 and 1975 used to suck liquidity out of the system whenever the market interest rate rose above the maximum banks could pay their depositors. By pegging the maximum interest rate on deposits to the market interest rate on Treasuries, the problems of the old Regulation Q would be avoided.

Of course, an institution that owned an insured depository would also need to be able to raise money in segregated, separately capitalized, uninsured subsidiaries by paying whatever rate the market required. Thus, depositors would have to make a choice. Depositors who wanted safety would put their money in the insured bank. Price-sensitive investors would put their money in uninsured, segregated subsidiaries.

Analysis undertaken by my firm suggests that under such a system most institutional investment money would leave insured banks for higher yields in uninsured banking subsidiaries or other money market instruments. That would remove some $450 billion of large domestic deposits and some $350 billion of large foreign deposits from insured banks, as well as some $200 billion of smaller deposits. Altogether, more than $1 trillion of deposits and other borrowed funds would leave insured banks and thrifts, significantly reducing the bank insurance fund's total exposure.

To fix the credit anomaly, the legal lending limit should be lowered to force federally insured banks to make only relatively small loans. Under present law, most banks can legally lend between 10% and 20% of their equity to a single borrower. A bank can therefore commit its entire equity to only five or 10 borrowers. Decrease the legal lending limit for all banks with more than $100 million in equity capital to 2% of their equity above the first $100 million and large insured banks would be forced to diversify their portfolios and to put the bulk of their insured deposits in loans to individuals, small businesses, and mid sized companies. Banks could, of course, make whatever loans they wanted from segregated, uninsured subsidiaries.

This system would force most large loans off the balance sheets of insured banks and into separately capitalized uninsured banking subsidiaries or finance companies. This would not unduly burden borrowers. It is small borrowers that have few alternatives to bank borrowing. Large, creditworthy borrowers have many alternatives. There would be no need to lower legal lending limits for small banks, whose very size keeps them focused on small borrowers in their communities. The problem is with larger banks that have taken on enormous exposures to real estate and highly leveraged companies.

Losses Avoided

In combination, limiting the rates paid on deposits and lowering the legal lending limit would force the use of insured deposits back to those essential core banking functions for which insured banks still uniquely add value. These reforms would help restore the profitability of insured banks. If insured banks had held to the loan loss rates that prevailed before 1980, some $20 billion of last year's $29 billion in insured bank loan losses could have been avoided.

Meanwhile, all of the non-core banking functions, including global money market activities and the underwriting of high risk credits, would be forced out into the marketplace where the only regulation would be securities law. This, of course, means that the U.S. must modernize its entire system of regulating financial institutions. But, unless the deposit and credit anomalies are fixed first, financial modernization will fail.

Mr. Bryan, a director of McKinsey & Co., is the author of "Bankrupt: Restoring the Health and Profitability of Our Banking System," to be published next month by Harper Collins.

190

Seidman Seeks Up to $80 Billion To Complete Thrift Bailout

The Resolution Trust Corporation (RTC) will need as much as $80 billion to finish the job of cleaning up the savings and loan disaster, the Senate Banking Committee was told June 21.

And L. William Seidman, chairman of the Federal Deposit Insurance Corporation (FDIC), testified that the time has come to wean the RTC's salvage operation from his agency and give it a new board of directors and management team accountable to the administration and Congress.

Seidman

Before outlining either his latest cost estimate or proposal for RTC restructuring, however, Seidman launched into a lengthy defense of the way the bailout has been handled since it began Aug. 9, 1989.

In recent months, the RTC has come under increasingly heavy fire for mismanagement and failure to move in the most expeditious and inexpensive manner.

That criticism will increase as Congress begins debating the call for more money for the bailout. To date, the RTC has been given $80 billion — about $50 billion from taxpayers and $30 billion borrowed by the thrift industry — to close failed thrifts. Through May 31, the RTC had closed almost 400 thrifts, and it expects to close at least 500 more in the next year or two.

Many in Congress have said they will not appropriate more money for the RTC until the agency is overhauled.

Seidman gave the committee two reorganization options. One would entail creation of an independent management board, similar to that of a private corporation, and a strong chief executive to manage daily affairs. The other would be to preserve the existing oversight board with less authority, a strong chief executive, and a new, independent management board.

The administration will formally request additional money for the RTC at a Senate Banking Committee hearing June 26. It is not clear whether the administration will offer suggestions for reorganizing the RTC.

Seidman's testimony seems to clearly signal that the magnitude of the monetary request will be at least as large as previously anticipated — $50 billion — and possibly much larger.

RTC Scorecard

In defense of the RTC, Seidman said the agency had accomplished about half the task it had been given.

Almost two-thirds of the 617 failed thrifts that have been handed over to the RTC have been closed, and 161 are expected to be closed between June 1 and Sept. 31.

During that period, however, more thrifts are likely to be given to the agency to resolve.

In addition, he said, the RTC has sold $157 billion in assets and has $164 billion on its books.

"I believe a fair assessment of these accomplishments would find that the RTC's performance, while certainly not what we would like it to be, is credible by any reasonable standard," Seidman told the committee.

The General Accounting Office (GAO), in particular, has been sharply critical of the RTC's management and recordkeeping. Several senators picked up on June 11 testimony by Comptroller General Charles A. Bowsher, who heads the GAO.

Alfonse M. D'Amato, R-N.Y., questioned Seidman about Bowsher's assertion that 64 percent of the assets held by RTC readily could be sold.

Seidman said that Bowsher was wrong and that perhaps a third of the RTC's assets were marketable. Most assets are either bad loans that could not be easily sold or mortgages that do not readily meet standards for sale on secondary mortgage markets, Seidman said. The RTC is moving ahead with plans to issue its own mortgage-backed securities as a means of unloading some of those loans, Seidman said. ■

By John R. Cranford

19

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

TEXT AS PREPARED
NOT FOR RELEASE UNTIL DELIVERY
Expected at 10:00 a.m.
Tuesday, June 11, 1991

TESTIMONY OF THE HONORABLE
DAVID C. MULFORD
UNDER SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS
BEFORE THE HOUSE COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS

June 11, 1991

I am pleased to be here today to testify on the treatment of foreign banks under the Administration's financial modernization legislation, Section 231 of H.R. 1505, the Financial Institutions Safety and Consumer Choice Act of 1991 (FISCCA).

I would like to thank you, Mr. Chairman and Members of the Committee, for working with the Administration to complete a comprehensive reform package to strengthen the U.S. banking system this year. In proposing a long-term financial services framework for the coming decades, the Treasury Department has sought to be fair and consistent, offering the same opportunities to U.S. and foreign banks.

As of December 31, 1990, there were 727 foreign bank establishments operating in the United States. These entities represented 294 foreign bank families from 60 countries and held 21 percent of U.S. banking assets. As their substantial presence in the U.S. economy demonstrates, foreign banks have benefitted in competition with U.S. banks from the openness of our market and the privileges accorded to them in it. U.S. consumers and the U.S. economy have also benefitted from the financial services and increased competition in our market provided by foreign banks.

ADMINISTRATION PROPOSAL

The Administration's proposal would replace treatment for foreign banks, which in some cases is preferential, with national treatment, according foreign banks the same treatment as U.S. banks. FISCCA would liberalize the U.S. banking system by offering U.S. and foreign banking organizations the opportunity to branch across state borders and, if the bank is well-capitalized, to engage in new securities and insurance activities through a financial services holding company structure.

192

TREATMENT OF FOREIGN BANKS

The Administration's bill would allow foreign banks that are engaged only in commercial banking to maintain their existing branches and agencies. They would also be allowed to branch in most states and, after three years, in all states on a full national treatment basis.

The proposal would introduce important changes in the treatment of foreign banking organizations that are engaged in securities activities through affiliates in the United States. Prior to 1978, foreign banks could establish direct branches in more than one state and could own full-service investment banks in the United States. These activities were denied U.S. banks, which were prohibited from branching across state borders by the McFadden Act and from engaging in securities activities by the Glass-Steagall Act.

The International Banking Act of 1978 (IBA) adopted the general principle of national treatment for foreign banks by applying the McFadden Act and the general prohibitions of the Glass-Steagall Act to foreign banks in the United States. In fact, the IBA stopped short of full national treatment by grandfathering securities affiliates and interstate branches that existed in 1978. These grandfather provisions have permitted some foreign banks to retain their preferential treatment, thereby conferring a competitive advantage over domestic banks in the U.S. market.

Under FISCCA, foreign banks that wish to engage in new securities and insurance activities are required to adopt the U.S. organizational structure. This would entail establishing a financial services holding company and rolling up existing branch and agency operations into one or more well-capitalized U.S. bank subsidiaries of the holding company.

Both U.S. and foreign banking organizations with "Section 20" securities affiliates, which can derive up to 10 percent of their annual revenues from securities underwriting and dealing in bank ineligible securities, would need to choose between discontinuing those specific securities activities or restructuring for full securities powers. Foreign banks with IBA-grandfathered securities affiliates would face a similar decision. Twenty-four of the 294 foreign bank families represented in the United States at the end of 1990 have IBA-grandfathered or Section 20 securities affiliates.

Requiring foreign banks to form U.S. subsidiaries to take advantage of far greater liberalization and expanded activities is consistent with national treatment by eliminating the better-than-national-treatment preferences retained in 1978.

Concerns that have been raised about the proposal include the segmentation of capital and its impact on foreign bank lending in the United States, the lack of grandfathering and the impact on the deposit insurance system.

CAPITAL REQUIREMENTS AND FINANCIAL EFFECTS

Concerns have been raised that the structure proposed in Section 231 of FISCCA would cause foreign banks to segregate their capital. In fact, under Federal and State law foreign banks already maintain funds in the United States in the form of capital equivalency deposits and similar asset maintenance requirements at many of their U.S. branches.

Under the Administration's proposal, U.S. financial services holding companies must have well-capitalized banks to engage in these new activities. They must meet standards above minimum Basle risk-based capital requirements as well as leverage ratios. This is not in contravention of the standards of the Basle Committee on Banking Regulations and Supervisory Practices. In fact, the Basle Committee stated that the agreed capital adequacy framework was designed to "establish minimum levels of capital for internationally active banks. National authorities will be free to adopt arrangements that set higher levels." And if a bank's capital falls below specified levels, the holding company could be required to divest the securities or insurance operations. This would be true whether the holding company and bank were owned by U.S. interests or foreign interests.

Under present tax law, foreign banks restructuring branches into subsidiaries will lose their deductions of net operating losses accumulated while operating in branch form. This may have potentially significant effects. Assistant Secretary of the Treasury for Tax Policy Kenneth Gideon will be testifying on the tax implications of FISCCA for foreign banks next week before the House Committee on Ways and Means and will address this issue more fully.

A major objective of FISCCA is to improve the safety and soundness of the U.S. banking system by, among other things, creating incentives to increase the capital of U.S. banks. We believe it is important to impose the same requirements on foreign and U.S. banks engaged in the same activities. Some of the alternative approaches that have been discussed could possibly result in extraterritorial application of U.S. law or might be judged to imply that foreign banks deserve different safety and soundness standards than U.S. banks.

FOREIGN BANK LENDING

Foreign banks have indicated that their preferred form of operation in the United States is through branches of the parent. Branching gives a bank maximum flexibility in deploying its resources.

Most of the 294 foreign bank families in the United States are likely to choose to continue to concentrate on commercial banking. These banks will not need to convert branches to subsidiaries.

Foreign banking organizations that seek expanded activities will no longer be able to branch directly into the United States. These banks will need to establish a financial services holding company with a U.S. bank subsidiary and transfer capital to the United States. They would be lending from a smaller capital base than a branch since legal lending limits would be based on capital held in the U.S. subsidiary.

In drafting the proposed legislation, we considered the possibility that, as a result of the legislation's requirements, some foreign banks might reduce their lending in the United States. However, some of the potential constraints can be alleviated. For example, the subsidiary can transfer loans that exceed lending limits back to its parent. Additional capital can be transferred into the United States to support larger loans. Loans that exceed lending limits of the subsidiary also could be provided cross-border from the parent. Most potential tax problems arising directly from such cross-border loans could be resolved through bilateral tax treaties.

GRANDFATHER ISSUE

Foreign banks have argued that their present operations should be grandfathered under the proposed legislation. Their arguments were accepted in 1978, when the International Banking Act subjected foreign banks to the same restrictions on their operations as U.S. banks. In 1978, there were only two alternatives for the foreign securities affiliates -- to be grandfathered or divested. Now the Administration is offering a full range of expanded activities to well-capitalized foreign banks.

Foreign banks are a much more important segment of the U.S. banking market than they were in 1978. As of the end of 1990, foreign banks operated 370 branches, 224 agencies and 101 subsidiaries in the United States and controlled 21 percent of U.S. banking assets. Leaving nearly a quarter of the U.S. banking market outside the requirements of FISCCA would weaken the effectiveness of the proposal. Grandfathering foreign bank operations today could confer upon them new competitive advantages over U.S. banks that will be required to establish holding companies and meet higher capital standards.

DEPOSIT INSURANCE FUND

The majority of foreign banks in the U.S. now operate through branches not insured by the FDIC. Those foreign banks engaged exclusively in wholesale commercial banking which do not seek new powers could continue these operations and would

195

continue to maintain a competitive advantage over U.S. banks by avoiding deposit insurance assessments. Domestic banks must participate in the deposit insurance system, regardless of whether they conduct retail deposit-taking activities or not.

Under the Administration's proposal, foreign banks expanding into new activities would be required to establish insured bank subsidiaries. But rather than weaken the deposit insurance fund, the contributions of foreign bank subsidiaries would strengthen the fund. By meeting the Zone 1 capital requirements, these bank subsidiaries would be among the strongest banks, and much less likely to draw on the fund.

TRENDS IN FOREIGN MARKETS

The Administration's proposal is consistent with recent trends in foreign markets:

- In the last decade, Australia, Canada, Finland, New Zealand, Norway and Sweden liberalized commercial banking activities, to allow foreign banks to operate in their markets -- but only through a subsidiary structure. (In the Nordic countries, there are plans that would eventually allow foreign commercial banks to branch.)

- Germany allows foreign banks to branch, but limits loans to one borrower to a percentage of the capital that the branch maintains in Germany rather than the bank's worldwide capital. In effect, U.S. bank branches in Germany must bring capital into the country to support their operations and they cannot lend locally based on their parent's capital.

- The European Community's Second Banking Directive requires foreign banks to establish a subsidiary to take advantage of the single European passport. The single passport will allow a bank subsidiary established in the EC to establish branches throughout the Community. Direct branches of non-EC banks will still be allowed, although they will be subject to the laws of each individual country and will not necessarily be entitled to engage in the same securities activities that the EC passport will allow.

We seek national treatment and liberalization in foreign markets. In our market, we will be offering national treatment, liberalization and expanded activities. Under these circumstances, we do not believe it is appropriate to provide foreign banks with preferential treatment through grandfathering. We believe foreign governments will come to recognize that the long-term benefits of our liberalization will outweigh the costs.

FEDERAL RESERVE BOARD'S FOREIGN BANK SUPERVISION ENHANCEMENT ACT

I would like for a moment to turn to H.R. 2432, the Federal Reserve Board's proposed "Foreign Bank Supervision Enhancement Act of 1991." The Treasury supports several important portions of the Federal Reserve's bill and shares the objective of establishing enhanced federal supervision of diverse foreign banking operations in the United States. We would also point out that in several respects, the Board's bill is inconsistent with portions of FISCCA.

I must stress that the Treasury does not consider the Board's proposal a substitute for FISCCA. The bill is a specific proposal that must be considered in its own right in relation to the broader need for enhanced supervision of foreign banks in the United States and in light of recent cases of foreign bank violations of U.S. law. The Administration's proposal includes a major revision of foreign bank regulation in the United States, while the Board's bill makes improvements in the present structure. Any changes to foreign bank supervision should be consistent with the overall approach of the Administration's proposal for regulatory restructuring.

First, the Treasury Department supports federal licensing and supervision of representative offices of foreign banks. Under present law Treasury registers but cannot supervise foreign bank representative offices in the United States. We believe these offices should be supervised by a federal banking regulator.

Second, the Treasury supports, and has itself proposed in Section 265 of FISCCA, Board approval of state-supervised foreign bank offices in the United States. This process in many cases will allow greater Federal-level scrutiny of state branches, agencies, and commercial lending companies before they are established in the United States without undue harm to the dual banking system. The approval provision in the Board's bill is consistent with the division of regulatory responsibility in the Administration's proposal.

Third, we support the provisions that enhance federal jurisdiction and supervision over foreign banks through additional criteria for approval, regulation, and termination of foreign bank offices in the United States. In addition, we support the bill's objectives of encouraging the sharing of information between U.S. and foreign bank supervisors and assuring greater attention of foreign bank supervisors to their banks' operations in the United States. One suggestion we would make to improve the Board's bill would be to enhance the authority of the Comptroller of the Currency to close federal branches and agencies by legislating criteria consistent with the criteria proposed by the Board for itself in connection with closing state branches and agencies.

197

Despite our general support, the Treasury Department does have some specific concerns with the Federal Reserve's proposal, resulting chiefly from the differences in regulatory approach between the two bills. Treasury has proposed a functional and streamlined regulatory regime in FISCCA that provides for effective regulation of foreign and domestic banks and their affiliates.

The Board's proposal would eliminate the requirement under Federal law that the Board use the examinations conducted by other Federal bank regulators. This provision differs from the regulatory scheme in FISCCA and present law, both of which provide for efficient use of Federal examination resources and protect against conflicting regulation at the Federal level.

The Board's legislation proposes new authority for the Board to supervise and examine any affiliate or office of a foreign bank in the United States, including Federal branches and agencies.

This proposal would circumvent the "functional" regulation proposed in FISCCA that would require the Board to consult with regulators of securities and insurance affiliates before examining these affiliates.

Clearly the Board's proposal for foreign banks would have to be modified in these respects if the Treasury approach to functional regulation were adopted.

CONCLUSION

Let me reiterate that we are offering foreign banks national treatment, including expanded market opportunities on the same terms as U.S. banks. We are seeking to be fair and consistent and we welcome the participation of foreign banks in our market. We hope that those foreign banks which find it in their strategic interest will participate in the liberalization offered by FISCCA.

198

ENVIRONMENT

Heaton, George and Robert Repetto and Rodney Sobin. Transforming Technology: An Agenda for Environmentally Sustainable Growth in the 21st Century, World Resources Institute, April, 1991. (Summary)

Lovejoy, Thomas E. "Debt Conversions and Their Potential to Assist Sustainable Development and the Protection of Natural Resources," Testimony before the Senate Finance Subcommittee, May 19, 1991.

Kirwin Joe, ed. "Brazilwatch on the Road to Rio," Tomorrow: The Global Environmental Magazine; Towmorrow Media: Stokholm, Volume 1, Number 1, 1991.

Alexander Nancy C. "Healing Community: Restoring Creation," Earth Ethics, Volume 2, Number 3, Spring 1991.

Bayon, Ricardo. "The Blame? Who Cares?" Tomorrow, Volume 1, Number 1, 1991.

Shrivastava, Paul. "Environmental Cold War, North and South Nations Must Cooperate to Avert Global Devastation," The Christian Science Monitor, May 16, 1991.

"Economic Reforms Can Help Prevent Environmental Destruction," World Bank News, June 20, 1991.

Morna, Colleen Lowe. "NGOs Criticize World Bank on 'Harmful' Environment Policies," Africa Recovery, United Nations Department of Public Information, June 1991.

"Mexico's Hydroelectric Project Balances Social, Environmental Concerns," World Bank News, April 4, 1991.

Boren David. Senator, "Boren Introduces New Trade Initiative That Fights Pollution," From The Office of Senator David Boren of Oklahoma, April 25, 1991.

Babbitt, Bruce. "Linkage Between Free Trade and the Environment," The Christian Science Monitor, April 22, 1991.

Sinclair, Jan. "Global Climate Change Has Already Begun," Our Planet, Volume 3, Number 2, 1991.

Oppenheimer, Michael. "Climate Catastrophe, the Return," The New York Times, April 27, 1991.

"Foreign Aid Bill May Go to Markup." Weekly Bulletin, The Environmental & Energy Study Institute, June 10, 1991.

George Heaton, Robert Repetto, Rodney Sobin

Transforming Technology:
An Agenda for Environmentally Sustainable Growth in the 21st Century

World Resources Institute, April 1991

EXECUTIVE SUMMARY

Two decades of environmental regulation in the industrialized countries have yielded some results, but also demonstrate the limitations of current approaches. In the United States, "pollution control" through end-of-pipe treatment has been countered by the lack of non-point source controls and the steadily expanding scale of economic activity. The ambitious goals adopted twenty years ago have not been met. Meanwhile, developing countries have increasingly joined the pattern of degradation begun in the developed world. The volume of pollutants expands worldwide. New classes of global and regional threats—global warming, ozone layer destruction, acid rain, deforestation, mass extinctions, marine degradation, and others—have emerged. This growing assault on the earth demonstrates that we now risk irrevocably altering the planetary life support system with little grasp of the consequences.

In principle, demands on the earth's resources could be reduced by diminishing economic growth, limiting population increase, or increasing the resource efficiency of production. However, the third option is the most viable. Demographic momentum points toward a doubling of global population by the mid-21st century. Economic growth is needed to meet the aspirations of most of the world's people.

These realities leave technological transformation as the primary strategy for avoiding environmental degradation. Technological transformation means widespread, continuing development and adoption of ever less polluting and more resource-efficient products, processes, and services. Technological change has contributed most to the expansion of wealth and productivity. Properly channelled, it could hold the key to environmental sustainability as well.

Technologies to reduce environmental problems while raising economic productivity exist. Studies of major sectors of the economy—energy, agriculture, and manufacturing—demonstrate clearly that far-reaching environmental improvements could be made immediately. For example, many opportunities in industrial pollution prevention and improved energy efficiency are highly profitable today. A variety of new renewable energy technologies, already commercially available, are becoming more widely competitive with conventional fossil fuels.

Emerging revolutions in advanced materials and biotechnology, along with continuing spectacular advances in information technologies and miniaturization, can provide radically new products and processes that harmonize environmental and economic objectives. Investment in environmentally preferable technologies represents an exciting opportunity to enhance competitiveness.

Much more needs to be done to capitalize on this potential. Current best practice must be diffused more rapidly. Environmentally superior products and processes need to be brought to market more quickly. Research and development should be encouraged and channelled in environmentally sound directions.

Technical constraints are not the principal factor limiting technological transformation. The biggest barriers to change are rooted in the social, economic, political, and cultural milieus in which technologies are developed, diffused, and used. Many impediments to technological transformation are imbedded in the structure of public and corporate policy regimes.

Environmental regulation should be reformed to encourage technological change. Many environmental laws favor old technologies over new. Relying on "best available technology" standards tends to entrench existing control technologies at the expense of long-term innovation. Regulations have largely been uncoordinated across media (air, water, and land), have focused on "end-of-pipe" pollution controls instead of pollution prevention options, and have provided no incentives for doing better than standards dictate. Cumbersome administrative procedures also impede innovation.

Given this poor record, serious consideration should be given to changes that require regulatory agencies to promote the development and deployment of new technology. This would necessitate a variety of new policy tools. Foremost among them would be greatly expanded use of performance-based standards and economic instruments. Public disclosure requirements, like the Toxic Release Inventory required under the United States Superfund Amendment and Reauthorization Act Title III can also increase public demands and corporate incentives for environmental protection.

Economic incentives should be employed in tandem with regulation to encourage technological transformation. Pollution charges that reflect the full social and economic costs of production, consumption, and waste disposal would provide long-term incentives for investments in clean technologies. Emissions trading also deserves wider use.

Economic indicators conventionally underestimate the value of the environment. National income accounts, such as GNP, treat activities that erode the soil, contaminate air and water, and diminish forests and fisheries as contributions to income rather than as consumption of capital. Similarly, measures of industrial productivity and corporate accounts fail to consider the costs of *not* protecting the environment. Without economic indicators that fully reflect the value of the environment, environmentally perverse public policies and private practices are likely to continue.

Technology policies have thus far largely ignored environmental objectives. Government support of new technologies through R&D funding, procurement, research consortia, and other mechanisms have led to great strides in aerospace, computers, defense, and medicine. Technology policies could play a critical role in advancing environmentally sustainable technologies while promoting commercial competitiveness. But, large areas of environmentally important "generic" research (widely applicable research too removed from marketable products to be adequately supported by industry but too "applied" for most academic laboratories) remain undersupported. Efforts to translate the fruits of laboratory research into marketable technologies have also been inadequate.

Technology and other policies are particularly critical in the early stages of technological development when an advantage given to one of several competing approaches may "lock in" a technology for many years even if that technology is, in the longer run, an inferior option. To avoid this problem, long-term consequences of technologies must be assessed more thoroughly at an early stage.

Rapid dissemination of clean technologies from the industrial countries to the developing and formerly centrally planned countries where over 80 percent of humanity lives and where much of the globe's economic and population growth will occur is vital for technological transformation. This diffusion of innovation may require new initiatives to overcome barriers in both technology exporting and importing countries to the flow of information, capital, and trade. A particularly useful role—that of technology broker—could be played by private sector intermediaries: for example, matching partners, arranging financing, and negotiating and managing licensing agreements.

Private companies, the main producers and users of new technologies, are central to any hope for technological transformation. Environmentally affirmative **corporate leadership** is likely to be a stronger force for technological change than public policies. Some companies have realized that environmentally sound investments are often rewarded by cost reductions, improved quality, and product innovation, and they see environmental performance as key to future business success. But many others do not yet treat environmental stewardship as integral to good management practice.

A switch to corporate accounting systems that more accurately reflect both the costs of environmental protection and the cost of forgoing environmental protection could stimulate environmentally sound innovations. Better accounting would show that pollution prevention is often a more cost-effective approach than pollution control. The growing market for "green" products shows that environmental concerns can be profitably integrated into product life-cycle design.

In the long-term, **better educated managers and engineers** are key. Business students must learn to incorporate environmental issues in business planning and decision-making. Engineers must be trained to integrate environmental factors into the design process and not address them as an afterthought. Curricula that bring environmental concerns into the mainstream need to be developed for these future professionals.

For two decades, environmental policy has focused—with only modest success—on abating pollution and cleaning up local problems. Today, newly recognized global hazards pose a profound challenge to society. Rapid technological change stands as the key element in reconciling inevitable economic and population growth with a livable environment. Many resource-efficient technologies are available today and emerging technologies can dramatically transform the economy for environmental benefit. Because technological change is at bottom a social process, it can be accomplished only by redirecting economic, political, and cultural channels in ways that guide the stream of technological transformation.

Debt Conversions and their Potential to Assist

Sustainable Development and the Protection of Natural Resources

Testimony of
THOMAS E. LOVEJOY
Assistant Secretary for External Affairs,
Smithsonian Institution
and President, Society for Conservation Biology

Before the

SENATE FINANCE SUBCOMMITTEE ON DEFICITS, DEBT MANAGEMENT AND INTERNATIONAL DEBT

May 10, 1991

I am Thomas E. Lovejoy, Assistant Secretary for External Affairs at the Smithsonian Institution and President of the Society for Conservation Biology. I would like to make some comments on the experience of debt-for-nature to date, in particular, the possible application to Brazil.

First, the need. There is widespread acknowledgement that the scale and rate of environmental destruction worldwide is without precedent in our history. The waste gasses of human society through the burning of fossil fuels and tropical forests coupled with the heat trapping capacity of chlorofluorocarbons are changing the very physics and chemistry of our planet. Tropical deforestation is a very significant portion of that problem, as well as the dominant part of the loss of biological diversity. The essential point is that tropical nations play a critical role in greenhouse, tropical deforestation and extinction problems.

These countries have sharply limited financial and manpower potential to address these challenges. Debt is not only an important root cause of these problems; it also, through debt conversion, can be an important part of the solution. The amount converted since debt-for-nature was first proposed in 1984 is disappointing. It has been largely limited by the financial resources available to private conservation organizations to buy commercial bank debt, and by tax consequences for banks interested in donating debt. While debt-for-nature is neither a solution to the debt or environmental problems by itself, it can play an important role, especially with environment.

The sovereignty issue. Debt-for-nature has often been misinterpreted as an invasion of sovereignty, as if the United States was rushing in and forcing a nation to fork over important land and resources in something akin to an environmental Louisiana Purchase. This is patently without basis, especially when such concerns are rarely raised about the far more frequent debt-for-equity swaps.

The inflation issue. Central banks and economic planners frequently wave the spectre of inflation generated by additional currency added to a national economy without any real addition to productivity. This assumes that environmental activity is uneconomic, which is simply untrue, but even if it were so, the debt relief involved is anti-inflationary. When Brazil buys dollars on local markets to pay its debt interest, it is not generating any financial productivity. It should be noted that inflation has not been a problem for Chile, which has carried out the most debt-for-equity swaps (literally in billions of dollars). Nor has inflation been seen as a problem for Costa Rica, which has converted 5% of its international debt for environmental purposes. Further, when debt is converted to interest-bearing instruments, the amount of currency is limited, and stability is provided via an endowment.

The issue of indigenous peoples. Debt-for-nature has sometimes been portrayed as a mechanism for elite flint-hearted environmentalists to take lands away from indigenous peoples. Debt conversion is, in fact, a mechanism which is available to such peoples for their own uses. COICA, the Coordinating Body of the Indigenous Organizations of the Amazon Basin, has recently proposed a mechanism for a debt swap. Furthermore, the environmental community has learned, in general, of the need to take local people, whether Indians or campesinos, into account. In the end, no conservation project will succeed unless it is integrated into the local social, as well as biological, landscape.

The accountability issue. The question is sometimes raised how can one achieve anything lasting with debt-for-nature? There is actually considerable experience in organizations like Conservation International, the World Wildlife Fund, The Nature Conservancy, etc. in executing social projects. The key is always in the project design and in the choice of partners. The local partners in all possible instances should include private organizations. As always, the benefits to be gained from a public/ private partnership are key. This should be an integral aspect of the Enterprise for the Americas Initiative, both in the countries in question, and on the United States board.

The nature of debt-for-nature. As always, when there are possible resources, many interests would like to gather under the tent. While I do believe it is important to think beyond protection of natural areas in the strict traditional national park or reserve sense, I believe it is important not to leave the door ajar. It would be useful to support pilot projects in sustainable extractive use to bring them to the point of commercial take-off. Traditional development should be left to traditional development sources. Urban air pollution could soak up most debt-for-nature contemplated by the Enterprise for the Americas Initiative--the amounts involved in the Enterprise are, after all, not that great--and should be left primarily to industrial sources and more traditional sources of finance. The desperate long-term needs for global forest management (and slowing of climate change) and biological diversity should receive the bulk of attention.

__Brazil.__ With the greatest debt burden and greatest environmental problems, Brazil has often seemed to many a logical, indeed urgent, prospect for debt-for-nature. The Sarney administration was unwilling to consider it, but asked for contributions to help with its Amazon and other environmental problems. The Collor administration has been considerably more forthcoming on environmental problems, but has yet to speak publicly in favor of debt-for-nature. Yet the private conservation groups in Brazil are interested, and in fact prepared a $25,000,000 proposed package for debt-for-nature in 1990. And the key institutions could be measurably strengthened and stabilized by endowments funded through debt conversion. I believe a carefully constructed debt-for-nature package for Brazil could become a harmonious overture to the 1992 United Nations Conference on Environment and Development in Rio de Janeiro.

The example of Brazil brings out a fundamental point. Brazil seems unwilling to consider debt-for-nature until it has some debt relief. Without commenting on whether debt relief for Brazil is appropriate or not, it seems one risks the loss of an important opportunity to address environmental problems unless debt-for-nature is considered along with debt restructuring and debt forgiveness. While it will require considerable diplomacy, it makes sense to have debt-for-nature as an integrated part of any nation's debt restructuring. It is all too easy to forgive massive amounts of debt as in the case of Egypt or Poland, and then be confronted later by environmental problems without the resources that had been available through the debt conversion mechanism.

Thank you.

Tomorrow, Volume 1, Number 1, 1991

EDITED BY JOE KIRWIN

BRAZILWATCH

On the Road to Rio

The name, date and format are set for the most crucial environmental gathering ever: the "Earth Summit" will bring together heads of state and government from around the world to try to hammer out a global action plan for the imperiled earth. The date: June 1-12, 1992; the place: Rio de Janeiro, Brazil.

Witnessed by thousands of delegates, nongovernmental representatives and journalists, world leaders are expected to sign a host of agreements at the meeting, formally known as the United Nations Conference on Environment and Development (UNCED). The organizers say the showpiece will be an omnibus statement called the Earth Charter, which will act as an ideological umbrella for "Agenda 21," a nonbinding environmental plan for the next century.

As a guide for TOMORROW readers, we have compiled a brief rundown on some of the most important issues.

NGOs: WHISTLING IN THE WIND OR A VALID VOICE?

Twenty years ago, when the first UNCED was held in Stockholm, nongovernmental organizations were considered radical factions not so distant from terrorist groups. Within some government circles, especially in developing countries, they still are. That contrasts with many Western and Eastern European nations, where the NGO representatives of a few years ago are today's government ministers or negotiators.

Nongovernmental organizations gained a major breakthrough in the U.N. negotiating process last year with the Bergen Process. In a nonbinding Agenda for Action drawn up at the regional U.N. meeting in Norway, NGOs gained full negotiating rights. Organized into groups that included business, trade unions, youth and environment, the NGOs were accorded observer status at a meeting of ministers several days later.

The breakthrough in Norway paved the way for NGO participation in the current UNCED preparatory meetings, but many complain that their opinions are still being ignored by uninformed official delegates.

"Many of the negotiators [at the preparatory meetings] were professional diplomats who didn't know the first thing about environmental issues," says Daniel Nelson, the editor of an environmental NGO newsletter called Crosscurrents. "So NGOs could speak all they wanted to, but many of the negotiators didn't know what they were talking about."

NGO planning for Rio continues. This spring business representatives adopted their own Brazil charter at a major conference hosted by the International Chamber of Commerce. Religious, youth and women's groups are planning similar statements. ●

TECHNOLOGY TRANSFER: A MISSING LINK TO SUSTAINABLE DEVELOPMENT

When researchers prepared a document this winter to address the issue of technology transfer for this spring's preparatory meetings, they called it the "Progress Report on Financial Resources."

Was the title a misnomer - or even a disguise? For starters, there was no progress to report. And the appropriate title - Funding for Technology Transfer - is a major missing link to worldwide sustainable development. The issue has probably caused more rancor between North and South than any other.

The dilemma that emerges from between the lines of bureaucratic jargon is this: if developing nations are going to avoid the same mistakes made by industrial nations, they need money and access to technology. But a Norwegian-Dutch plan for industrialized countries to contribute a fixed percentage of their GNPs to a technology tranfer fund has met with a decidedly chilly reception from most other Western countries.

Whatever the mechanism, most pundits say it is going to take a lot of money - much more than is available now - to solve the complex problems of intellectual property rights and patents that are closely tied to the technology transfer issue.

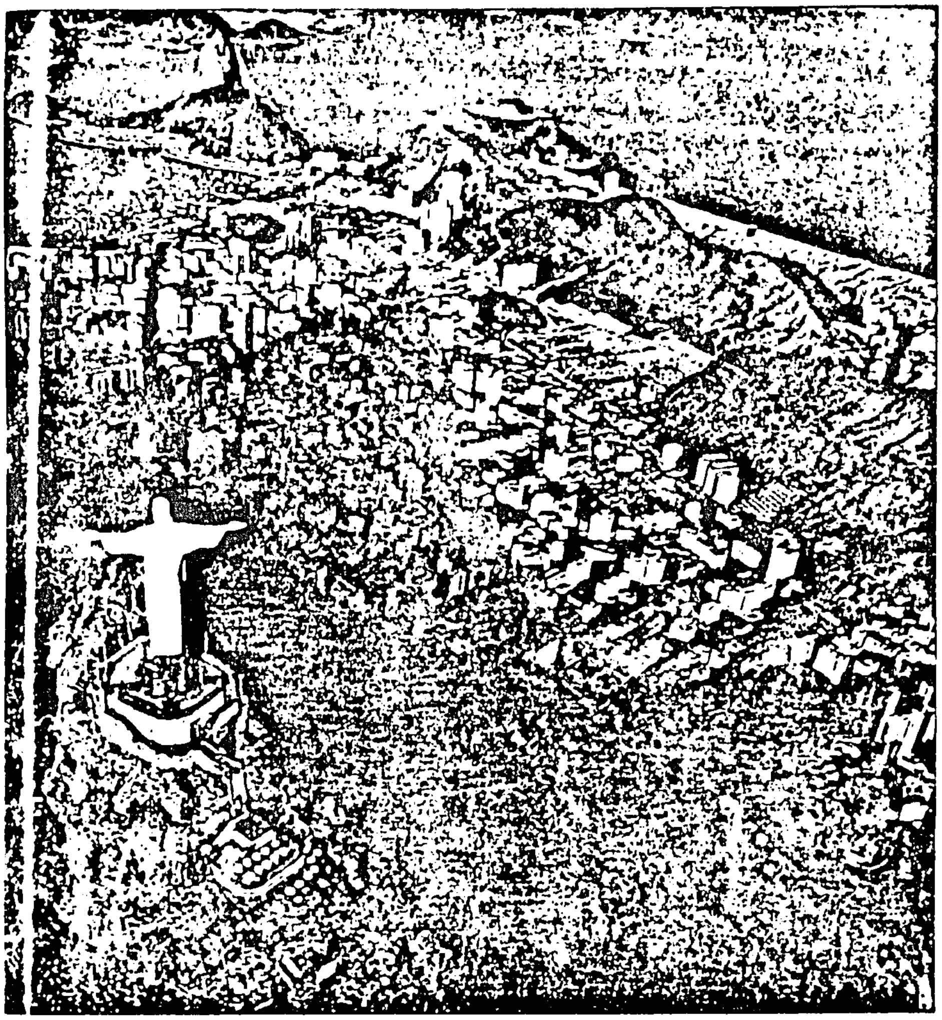
"This [technology transfer] is what many of the issues come down to," says Ezra Karadag, an environmental expert with the Turkish government and an international delegate. "If we don't have the money to finance improved technology, people are not interested in suffering in the name of sustainable development." ●

Rio de Janeiro, site of the 1992 'Earth

CLIMATE CHANGE: SHIFTING WINDS PUT AGREEMENT IN DOUBT

The past two years of international negotiations on climate change might be compared to a sandstorm raging in the desert. As scientific uncertainty and economic repercussions stir up concern, shifting strategies have, during pauses in negotiations, revealed some unusual bedfellows.

This occurred repeatedly in 1990. When the Intergovernmental Panel for Climate Change (IPCC) adopted its final report last summer in Sweden, the United States, an antagonist to European attempts to set greenhouse gas reduction goals, discovered it had



lost two allies in Great Britain and Japan. But America readily welcomed the Soviet Union and Saudi Arabia into its wait-and-see camp.

This winter in Washington, D.C., during the first round of convention negotiations, the Americans unveiled a plan to eliminate the classification of greenhouse gases. Instead of separate targets for carbon dioxide, methane and CFC emissions, a sum-total accounting system would be used, allowing continued high rates of fossil fuel use if, for instance, freon was cut back. The proposal caused chagrin in some European capitals, but a similar approach was being discussed in the Norwegian and Swedish parliaments. Previously, the Scandinavians had expressed outrage at the recalcitrant American position on global warming.

Indeed, feuding seems to be the order of the day. If the U.S., due to the skeptical approach taken by the Bush Administration on climate change, isn't feuding with Europeans, then developing nations are either fighting among themselves or are railing against the North.

In the end, it comes down to money and sovereignty. Most analysts agree that developing nations want financial and technological assistance similar to the funding approved in the Montreal Protocol. The Group of 77 - as the developing nations are referred to in the U.N. - made sure they would not be outflanked on this issue when the negotiations were moved last winter to the General Assembly from the U.N. Environment Programme. Within the main voting body, the one-nation, one-vote process gives developing countries hegemony.

However, there is dissension within the ranks of developing nations over climate change. Low-lying nations are desperate for strong action while rain-forest nations want nothing to do with timber restrictions.

As Professor Bert Bolin, the chairman of the IPCC and an important mediator in the climate change dispute, glumly sums up the situation, "It will be very difficult to come up with a convention in Brazil that is substantial and pleases all parties." ●

BIOLOGICAL DIVERSITY: **THE KEY TO FEEDING FUTURE GENERATIONS**

This issue might have fallen in the shadow of the more publicized issue of climate change. However, within a decade or two, as the world's population expands, it will likely be the new environmental *cause célèbre*.

World population is expected to increase from five billion to eight or ten billion in the next few decades. While improvement of traditional agriculture and distribution methods are the most effective ways to increase food supplies in the poorer countries, plant breeding and genetic manipulation could make an important contribution.

A large majority of the world's plants and animals grow in warm, wet environments in developing nations. The gene banks and the multi-billion dollar pharmaceutical and biotechnology industries, which often depend on resources from the tropics, are situated in the North. Thus, negotiations for a convention will probably be another classic North-South showdown.

In all, UNCED scientists studying the biodiversity issue say there are 11 crucial areas of negotiation. These include protection of habitat, improved international trading rights and a review of subsidies for land development.

But there is little argument about what is the most crucial concern.

"Much of the genetic engineering work is of a proprietary nature," says Nay Htun, a scientist and an UNCED specialist in biological diversity convention. "Most Western companies in this business, especially in the U.S., are not interested in giving away technology they developed at great expense." ●

Earth Ethics

Evolving Values for an Earth Community

Vol. 2, No. 3 Spring 1991

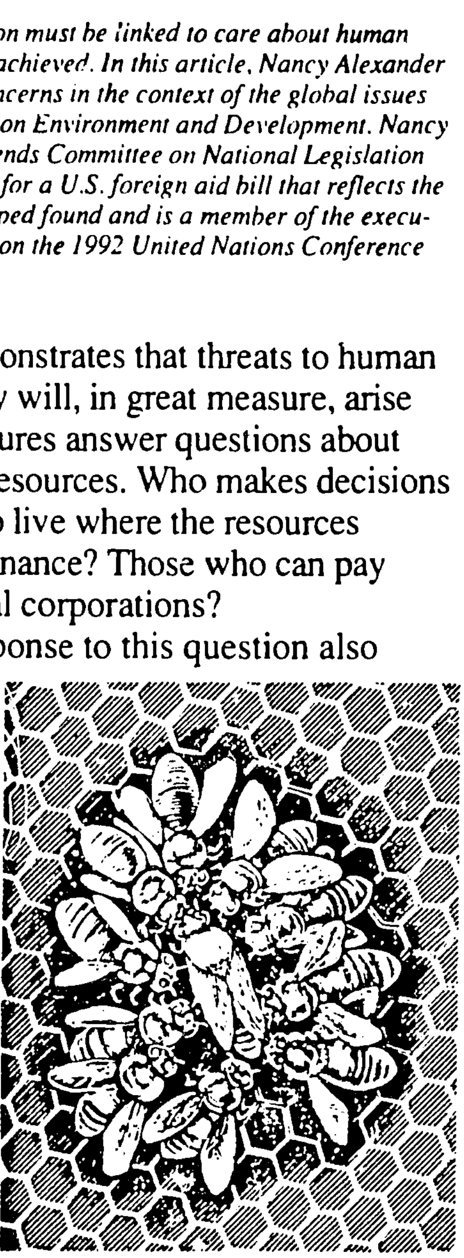
Healing Community: Restoring Creation

by Nancy C. Alexander

Concern about environmental degradation must be linked to care about human communities if a sustainable future is to be achieved. In this article, Nancy Alexander shows the connection between those two concerns in the context of the global issues facing the 1992 United Nations Conference on Environment and Development. Nancy Alexander is legislative secretary at the Friends Committee on National Legislation in Washington, D.C., where she has lobbied for a U.S. foreign aid bill that reflects the values discussed in this article. She also helped found and is a member of the executive committee of the U.S. Citizens Network on the 1992 United Nations Conference on Environment and Development.

The Persian Gulf crisis demonstrates that threats to human security in the 21st century will, in great measure, arise from how nations and cultures answer questions about who has rights over the world's resources. Who makes decisions about resources? The people who live where the resources reside? Those with military dominance? Those who can pay the most for them? Transnational corporations?

The values that frame our response to this question also frame our approach to how sustainable development for the world's human population should be achieved. I propose that community is the central value needing attention. Genuine community upholds three further values: participation, equity, and sustainability. Further, I propose that a transformative spirituality, nurtured by faith communities, can be the great agent of change that will help people move toward values that will enable us to survive and flourish on this planet for the long term.



Building Communities

As the world population explodes exponentially and the environment becomes increasingly degraded, the question of who makes decisions about resources will dominate all local and global politics. To understand the significance of the decisionmaking process, we need only ask: Were the populations of Love Canal or Bhopal given appropriate information to make decisions about the safety of their community? When World Bank support for construction of hydroelectric dams forces relocation of hundreds of thousands of indigenous people from ancestral lands, are the rights of these people to remain on their lands acknowledged? Do the governments of poor countries consult their citizens when they accept payment for storage of toxic wastes from industrialized nations?

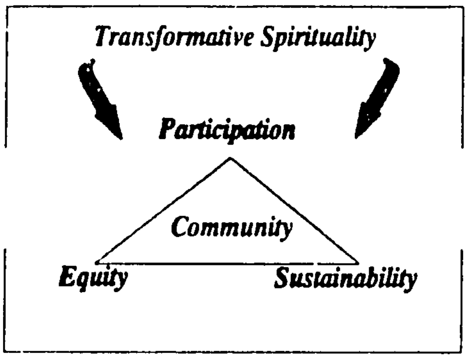
People have a right to participate in decisions that affect them. That is what democracy is all about. For that reason, participation is at the apex of the values pyramid shown in the graphic (page 3). Sustainable development is not something that is going to happen *to* people; it will be brought about *by* people. People protect the places they call home and the people they love and identify with. Consider the statement of an Australian woman aborigine: "If you have come to offer me your help, you can go home again. But if you see my struggle as part of your own survival, then perhaps we can work together." Such peoples hope for partnership in the human path toward the future, not simply to be beneficiaries of plans made without their participation.

This reality shows us that support for local communities must be the central value in any agenda for a sustainable future. At present, the general public and policymakers hold sustainability, narrowly conceived as a global environmental goal, to be the central value. The power of this value is reflected in the strength and influence of the environmental lobby as contrasted with the relatively weak anti-poverty lobby. But a single-minded approach to sustainability overlooks the fact that ultimately it is grassroots communities in developing countries that will protect or despoil their environments. Resources cannot be protected by armed guards. Rather they must be protected by local people living in harmony with the earth while applying their knowledge and experience to earn a livelihood from it. Unless our policies help foster such communities, efforts to foster sustainability will be ineffectual.

In order to create a truly sustainable future, we will need to move away from values that encourage consumption of material goods and the creation of financial wealth as goals in themselves. A central question should be: How can we focus on quality and fullness of life in our communities rather than standards of living that measure how *much* we consume?

A purely technical approach will not work in creating a sustainable future. Technocrats (those who focus almost solely on technical solutions for environmental problems) believe they understand the massive problems that confront our species and our planet. For them, the quest for sustainability is a managerial problem; people are simply one of the many elements to be manipulated toward a solution. While the technical approach has a contribution to make, it must be complemented by a participatory approach that views the future from the perspective of the people being managed and asks: How can people be empowered to invent their own futures?

Once participation is seen as essential to building sustainable societies, equity for those who have less access to power in local, national, or global societies becomes an important value as well. Too often, debate over environmental issues ignores the interests of the poor. For example, in the 1990 debate over the Clean Air bill in the U.S. Congress, a representative from the National Council of Churches was the *only* lobbyist who worried about the effect of the bill on people



living in poverty. This lobbyist persuaded one legislator to introduce several provisions in the bill to shield people living on a poverty level from the increases in the cost of electricity that would follow from the legislation. In conference, however, those provisions were eliminated from the bill. Clearly, as this example shows, the joining of equity with environmental sustainability values will not be an easy political achievement. Yet, a society that is to endure in the long run must work for equity for all its members. Without the pressure of equity as a value, plans for environmental sustainability can too easily be formulated in ways that simply satisfy already entrenched interests.

Value Debates and the 1992 UN Conference

One can see the interrelationship of the values of equity, participation, sustainability, and community by considering the issues that are likely to be discussed at the upcoming United Nations Conference on Environment and Development. This conference, which is scheduled for June of 1992 in Rio de Janeiro, will mark the 20th anniversary of the 1972 Stockholm Conference on the Human Environment. The conference is expected to create a Magna Carta for the Earth—a charter declaring the principles and behavior that should govern humankind's relationship with the earth. The conference will also create a Twenty-First Century Agenda, which will include goals for the next century, assign roles and responsibilities, and create a timetable for achieving the goals.

The focus of the conference is on building cooperation between the countries of the North, which are, on the whole, rich and industrialized, and the countries of the South, which are, on the whole, poor and unindustrialized. The less developed countries of the South are critical to the successful resolution of major issues that may be negotiated at the conference—issues relating to climate, forests, biological diversity, and technology transfer. But the willingness of poor countries to undertake global accords on environmental issues will depend on the extent to which wealthy nations offer them an equitable place in the global economy. In the planning sessions for the conference, southern countries have been demanding that northern countries provide financial aid, in return for which southern countries would apply environmentally sound technologies. The fact that the United States has so far refused to promise additional aid to less developed countries has already resulted in some weakening of support for the conference among a number of southern countries.

In the arduous negotiations which gave birth to the 1989 United Nations resolution authorizing this conference, enormous differences between rich and poor countries were papered over. The northern countries see the conference as primarily an *environmental* meeting. Southern countries, on the other hand, see it as a *development* conference, one that can address social justice issues. Many southerners feel that northern countries have achieved some of their wealth at the expense of southern countries and that the North is, to some extent, precluding successful industrialization in the South by imposing trade and environmental barriers to production.

Trade barriers can take many forms, one of which is higher tariffs for finished goods than for raw materials. Southern countries find it easier, as a result of the existing tariff structure, to export commodities such as iron ore and cotton instead of manufactured products such as iron, steel or clothing. As a consequence, southern land and other resources are often overused or misused to produce raw materials for export.

The cost of environmentally sound technology is another barrier to industrialization in southern nations. Northern

"People in the South ask, 'Who are you northerners to preach to us about population when you are the major consumers of the world's resources'?"

countries can exert financial leverage to force the application of sound technology in southern countries. But southern countries lack the power to force environmental prudence on wealthy northern nations, who themselves earlier took the cheap and dirty route to industrialization. Still, the less developed countries are not about to be consigned to perpetual underdevelopment. And, in any case, they see hypocrisy in the demands of northern countries who have yet to deal with major environmental problems of their own, including issues related to transboundary pollution.

Consider three other areas in which the interests of northern and southern nations differ, and in which questions about equity, participation, and environmental sustainability converge: forests, population, and debt.

Half of the forests in the developing world have been cut in this century. People in the South see rain forests as the key to their immediate survival, the only resource on hand to provide them with land and livelihood. They perceive northerners as interested in the rain forests as a source of wood for furniture or as a giant air conditioner to counter-balance the effects of the carbon dioxide that northern cars and factories are pumping into the atmosphere. In short, they see northerners as unconcerned with their societal welfare. Too often public events seem to reinforce that conclusion. At the July 1990 economic summit meeting of the seven major industrial nations, for example, a consensus was reached on a major environmental action: that Brazil should save its forests. Brazil was not at the summit, yet the seven industrialized nations had no reservations about setting that country's priorities, while they neglected to set environmental agendas for their own nations. The message that goes out to the developing world is: "We've got ours and you can't have any." Ethically, as one U.S. Quaker Yearly Meeting put it, northerners need to ask, "How, after we have feasted for centuries at nature's table, can we now tell those who are poor or starving to suppress their appetites?" Surely we cannot do this without learning to restrain our own.

A second issue generating North-South friction is the interaction of population and environmental issues. There is a tendency among northerners to view the pressures imposed on the environment by explosive human population growth as largely a southern problem. But this view ignores the vast discrepancy in the relative demand made by individuals in industrialized and non-industrialized nations on the earth's resources. If, for example, my adopted Indian daughter lived her entire life in India, she would consume only 1/35th of the energy that a typical American consumes. People in the South ask, "Who are you northerners to preach to us about population when you are the major consumers of the world's resources?" Because children in countries like India, especially boys, are viewed as sources of social security, and because infant mortality rates are high in many places, large families provide assurance that some children will survive. Until equity issues related to health—not to mention literacy and women's rights—are dealt with, population pressures will continue.

A final issue dividing North and South is debt. Crushing national debt drives the destruction of communities and the environment in developing countries, which are damaging their environments in order to grow crops for export. In Costa Rica, for example, where deforestation is proceeding even more rapidly than in the Amazon, there has been large-scale clearcutting for cattle ranching and the expansion of banana and coffee plantations. At the same time, deforestation is also being caused by poor farmers who are driven onto marginal land to make a living. Predictably, more attention is given to the negative role of the poor in this phenomenon than to the role of affluent interests.

The force behind the Costa Rican and, indeed, the global economy, is a free-market, export-oriented development paradigm. In this paradigm, international lenders lend principally to encourage economic growth, investment, and free trade. Creditors dispense economic "medicine" intended to stimulate the economies of debtors and permit them, among other things, to service their debt. However, in many cases, the side effects of the free-market "cure" are worse than the "disease"—at least for the poor majority. Poor countries, desperate to earn foreign exchange, both to pay their gargantuan debts and to import necessities, are driven to plunder the earth and exploit their people in order to increase their exports, making long-term sustainability impossible.

Proponents of an alternate paradigm, one that seeks global equilibrium, see three inherent contradictions in the so-called "sustainable growth" orientation of free-market advocates. First, particularly in developing countries, growth too often leads to the depletion and despoliation of resource capital. Second, our way of understanding "growth" doesn't differentiate between production that enhances communities and production that destroys them. When development or production decisions are imposed on communities, rather than being made by the communities themselves, sustainability is not served. Third, our way of measuring "growth," through indicators like the Gross National Product, does not differentiate between the quantity and the quality of what is produced. The economy consumes resources and expels waste, and everything sold—from bombs to baby bottles—adds to the total GNP, which may climb upward while the natural environment and our communities decline. For a sustainable future, we need an economics that counts what matters, that

201

helps human and natural communities to flourish and endure.

In short, the orthodox paradigm for development must be recast in order to heal communities and restore creation. Free-market economics must become the servant rather than the master of development, with the "ends" of economic growth, investment, and trade becoming "means," to be employed in ways that foster community and sustainability.

Spiritual Transformation

Faith communities are vital midwives for the inner values transformation that is necessary if we are to move from consumption- and wealth-oriented societies to societies built on community and the accompanying values of equity, sustainability, and participation. By giving us a compelling vision of a peaceable realm, faith communities can inspire the spiritual transformation that will become the driving force to shape new values, new institutions, and a new economics for a sustainable future.

A vision of peaceable societies focuses on lives rich in connections to people and the earth. When we are focused, spiritually, on improving the *quality* of life, high levels of material consumption will be viewed as bondage. On Earth Day 1990, cultural historian and poet Wendell Berry remarked that people won't be serious about the idea of a sustainable future until they've realized that their own standard of living (in the quantitative, material sense) will need to be lowered. I often think of such a future state of global equilibrium as one in which human communities are living from the "interest" of the earth, which can be renewed and restored, and not from its "capital."

A transformative spirituality would acknowledge that because we are all connected to one another and the earth, we need to grapple with moral choices in ways that bring to bear all the values of sustainability, equity, participation, and community. In thinking about saving spotted owls, we also need to think about creating new jobs and providing retraining to workers in an economic conversion program that will sustain human communities. The voices of those affected must be heard in planning for the future.

Real community is characterized by inclusiveness. What happens to morality when the world is divided into insiders and outsiders is shown vividly in the film *The Godfather*, in which the warm, rich, caring life within a Mafia "family" contrasts with the brutality that marks its dealings with its rivals. One reason why people set themselves against each other, as insiders and outsiders, is the perception that there is not enough of what is essential to go around. When we believe this, we become greedy and fearful. Our desire to ensure a sufficiency for ourselves then requires that we think of some other people as intrinsically less deserving or needful. The inevitable effect is suffering, both on the part of the seemingly powerful insiders and the outsiders—too often, in the real world, women, children, and people of color—who lack access to vital material goods. In fact, although real scarcity does occur, we may have the illusion that "there isn't enough to go around" because we are so poorly connected with our bodies, our communities, and the earth—in short, because we are deprived of the sources of lasting pleasure. A transformative spirituality will need to lead us back to these profound and rewarding connections.

The overriding emotion of transformative spirituality is gratitude. Meister Eckhart, the great medieval mystic, said that the only prayer necessary in life is "Thank you." Gratitude means not taking anything for granted, not allowing human conceit to overtake awe. It means having courage, a word derived from the French words for "big heart." With courage, we know that we can heal communities and the earth; it's not an either-or game in which we must choose one or the other. With courage, we can accept everyone as insiders, especially those who are struggling to become whole against great odds. With courage, we can strive to give back more than we have received from the earth's bounty.

The realization that we are interconnected with all peoples and the earth can be the cause for affirming life. One of my personal images of the power of interconnectedness is the gathered Quaker meeting for worship with its attendant sense of unity and blessedness. The experience that God is a verb—that God is "happening" between people gathered in community—is precious to me. Rather than stress that God happens within us (immanently) or above us (transcendently), a transformative spirituality senses God happening everywhere, especially between people and between people and the earth.

Each of us has a unique potential to be a transformative presence in the world. In the following passage from her poem "Natural Resources," Adrienne Rich describes the challenge we all face:

> "My heart is moved by all I
> cannot save:
> so much has been destroyed
>
> I have to cast my lot with those
> who age after age, perversely,
>
> with no extraordinary power,
> reconstitute the world." ■

210

Tomorrow, Volume 1, Number 1, 1991

OPINION: BY RICARDO BAYÓN

The Blame? WHO CARES?

An expanding population destroying natural resources in the South. Extravagant lifestyles built upon squandered energy in the North. Who is more at fault for the world's environmental crisis? Ricardo Bayón writes that it's time to move beyond establishing guilt and work toward finding solutions.

Any discussion of the environment in developing countries inevitably runs into a major barrier: differences in the meaning of "environmentalism" in the industrialized North and the underdeveloped South.

As the world prepares for its biggest environmental meeting ever, the "Earth Summit" to be held in Rio de Janeiro in 1992, I thought we had put that obstacle aside in favor of more global concerns. I am beginning to realize I was wrong. I recently met with environmental journalists from throughout Latin America and was astonished to find that a central part of the discussion was still the same old "Is the North or the South to blame?" This is not to say that all the journalists present at that meeting were obsessed with that debate, but some were, and at times it seemed we would never discuss anything else. The issue has a way of derailing talks.

This is nothing new. At the first World Conference on the Environment, held in 1972 in Stockholm, the North-South split basically undermined the whole meeting. Third World countries refused to address environmental problems because they were more concerned with development. Many labelled the North's concern with the environment a farce.

The tune has changed slightly since then, and that could be a sign of hope, because pursuing development at the expense of the environment is also a farce. Hence the validity of the term "sustainable development," which stresses progress that can be maintained without undermining future generations' ability to develop.

One reason the North-South debate has been so heated is that some southerners view environmentalism as a means for northerners, who have already achieved a decent standard of living, to tell the poor: "You must not do the same." They see it as a hurdle on the road to development.

In many ways they are right; the North's attitude is grossly hypocritical. Indiscriminate use of fossil fuels and overconsumption of natural resources by the developed countries pose the greatest threats to the global environment.

Having acknowledged this, though, how much more can be said about the subject? OK, so developed nations will have to alter their lifestyles if the environment is to be "saved." However, this does not free the poorer countries of the world from their environmental responsibilities. We cannot follow the industrialized countries' model of wasteful development without risking environmental catastrophe.

Still, many obstinate southerners say "the North wants us to concern ourselves with the degradation of environments like the Amazon and Patagonia because it affects them. If that's the case, well, let them pay."

That completely misses the point. Developing countries should pay more attention to what is happening to the environment, not because it concerns the North, but because they stand to lose the most from the destruction of those ecosystems. We should wage the environmental battle for ourselves, not for anybody else.

Now, if the North could kindly contribute to our cause, that would be marvelous (and to their own benefit), but a contribution by the rich cannot be a precondition for environmental action in the South. That kind of thinking has often been an excuse for the South to avoid responsibility and continue committing environmental suicide.

It all boils down to responsibilities. Developed and developing countries each have different responsibilities to their people and to the world.

The North has achieved economic strength artificially. By disregarding the effects of growth on the environment, the wealthy countries have used the equivalent of steroids to put on industrial muscle. That dependency is now threatening their very existence. Theirs is, therefore, a rehabilitation problem. They face the daunting task of recovering from a dangerous addiction. And we all know bad habits are hard to break.

The South is in a very different situation. Ours is a muscular deficiency. We need to put on some muscle, but we must choose whether we want to do it the easy way or the hard way. The easy way would be to set environmental concerns aside and focus on development à la the United States or Europe. Any such development would be artificial and – as we have seen in Eastern Europe – could even be deadly in the long run.

If the 1992 talks are to be a success, both sides of the globe must stop focusing on the other side's problems and turn their attention homeward. Only if North and South start learning from each other's problems and accepting their respective responsibilities to humanity will the environmental issues be properly addressed.

In 1992 the question has to shift from "who's to blame?" to "what can we all do?" The answers aren't going to be easy for either North or South. ●

A native of Colombia, Ricardo Bayón is editor of Network '92, the newsletter of the Centre for Our Common Future in Geneva. The Centre is a clearing-house for information on sustainable development. PHOTO: SUSAN FARKAS

211

Environmental Cold War

North and South nations must cooperate to avert global devastation

By Paul Shrivastava

THE United States stands victorious as the world's only superpower. However, an emerging conflict – an environmental cold war – could become a major threat to global security, and the US is ill-prepared to deal with it.

Unlike traditional defense issues, this conflict is not between East and West. Rather, it engages North (industrialized countries) vs. South (the developing world). Without international cooperation – and recognition of the South's vital role in devising solutions – the world can do little to avert environmental ruin.

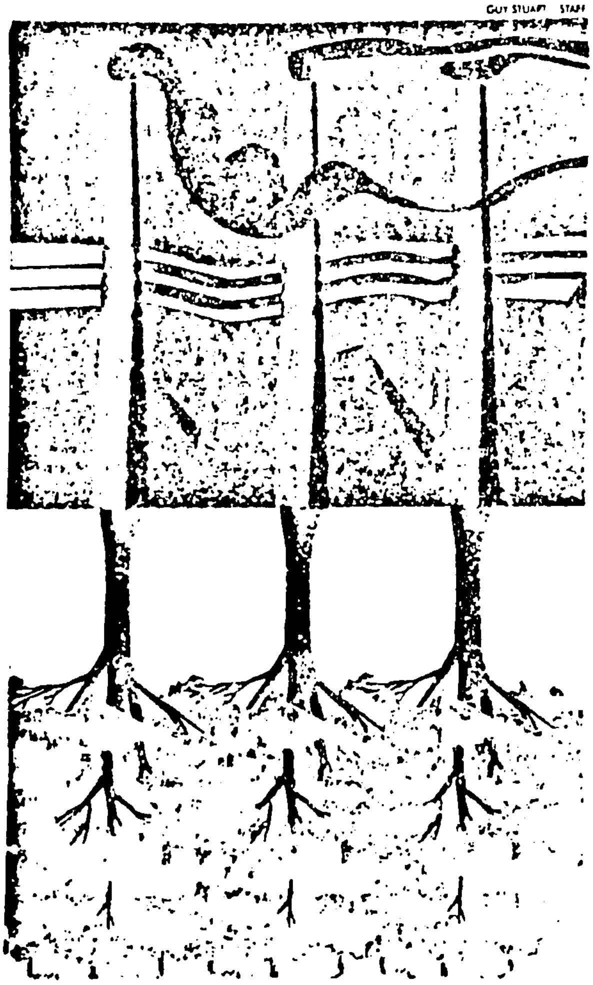
Environmental crises are fundamentally international because they originate from multinational sources and cross national borders. Deforestation in Brazil, Africa, and Asia contributes to global climate changes. Industrial and automobile air pollution fuels the global greenhouse effect and acid-rain problems. The accident at Chernobyl rained nuclear radiation over Sweden, Finland, Italy, Germany, and France.

Resolution of such crises requires the cooperation of developing countries. If they don't agree with global initiatives, these countries can jeopardize the future of the planet's environment and create major threats to global security. The indispensability of global cooperation gives unprecedented power to historically impoverished nations.

For example, China and India do not participate in the Montreal Protocol for the reduction of ozone-destroying chlorofluorocarbons (CFCs). Although they currently account for only 15 percent of CFC use, this figure is projected to rise to 50 percent by the end of the decade. China alone plans to manufacture 800 million CFC-using refrigerators in the next few years, enough to do catastrophic damage to the ozone layer.

Developing nations argue that they cannot afford to invest in CFC-substitute technologies unless they receive financial and technological aid from the North. They are in a hurry to improve the standard of living of their exploding populations through industrialization. If the 3 billion people living in developing countries reach standards of living prevalent in the industrialized North, we can expect devastating environmental destruction.

GUY STUART STAFF



Yet North telling South to slow its economic development in the interest of the global environment is hypocritical, since developed nations have destroyed much of the environment while industrializing.

The stage is thus set for the environmental cold war. In the coming years, we should expect North-South conflicts over such international quandaries as reducing greenhouse gases, curbing nuclear proliferation, and disposing of hazardous wastes.

Few mechanisms currently exist for North and South to communicate. Over the past 40 years, many international treaties, laws, institutions, and intelligence and monitoring systems were set up to manage East-West relations. With the exceptions of the United Nations Environment Program, such mechanisms do not exist between North and South nations.

The UN program is insufficient for coordinating the many complex issues involved in global environmental crises. We need environmental forums in which representatives of industry, government, scientific establishments, and the public can discuss issues of mutual concern. We also need new research institutions that will generate the information necessary for informed dialogue.

Only after effective means of dialogue are established can substantive issues be addressed. Foremost among these is the transfer of environmental-protection technologies to South nations. Scientists, engineers, and policymakers must be engaged in these discussions. Who will develop these technologies? Who will pay? How will they be distributed, operated, and controlled? How can international market systems be modified to promote wide dissemination?

If the US is going to succeed in this new environmental cold war, it must develop a new arsenal of weapons. Luckily, we do not need nuclear and chemical missiles in this arsenal. We do need visionary thinking, backed with solid research into alternative, environmentally safe technologies.

We need the ethical resolve to set a new course for world action through our example, not through preaching. And we need political leadership. Such is the environmental challenge of the 21st century.

■ *Paul Shrivastava is a professor of management at Bucknell University in Lewisburg, Pa. He is also editor of the Industrial Crisis Quarterly.*

WORLD BANK NEWS, June 20, 1991

Economic Reforms Can Help Prevent Environmental Destruction

Environmental degradation is widespread because the costs of environmental damage are lower for polluters than for society as a whole, according to Visvanathan Rajagopalan, World Bank Vice President for Sector Policy and Research.

Individual polluters have insufficient incentive to stop harming the environment, Mr. Rajagopalan added. "The fertilizers and irrigation which raise crop yields for one farmer can pollute a village's water and increase soil salinity for other farmers," the World Bank official said.

Speaking at the Developing Countries' Ministerial Conference on Environment and Development in Beijing, June 18-19, Mr. Rajagopalan said that "For a very long time, economics has generally taken nature for granted and has even been an instrument of human dominion over nature. More recently, that view has been tempered by the recognition that ecological systems have their own logic. Thus, market forces might eventually increase costs sufficiently to deter further pollution."

But nature and the market do not necessarily work at the same pace and irreversible damage can be inflicted in the meantime, he warned. "The costs of remedial action can be far higher than the cost of preventive action, as we see may be possible with global warming."

Soundly based interventions are needed to protect the environment, but intervention can fail just as the market has failed, he cautioned. The World Bank estimates that coal was so heavily subsidized in Poland that it was used inefficiently and the cost of lower productivity caused by ill-health from foul air was perhaps 1.5 percent of Poland's gross domestic product during the 1980s. "Energy for heating greenhouses was so cheap that Poland became an exporter of tropical flowers," he said.

Mr. Rajagopalan said prices should encourage more efficient resource use. Macroeconomic policy which keeps prices as undistorted as possible is fundamental to good environment policy. Poland is raising coal prices sixfold to bring them more into line with international prices, he noted, adding that using the market to determine prices has the advantage of minimizing administrative costs and reducing the opportunities for corruption and favor-seeking which can undermine regulation.

Developing countries need better technology for environmental protection, Mr. Rajagopalan said. But technology is transferred in equipment, and industrial countries will more readily transfer technology if they have more freedom to invest in developing countries.

Mr. Rajagopalan said that the evidence is overwhelming that sound environmental protection is an investment, not a cost. But environmental protection involves more than saving whales or forests, even though these measures have intrinsic merit, he said. "The issue is whether our children and their children will inhabit a planet whose environment can support rising living standards and a rising population."

He called on industrial countries to "modify their claims on the world's resources and to abandon the assumption that conventionally defined living standards can rise without limit." And he said that "developing countries can no longer afford to dismiss environmental concern as a luxury."

He noted that industrial countries produce about two-thirds of global carbon dioxide emissions and 80 percent of chlorofluorocarbons (CFCs), and he stressed that these countries "have a moral obligation to reduce emissions and to help developing countries with the consequences of global warming and ozone depletion."

"Economic growth is indispensable to reducing global poverty in the long term. Growth also tends to raise environmental expectations and to generate resources for investment," he said.

But, international cooperation to tackle environmental problems is essential, Mr. Rajagopalan said, partly because no single group is likely to accumulate sufficient knowledge to be able to overcome global environmental difficulties by itself.

The World Bank has helped launch the Global Environment Facility (GEF) with the United Nations Development Programme and the U.N. Environment Programme, he said. The GEF aims to help lower-income developing countries meet the costs of dealing with global environmental problems such as global warming, loss of biodiversity and water pollution.

The industrial countries have a moral obligation...to help developing countries with the consequences of global warming and ozone depletion.

The Bank is committed to the objectives of the U.N. Conference on Environment and Development to be held in Rio de Janeiro next year and is featuring environmental issues in next year's "World Development Report," Mr. Rajagopalan added. The Bank is also integrating environmental considerations into its daily work, he said, noting that the institution will have lent about $1 billion for free-standing environmental-protection projects during the Bank's current fiscal year, which will end on June 30.

214

NGOs criticize World Bank on 'harmful' environment policies

Non-governmental organizations have called on donor governments to withhold contributions to the new Global Environment Facility (GEF) recently set up by the World Bank, UN Development Programme and UN Environment Programme, and to suspend all its projects. More than 60 NGOs from four continents, meeting in Washington with the World Bank in late April, also urged the Bank to freeze any lending to logging, industrial and infrastructural projects located in natural forests. NGOs described a draft policy on tropical forestry development, presented to the meeting by the World Bank, as "fundamentally flawed."

The Bank has taken "due note" of NGO concerns, a spokesman told *Africa Recovery*, pointing to the growing level of NGO input into the revision of Bank policies on the environment. The Bank's executive board will consider the NGOs' views at a late-May appraisal of the Forestry Policy Paper, officials said. These views have been synthesized by the director of the Bank's Agriculture and Rural Development Department Michel Petit, who chaired some of the sessions of the joint Bank/NGO forum.

The GEF was created in 1990 as a $1.5 bn, three-year pilot programme to help developing countries "meet their share of the costs of tackling global environmental problems", according to World Bank President Barber Conable. But NGOs argue that the global environmental crisis must be tackled at its source, in industrial countries. They called for a halt to GEF operations until, among other things, regional and international meetings were held with local people affected by GEF projects; NGO observers participated in the twice-yearly GEF donors' meetings; and the Bank reformed its lending practices, with all GEF projects subject to "the most stringent environmental and social assessments possible."

However, the consensus among GEF donors, especially the Europeans, who met in Washington at the beginning of May, was for its operations to go ahead, said an official in the Bank's Environment Department, although the US wanted a small delay to seek advice from an independent panel of American scientists and technicians. During the May meeting many donors spoke against NGO participation in their deliberations.

On forest sector policy, the NGOs claimed that "no sector of Bank lending has had such a poor recent record". They expressed concern over forestry sector loans totalling $113 mn that are currently in the pipeline for Cameroon, Gabon and Zaire. The NGOs argue that the loan preparation could not have reflected a new policy approach "since the policy does not yet exist."

NGOs recognized the positive general statements in the Bank's forestry policy paper. An earlier Bank report on progress in its collaboration with NGOs noted that some 50 per cent of Bank loans in the 1990 financial year contained environmental components. However, the NGOs said at the April meeting that the Bank's forest policy "does not direct the Bank to stop its involvement," through its lending policies and practices, in the annual destruction of over 20 mn hectares of tropical forest. The Bank stresses that its environment policies are in the process of being revised. ■

Exploitation of tropical forests, such as in Cameroon, remains a major point of disagreement between the World Bank and environmental NGOs.

Forward movement on capacity-building

A new body to strengthen economic management and policy analysis in Africa has opened its doors in Harare. With its fund of $100 mn, the African Capacity Building Foundation (ACBF) will act as a "facilitator, coordinator, and resource mobilizer", says its recently appointed executive director, Jonathan Frimpong-Ansah, formerly a senior adviser in Standard Chartered Bank and an ex-Governor of the Bank of Ghana.

The ACBF, a four-year pilot project to which eight African countries have so far contributed $250,000 each, is an initiative of the African Development Bank, the UN Development Programme and the World Bank. Its immediate aim is to reinforce African policy formulation and development management by promoting the use of African researchers, analysts and managers. The initial focus on policy analysis and development management was chosen because they impact on progress in all other sectors. "You can't take on all burdens at once, or in one institution", argues Frimpong-Ansah.

"Our first approach when we get to a country will be to go to the users of the product — for example, to the government and private sector institutions involved in policy analysis and development planning, says Frimpong-Ansah. "We would spend a lot of time finding out what the gaps are and what it would require to enhance their management capacity." Universities will be another focus of ACBF activities.

Backing regional institutions is also a key element of the strategy, Frimpong-Ansah says. One example is the African Centre for Monetary Studies in Dakar, set up by the Association of African Central Banks. He said that the centre, "if adequately enhanced in coordination with the needs of central banks, could help all the central banks in Africa."

Acknowledging the need to get more African professionals to return home from abroad, Frimpong-Ansah argues, however, that providing special incentives for them discriminates against those who chose to stay. The ACBF fund, he says, will make a special effort to involve African professionals abroad in its seminars and training programmes. On reversing the brain drain, Frimpong-Ansah feels that with widespread economic liberalization, "and hopefully with the political liberalization that is bound to follow, Africans will not need as much money as they are receiving outside to be attracted back."

Colleen Lowe Morna

WORLD BANK NEWS, April 4, 1991

Mexico's Hydroelectric Project Balances Social, Environmental Concerns

Resettling people involuntarily displaced by large hydroelectric dams is hardly the first place one would think to look for examples of the Bank's increased interest in "participatory development."

Although hydroelectric power is the cleanest source of energy and one available to nearly all developing countries, hydroelectric projects can be fraught with severe social and environmental problems, most notably the problem of what to do with the people displaced by reservoirs. Nevertheless, two large dams being built by Mexico's Comision Federal de Electricidad (CFE) are showing how even the most difficult issues in balancing developmental, social, and environmental needs can be resolved.

The 200-meter dam at Zimapan, in Central Mexico, and the 180-meter Aquamilpa dam in the northwest part of the country are the core of a World Bank-assisted integrated energy project that ranges from physical infrastructure to financial, social and environmental reforms. The project will add 1,240 megawatts to Mexico's energy system and improve the power company's finances. But these reasons weren't very meaningful to the 4,000 people being displaced by the two dams. Most of the 800 people who would be affected by the Aquamilpa project are Huichol Indians. After centuries of being pushed farther and farther up into the steep, arid mountains of the Sierra Madre Occidental, there was nowhere for them to go when the water from the reservoir would start to rise.

Even the most difficult issues in balancing developmental, social, and environmental needs can be resolved.

Resettlement did not get off to a good start in either project. Villagers from Zimapan petitioned the Mexican government and the Bank not to go ahead with the project. And in Aquamilpa, the local population was so impoverished that compensation for their lost assets was extremely low. On the one hand, a resettlement program that aimed to restore pre-move living standards would be aiming to recreate abject poverty. On the other hand, moving the Huichol to more productive irrigated sugar or fruit plantations in the lowlands not only would expose them to unfamiliar health, economic, and cultural risks, but would also override their own wish to stay in their ancestral homelands.

Luis Luzuriaga, who works in the World Bank's Latin America and the Caribbean Country region, was familiar with the problems resettlement posed. Bank policies for projects with resettlement are stringent. The Bank's clear, tight policy framework assisted him during negotiations with the government. Mr. Luzuriaga insisted that all the resettlement planning issues be resolved before the loan went to the Bank's Board for consideration. As he put it, "It took three years of close work with the Mexican government before we felt that we could honestly say that we had an acceptable resettlement plan."

At first it appeared that the project might founder when the Bank insisted on a fully developed resettlement plan before it would go ahead with the project. Over time, though, confrontation turned to collaboration as solutions to the resettlement dilemma were found. CFE's new president took an active interest in the resettlement program, and the company formed a high-level Social Development Unit that fielded experienced technicians to work with the affected people. In Zimapan, the farmers formed a negotiating committee that helped CFE find potential replacement farms. Detailed studies in Aquamilpa by specialists who lived with Huichol families gave rise to modest projects that can be continued by the Huichol once CFE leaves: among them, bee-keeping, erosion control, fisheries, and a small project developed and run by a Huichol artist to market the beautiful Huichol arts and crafts.

By all accounts the biggest innovation has been CFE's promotion of mechanisms to increase local participation in the design and management of the resettlement program. In Zimapan, a joint CFE-villager committee developed housing designs. A bimonthly newsletter is circulated through the villages. Senior CFE officials regularly attend community meetings and are learning to give as well as take criticism.

Huichol resettlers are working with CFE to set up small community development funds to provide the resources for designing their own projects, and CFE is preparing technical manuals written in the Huichol language. Villagers choose their replacement houses from among several housing models developed by an

219

anthropologist and an architect. The homes' construction is based on local materials and traditional interior designs.

Participation has taken many forms in this project. For example, villagers in Zimapan elected their own council to manage compensation negotiations. Resettlement broke down for several months as the two sides argued over the company's legally mandated expropriation rates and the farmers' knowledge of their property's values, and in the end, the company surrendered.

How does Mr. Luzuriaga evaluate the World Bank's role in CFE's new approach to resettlement? "We like to think that we helped CFE rethink the problem by showing them that constructive solutions were possible. First, the Bank has sent a clear, strong signal that we consider social and environmental issues as important as the technical and financial ones. Second, using the Bank's resettlement policies to focus on reestablishing people's lost productivity rather than simply removing them from the site of a big project cast the resettlement problem in an entirely different light. Finally, the project's policy and institutional reforms provided a favorable environment and the funds for strengthening CFE's social and environmental capabilities. For example, CFE's resettlement unit recently visited the Navaho-Hopi Relocation program in Arizona, where they not only gained experience but also gave the Americans many new ideas about how to improve their own program."

Because the project marks such a strong contrast with traditional approaches to resettlement, it has attracted the attention of many visitors keen to study its progress. At first a bit nervous about exposing to public view such a sensitive subject, CFE is now proud of the favorable reports it is receiving in publications such as the "Christian Science Monitor" and in university studies by Mexican and foreign researchers.

It is far too soon to declare the resettlement component of Mexico's Hydroelectric Project a success. Only a few families have made the move so far. Every side continues to harbor suspicions of the other's intentions, and the outcomes of the post-relocation development programs will not be known for several years. But the planning for this project provides important lessons both to the Bank and to borrowers about how social problems can be reconciled with development's needs.

And what do the farmers think? One man told us, "We've always worn huaraches (sandals). You're helping us put on shoes." CFE, the Government of Mexico, and the World Bank are waiting to see if they fit. **--Adapted from an article in the "Bank's World" by Scott Guggenheim, an anthropologist with the World Bank's Agriculture Department.**

U.S. Senator David Boren of Oklahoma

FOR IMMEDIATE RELEASE
APRIL 25, 1991

BOREN INTRODUCES NEW TRADE INITIATIVE THAT FIGHTS POLLUTION

WASHINGTON -- Senator David Boren introduced legislation today that would help American companies compete with foreign manufacturers that do not meet adequate environmental standards and would encourage polluting countries to enact and enforce more stringent pollution control measures.

"We are upholding our responsibilities to the world environment but many of our trading partners are not," said Boren. "This means fewer jobs in America as cheaper foreign goods compete with our products and it means more environmental problems for everybody because pollution knows no national boundaries."

Under's Boren's proposal, goods produced abroad under environmental standards less strict than those in America would be subject to a "countervailing duty" when imported into the United States. This duty would be equal to the amount saved by foreign firms because of their smaller environmental burden.

Half of the funds resulting from these countervailing duties would be used to finance the sale of American pollution control equipment to the United States' poorer trading partners that are trying to improve their pollution control. The other half would help finance the research and development of new pollution control technology by U.S. companies.

"I see the unfair advantage enjoyed by foreign producers when I look at many industries important to my own state of Oklahoma -- steel, oil and gas, petrochemicals, and auto parts manufacturers, just to name a few," said Boren.

"America's manufacturers are some of the best and most productive companies in the world today. But by bearing environmental expenses that their foreign competitors aren't paying, they are being unfairly penalized in the world marketplace."

Boren cited the situation in Mexico as an example of the inter-nation consequences of lax environmental standards. Rampant pollution from companies in Mexico has caused public health emergencies in Arizona -- where the incidence of hepatitis near the Mexican border is 20 times the national average -- and in Mexico City -- where 95,000 children under the age of five died in 1989 as a result of pollution-induced respiratory illnesses.

"We should not enter into negotiations with Mexico on a Free Trade Agreement until we have established that the people of Mexico and the people who live near Mexico will not be endangered by further environmental exploitation," said Boren. "We must send a clear signal to companies around the world that abdicating their public health responsibilities will not lead to economic gain and that American companies will not be penalized because they are meeting their environmental obligations."

Linkage Between Free Trade and the Environment

By Bruce Babbitt

THE United States and Mexico share a 2,000 mile border. From San Diego to Brownsville, Texas, from Tijuana to Matamoros, the border is bursting with population growth, economic activity - and environmental problems. The beaches of Coronado and the waters of the Rio Grande are too contaminated for swimming. The rivers in Calexico and Nogales are a stew of arsenic, cadmium, and other toxic wastes.

Environmentalists cannot accept, and will certainly oppose, any free trade agreement with Mexico that is not linked, directly or indirectly, to strong environmental accords. The more immediate issue, however, is whether environmentalists will oppose the "fast track" negotiating process.

For my part, I will support fast track provided the president's action plan makes a serious commitment to the resolution of environmental issues.

However, when and if fast track carries the day, our task as environmentalists will just begin. For we can't return in 1992 to support ratification of a free trade treaty on the basis of more promises or statements of intention. A free trade treaty will have to go to Capitol Hill accompanied by environmental treaties. And it is none too early to suggest just a few of the issues that must be resolved.

Border environmental losses. Our border with Mexico once largely empty spaces, is now the most rapidly growing section of both countries. Without mutual, enforceable environmental standards, human health, water quality, and air quality will continue to decline. We must have a border environmental treaty that incorporates for both countries the highest of standards in either country. The fact that most *maquila* companies are American owned is one of many reasons to require strong environmental standards, including occupational safety standards, on both sides of the border. Environmental protection is, of course, more than a border issue, and our two countries must also negotiate for the ultimate extension of environmental standards throughout both countries.

Habitat and species protection. The destruction of forests, habitat, and endangered species in both countries should be the subject of a treaty to be negotiated and presented to Congress for approval along with a completed free trade agreement. Within the last several years, Mexico has taken meaningful steps to control the destruction of its tropical forests. Yet is has been slow to join international efforts to halt the destruction of wildlife. It has not yet agreed to join the Convention on Trade in Endangered Species. And it has recently challenged American policy banning the import of tuna harvested with nets that kill dolphins. These are examples of the need for enforceable, bi-national treaties.

A new world trading and environmental agreement. The Mexican trade negotiations should serve as the starting point to explore the larger issue of the relation between environmental standards and the entire GATT world trading system. Just as environmental contamination does not respect the border between Mexico and the US, so it does not respect any other national boundary. Gains made between Mexico and the US will be illusory unless they are paralleled by progress in the world trading system.

The Bush administration will not yet concede the need for direct linkage between trade and the environment. In its view each boat must reach shore under its own sail. Nonetheless, the day is near at hand for both the Bush and Salinas administrations to understand the de facto linkage - if either boat sinks before reaching shore, there will probably be no chance for treaty ratification in 1992.

The day when environmental and trade issues can be treated separately is gone. The negotiations with Mexico are the proper place to begin transforming GATT into GATE, a General Agreement on Trade and the Environment.

The time is at hand for Americans to voice their confidence in North American free trade. It is also time to call for a larger vision - a new world order that includes expanded progress on the global environment. The place to start is close to home - along our own borders, on our own continent - with Mexico.

■ *Excerpt from a speech Bruce Babbitt, former governor of Arizona, delivered at a conference on the implications of a North American free trade agreement sponsored by the Center for the New West in Denver.*

220

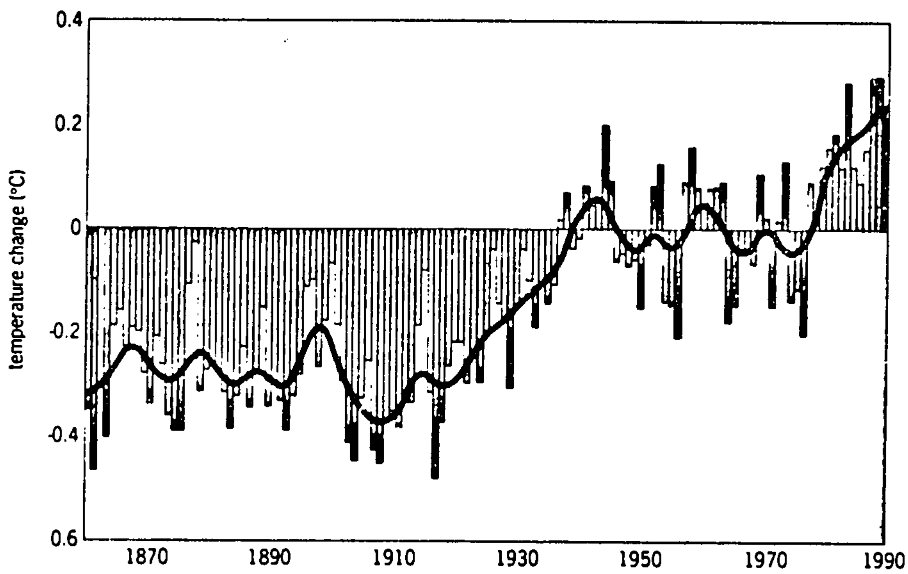
GLOBAL CLIMATE CHANGE HAS ALREADY BEGUN

by JAN SINCLAIR

Land, air and oceans have warmed throughout this century; glaciers and snow are melting at surprising rates; in many parts of the world, winter temperatures no longer drop as low as they did; and the rate of warming appears to be accelerating.

Global warming and climate change is now evident around the planet. Intensive investigation of the available scientific research, carried out by the Intergovernmental Panel on Climate Change, jointly established by UNEP and the World Meteorological Organization (WMO), has revealed many indications of a planet already reacting to the imbalance human activities have sparked.

Six of the eight warmest years on record occurred in the 1980s, while 1990 broke new ground as the hottest year on record. One of the world's leading authorities on climate, Dr Tom Wigley of the University of East Anglia in the United Kingdom, told the Second World Climate Conference in Geneva late last year that, when the natural variations of the Southern Oscillation (a recurrent and very significant climatic phenomenon which is centred over the Pacific but affects 32 percent of the earth's surface) is removed from the global temperature record, it becomes clear that every one of the last six years has been warmer than the year before.



Global-mean combined land-air and sea-surface temperatures, 1861–1989, relative to the average for 1951–80

> *'... global warming is fact ...'*
>
> Dr Mostafa K. Tolba, Executive Director, UNEP

Scientific certainty has always been a demanding goal, and the study of climate poses particular difficulties. Climate has always varied from decade to decade. For climatologists to be able to say with certainty that the climate has indeed changed permanently and that the changes being observed are not just a natural aberration, they need a record of observations of apparent change that extends for at least 30 years.

At present, although there has been a gradual warming observed throughout this century, sharp alterations in various features of global climate only begin from the start of the 1980s. Consequently, if climatologists follow the traditional demands of their discipline, it will be the first decade of next century before they can announce that human activity has indeed sparked an irreversible change in global climate.

The IPCC report on the known data about climate change could not, in the name of scientific accuracy, say definitively that global warming was already fact. It did, however, present a worrying catalogue of changes world-wide. Independent records of air temperatures over land and oceans and temperatures at the sea surface all show a continuing rise throughout this century. Three independent analyses show that global temperatures over the last decade have been higher than in any other decade since records began.

By the mid-1980s, scientists were recording a 'rather sudden' increase in air temperatures at the Earth's surface, and higher up in the mid-troposphere. The planet's snow and ice cover is also showing signs of an unaccustomed atmospheric warming. Since the beginning of this century, there has been a marked retreat of mountain glaciers in all parts of the world—and the IPCC says climate change is the most plausible explanation.

Since the start of the 1980s, there has been a sharp decrease in the amount of snow cover on Earth's land masses. Since 1976, scientists have recorded a decrease of 15 percent or more in the thickness of the sea ice over a large area north of Greenland.

In the southern hemisphere, sea surface temperatures in the mid 1970s began a rise which continues to break existing records. Air temperatures in the southern hemisphere have risen consistently throughout this century.

The pattern was somewhat different in the northern hemisphere: temperatures rose till the 1940s, but then dropped again, before beginning a rise in the 1970s which continues today. One theory given increasing credibility within the international scientific community is that industrial pollution in the northern hemisphere masked the signals of global warming till the warming became too great to be obscured by the pollution. The more polluting particles there are in the air, the more reflective clouds become. Consequently, they reflect more of the sun's heat back to space. Scientists now theorize that the cleaner southern hemisphere gives a more accurate record of the inexorable rise in temperatures throughout the century.

As the planet becomes progressively warmer, it is expected that more water will evaporate. The IPCC has already reported that global water vapour increased by a few percent during the 1980s, compared with the 1970s. In addition, weather records show that, throughout this century,

Destruction of wildlife and trees caused by a cyclone in the Pacific region.

there have been substantial increases in cloudiness over North America, Europe, Australia and the Indian subcontinent.

Water supplies are expected to become less reliable in many parts of the world as global warming gains momentum. At the Second World Climate Conference, meteorologists from the Mediterranean region and Africa reported that drought was now seriously threatening water supplies. French scientist Dr J. Sircoulon told the conference that certain regions of France had seen a 30 percent drop in annual rainfall over the past two years. By the end of September 1990, 60 French Departements had to economize on water, and the water shortages became so bad that there was a period where the French authorities envisaged simply shutting down certain nuclear power plants.

'Climate change is on ...'

Dr Bert Bolin, Chairman, Intergovernmental Panel on Climate Change

As global warming progresses, it is expected that warmer temperatures will whip the world's weather systems into more intense activity—and the IPCC does indeed report an apparent increase in the frequency of tropical cyclones since 1950 in the eastern North Pacific, the south-west Indian Ocean and in the Australian region. While the IPCC says this apparent increase probably simply reflects better monitoring, low-lying island nations attending the Second World Climate Conference disagreed.

Three years ago, for the first time in recorded or oral history, all of the islands of the Maldives, spread over 600 miles of the Indian Ocean, were affected by inundation from large swells. Tuvalu, a small low-lying island group in the Pacific, was hit by only four cyclones in 1940—then considered an average number of cyclones for one year. In 1989, Tuvalu suffered 21 tropical cyclones. Trinidad and Tobago reported that in the past two years, it had been hit by tornados—previously an unknown experience for the islands' people.

Science may not yet be able to say with absolute certainty that global warming is a fact already, but the IPCC has said it is inevitable, and that the changes in climate will be irreversible. These global imbalances, which we have initiated, seem set to worsen unless humans reduce greenhouse gas emissions especially from factories and vehicles, and begin restoration of the planet's forests, so vital in the absorption of carbon dioxide, the major greenhouse gas.

THE NEW YORK TIMES, April 27, 1991

Climate Catastrophe, the Rerun

By Michael Oppenheimer

Ozone amnesia is slowing action on global warming.

The National Academy of Science's declaration on April 10 that the U.S. should act immediately to slow global warming followed directly on the heels of NASA's finding that the depletion of Earth's ozone layer was accelerating. Despite White House claims this week of deepening concern, its response to both events vindicates Hegel's observation that governments never have learned anything from history.

The greenhouse debate is eerily reminiscent of earlier arguments over the ozone layer. As with that debate, it is the magnitude of impending change, not the underlying theory, that is in dispute. Emissions of industrial and agricultural gases, primarily carbon dioxide from fossil- fuel combustion, will surely cause global warming if not curtailed. Similarly, there has long been agreement that chlorofluorocarbons, which are used in refrigeration, air-conditioning, foam plastics and solvents, destroy ozone in the stratosphere.

The best estimate is that the globe will warm by five degrees Fahrenheit by late in the 21st century, but current warming is small enough that the future is highly uncertain. The Earth may heat up by only two degrees, which would be manageable, or by as much as nine degrees, which would be catastrophic. We won't be sure how much warming is in the cards until it happens. But once altered, the climate, like ozone, will not return to normal for generations.

It is worth remembering that only six years ago, global ozone depletion had not yet been detected. At that time, the best estimate of the 1990 depletion was 1 percent. NASA's recent finding is that depletion over the United States has already reached 4 to 5 percent.

The Administration is still wringing its hands over the potential cost of reducing carbon dioxide emissions. But the Academy found that efficiency measures like increased automobile fuel economy, implemented through Federal and state policies, are an inexpensive, perhaps even money-saving way, to slash the risk of catastrophic warming.

The Administration's wild exaggerations of costs are reminiscent of industry arguments that there were no practical substitutes for chlorofluorocarbons. But an international treaty signed in London last June will eliminate production of the major ozone-depleting chemicals over the next two decades, permitting the ozone layer to slowly recover. The supply of air- conditioners, refrigerators and foam cushions will hardly be affected, since companies have been developing profitable substitutes for chlorofluorocarbons since the day that regulation appeared inevitable.

Yet millions of Americans may contract skin cancer and 200,000 are expected to die as a consequence of enhanced ultraviolet radiation before ozone levels rebound, according to an Environmental Protection Agency estimate. Worse, we don't know how far ozone depletion will proceed, which ought to chill optimism about our ability to adapt to climate change.

The lesson, for those who care to pay attention, is that the ozone debacle could have been avoided. Shortly after the threat was identified in 1974, the public began boycotting aerosol spray cans in such numbers that the E.P.A.'s ban of those containing chlorofluorocarbons in 1978 was anticlimatic. But with ozone depletion not yet measurable, our Government lost interest in the problem.

It stopped short of implementing changes that consumers could not bring about on their own, like encouraging new technologies for refrigeration. By the time large ozone depletions could be measured, in 1985, it was too late to avoid calamitous increases in cancer.

Sadly, the White House has responded to both the new ozone findings and the Academy report as if it were staffed by amnesia victims. It declared that the accelerating ozone depletion was an occasion for "deliberative and comprehensive" study rather than for speeding the elimination of ozone-depleting chemicals. The Academy's call for Federal incentives to encourage energy efficiency by consumers and industry was ignored in favor of modest cuts in the Government's own energy use, only two percent of the U.S. total.

Earlier administrations tragically miscalculated the threat to ozone. The Bush Administration seems intent on a repeat performance with global warming. □

Michael Oppenheimer is senior scientist at the Environmental Defense Fund.

225

Appropriations

Foreign aid bill may go to markup

The House Appropriations Committee this week could mark up a draft fiscal 1992 foreign aid appropriations bill that aides say would earmark $50 million for an international fund to help developing countries address global environmental issues.

Established last spring, the "global environment facility" is managed by the World Bank, the United Nations Development Program and the United Nations Environment Program.

An aide to the foreign operations subcommittee said the facility so far has received from donor countries $800 million that can be used to fund activities related to four basic objectives — reducing the threat of global warming, protecting Earth's stratospheric ozone layer, preserving biological diversity and protecting international waterways.

Essentially, the overall aim of the pilot facility is to fund "innovative ways to keep the environment clean" in developing countries, the aide said.

The Bush administration's budget proposal for fiscal 1992 included a $50 million request for a U.S. contribution to the global environment facility. The administration wanted the funds to be administered through the Agency for Inter-

For background on foreign aid and global environment, see *Briefing Book*, p.27.)

At press time, House Appropriations Chairman Jamie L. Whitten (D-Miss.) had not scheduled full committee action on the bill, but aides said a markup was possible sometime this week.

House Appropriations contacts: Mark Murray, majority, x52041 or Anne Georges (Obey), x53365; Patricia Knight, minority, x53481.—*DR*

AFRICA

Clark, Dick. What Role Can America Play in a Changing South Africa? Speech given by Herman Cohen in The Southern Africa Policy Forum, Fourth Conference. Aspen Institute, April 1-6, 1991.

Rotberg, Robert L. "South Africa's Rehabilitation," The Christian Science Monitor, June 21, 1991.

Fukuyama, Francis. "South Africa's Alternative Futures," The Wall Street Journal, June 17, 1991.

Horne, Gerald. "Waiting in the Wings: Economic Apartheid," The Los Angeles Times, April 17, 1991.

Lamar, Stephen. "Business Prospects Brighten in Southern Africa," Business America, May 20, 1991.

"Making Peace in Southern Africa," Financial Times, May 1, 1991.

Bing, Adotey. "Ghana: Devaluation Brings Little Gain," Africa Recovery, United Nations Department of Public Information, June 1991.

Harsch, Ernest. "Burkina Secures Adjustment Deal," Africa Recovery, United Nations Department of Public Information, June, 1991.

Kelly, Michael J. Education in a Declining Economy, The Case of Zambia, 1975-1985, Economic Development Institute of the World Bank, March, 1991.

Zambia's Three-Year Economic and Financial Program, Press Release by External Relations Department, International Monetary Fund, April 17, 1991.

"The IMF's Troubled Role in Africa," Africa Recovery, United Nations Department of Public Information, June 1991.

Dagne, Theodore S. "Ethiopia: New Thinking in U.S. Policy," Congressional Research Service, Report for Congress, The Library of Congress, June 18, 1991.

Pauling, Sharon. "Ending War and Famine in the Horn of Africa Through Grassroots Initiatives," Bread for the World Background Paper No.119, March 1991.

Ozanne, Julian and Michael Holman. "Cry, the Unloved Continent," Financial Times, May 8, 1991.

Williams, Larry. Statement before the House Banking Subcommittee on International Development, Finance, Trade and Monetary

Policy, May 30, 1991.
"International Coalition of Relief Organizations and Churches Calls on UN, Donor Governments to Respond to Sudan Famine," News from CRS, Catholic Relief Services, May 1991.

Bjerstrom, Erika. "Cameroon: Fighting Poverty to Save a Forest," Tomorrow: The Global Environment Magazine,Tomorrow, Media: Stokholm, Volume 1, Number 1, 1991.

"Debt Initiative May Be Lasting Summit Legacy," Africa News, May 20, 1991.

"Amid Continent's Drama, Summit Ponders Future," Africa News, June 24, 1991.

Duodo, Cameron. "Arms and Africa's Military Spenders," The Washington Times, June 18, 1991.

The Southern Africa Policy Forum
Fourth Conference, April 1-6, 1991

The Aspen Institute
Dick Clark

What Role Can America Play in a Changing South Africa?

Herman Cohen

Assistant Secretary of State for African Affairs, U.S. Department of State

TEN BASIC PREMISES UNDERLYING U.S. INITIATIVES IN SOUTH AFRICA

1. The success of South Africa's transition from apartheid to democracy will depend primarily upon South Africans. While the United States and other well wishers can assist, nothing can replace South African initiative, determination and goodwill in constructing a new social contract.

2. The external world can nonetheless make a substantial contribution to a successful transition. South Africa has the human and material resources to solve its own problems, but external contributions can make a difference.

3. We believe that South Africa's move away from apartheid is irreversible, but a positive final outcome is not guaranteed. We need to remain engaged, providing assistance where necessary to support democratic initiatives and trying, in a non-obstructive way, to help level the playing field.

4. Without substantial sustained economic growth, South Africa will not be able to make it.

5. A strategy dependent upon the wholesale redistribution of existing wealth will not work. The reordering of priorities and the creation of new opportunities is a better idea.

- Redistribution through nationalization has proven in other places to be wasteful and the forerunner of economic stagnation.

- Reordering of priorities, on the other hand, promises use of tax policy, fiscal policy, affirmative action and investment policy to redress the vast economic imbalances, while retaining the engine of growth.

6. While economic growth should be driven mainly by a healthy and predominant private sector, the post-Apartheid South African Government will have to attend to macro-economic management, just as the U.S. Government did during the 1930s depression. South Africa's social agenda won't go away, and the private sector alone cannot address it. A partnership between government and business in addressing the issues would be optimal.

7. Expanded regional economic integration should be encouraged. The idea that South Africa can be the engine of growth and development for the southern tier of the continent is valid. The whole can be bigger than the sum of its parts.

8. The domestic rate of savings in South Africa is not sufficient to sustain a level of economic growth required both to redress historical imbalances and to accommodate a rapidly expanding population. Therefore, external capital and investment will be crucial in creating that growth.

9. South Africa should be seen as being simultaneously a developed and a developing economy. Africans living in rural areas, in tribal trust lands and in the so-called "homelands" represent 65 percent of the black population; they live in conditions of underdevelopment similar to the rest of Africa and the needs are enormous. The modern sector, on the other hand, resembles a Western economy and holds the key for the development of the entire nation.

10. To accomplish the transition from apartheid, there is no alternative to negotiations. For the post-apartheid era, there can be no alternative to democracy. In both instances, the international community will support nothing else.

224

HOW CAN THE UNITED STATES CONTRIBUTE TO A SUCCESSFUL TRANSITION FROM APARTHEID TO DEMOCRACY, AND TO POST-APARTHEID NATION BUILDING?

Political

The United States will continue to support good faith negotiations leading to a constitutional settlement. We will work to persuade those elements in both the white and black communities who currently reject negotiations to come to the table.

Both the Government and the opposition need each other as viable negotiating partners. Black political organizations need assistance in making the transition from liberation movements to capable interlocutors in the negotiations process. The Congressionally-mandated $10 million assistance package could go a long way toward this important goal and should be released without delay.

We will continue to work in the United Nations to strengthen consensus in support of negotiations in South Africa. The UN General Assemblies of 1989 and 1990 were outstanding examples of such consensus, reflecting encouragement and support for the process emerging within South Africa, rather than attempting to impose an internationally dictated formula.

We need to find a way to help the multi-racial universities continue their good work of integrating higher education. Sanctions currently prevent us from assisting them directly.

Economic

We need to continue to expand our support to education and training to help prepare blacks to assume positions of responsibility in the political and economic power structure. For FY-91, our assistance budget is $40 million, representing a 25 percent increase over 1990; it is broken down as follows:

Scholarships inside S.A.	10 million
Scholarships in the U.S.	10 million
Other education programs	10.5 million
Human rights assistance	2 million
Labor union training	3.5 million
Community development	4 million

We must also undertake efforts to promote economic growth and reduce unemployment. Our activity in this area is currently subject to legal prohibitions in many areas. The CAAA enacted a comprehensive set of trade and investment loans. The CAAA does not define all U.S. sanctions. The Rangel Amendment limits U.S. business interest in South Africa through double taxation. The Gramm Amendment severely limits the circumstances in which the United States can support South African access to IMF facilities. There are also a myriad of state and local sanctions.

However, because so many disadvantaged South Africans live in rural areas, we should not wait for a new constitution before attacking the problem of rural poverty. Down the road we should consider starting a Peace Corps program and encouraging the World Bank, IMF, and UN agencies to start programs in rural education, health and agriculture.

We should continue to support programs that encourage regional integration as we have been doing through SADCC. We have emphasized transport links so far. Now we should move into support for regional trade expansion.

Meanwhile, we should reject a simplistic emphasis on the debate over free markets vs. government controls. The private sector will remain the primary engine of growth in South Africa. However, the post-apartheid South African Government will have to adopt policies to meet social goals. We should concentrate on cooperation, advice and training in the public sector, while simultaneously promoting investment in the private sector.

The time has come for the OECD governments to consider post-apartheid South Africa to be an emerging democracy no less important than the countries of Eastern Europe. As we have done in Eastern Europe, we should collectively encourage renewed capital flows, provided the political system remains democratic, and the economic system assigns the predominant role in promoting growth to the private sector.

CONCLUSION

I believe it is important for South Africans to know that we and the international community will remain engaged as helpful partners in South Africa's nation building process. Recognizing from the outset that the process—from the negotiation of a new social contract to the generation of new wealth—is essentially a South African affair, we can and do share a common interest with South Africans and, indeed all Southern Africans, in seeing this process succeed.

OPINION

■ *When South Africa's homeland laws go, every segregationist measure that has been voted into law since 1948 will be revoked. But a basic distinction between whites and blacks will remain: Blacks have never voted directly for national representatives.*

South Africa's Rehabilitation

By Robert I. Rotberg

SOUTH Africa is coming in from the cold. Already black Africa is paying much more attention and trading openly. Europe has begun relaxing sanctions. Japan is buying formerly banned coal, and the United States could soon ease its own economic boycott.

Each of these trends is based on the growing perception that apartheid is really ending. President Ibrahim Babangida of Nigeria has called President Frederik W. de Klerk of South Africa a man of courage; President Daniel arap Moi of Kenya this month welcomed Mr. De Klerk to his own country; and the Organization of African Unity (OAU), at its meeting this month in Abuja, Nigeria, agreed to study OAU strictures against South Africa to see if and when they can be lifted.

The legal underpinnings of apartheid will in fact be erased from the South African statue book by the end of this month. The hated Lands acts of 1913 and 1936, which crowded 87 percent of the population into 13 percent of the country, are gone. So is the Group Areas Act, which segregated urban areas. The Population Registration Act, which separated all South Africans by color, is also being repealed.

Hernus Kriel, minister of planning, provincial affairs, and national housing, said that the intention of the ruling white National Party was to turn apartheid into a "political dodo." Apartheid, he said, had been a "social experiment that was supposed to bring peace, safety, and prosperity," but it had failed.

At the end of this month all that will be left of the legal superstructure of apartheid will be the Promotion of Black Self-Government and National States Constitution acts. Together, they created South Africa's homelands, nearly all of which now would prefer to be dismantled.

When the homeland laws go, every segregationist measure that the National Party voted into law since 1948 will be revoked. But a fundamental distinction between whites and blacks will remain: Blacks have never voted directly for national representatives. Nelson Mandela and the African National Congress are clamoring for the right to vote alongside whites, Asians, and Coloreds, and thus for majority rule.

The ANC and its allies want American, European, and African sanctions to remain until De Klerk and the National Party show a continuing, even a conclusive, willingness to share power decisively with blacks and to give them the vote.

Yet because South Africa is the economic powerhouse of Africa, and because it can pay high prices for Nigerian oil, purchase agriculture products from Kenya, invest in Madagascar, and so on, there are incentives for open resumptions of trade and, in many cases, even the renewal of air links. Given the revocation of legal apartheid, the incentives have recently become overpowering.

South Africa managed last month to borrow large sums of capital for the first time in many years in Germany and Britain. The Japanese reportedly want to lift their own formal sanctions, following the lead of the European Community.

IN the United States, however, a relaxation of trading and investing bans against South Africa could take considerably longer. Although South Africa may well have fulfilled most of the conditions contained in the Comprehensive Anti-Apartheid Act of 1986, including the repeal of laws, the release of prisoners, and the beginning of negotiations, precisely how whites will share power and how and when blacks will be able to vote is still undecided and uncertain.

President Bush admires De Klerk and wants to support his efforts. But Congress will want to see proof of more than good intentions. It may wish to examine the manner in which the white parliament has revoked segregationist laws while giving neighborhood committees the right to set norms for their residential environments and white-run school committees the right to establish separate-race schools.

The National Party cannot recreate apartheid in miniature or disguise, but it doubtless wants to cushion whites against change and a widely feared "lowering of standards." Now that the Lands acts are repealed, too, it is afraid to restore ancestral territories that were taken away from 3.5 million blacks since 1960, lands they now seek to have restored.

All of these caveats, and the absence of the vote, will likely stay Congress's hand. Official sanctions, as well as the prohibitions against doing business with South Africa through US companies that have been enacted by 127 states and cities, will consequently remain until Mr Mandela and the ANC decide otherwise.

However much South Africa desperately needs investment from outside, and renewed trade with the West, the ANC does not yet want to lose its leverage on whites – a leverage that the ANC believes has helped bring about the end of apartheid.

■ *Robert I. Rotberg is president of Lafayette College in Easton, Pa.*

229

South Africa's Alternative Futures

By FRANCIS FUKUYAMA

As South Africa moves toward full democracy, it possesses three things that Eastern Europe is now desperately seeking: a functioning market economy, a democratic tradition (albeit limited to whites), and a civil society. On the other hand, most of the former communist world has one advantage not shared by South Africa: an almost universal abhorrence of the socialist system and a broad consensus on the need to replace it with democracy and free markets.

The economic thinking of the African National Congress has been in a deep freeze for several decades, and what is thawing is a mixture of orthodox Marxism and a kind of '50s Keynesianism exemplified by the slogan "growth through redistribution." The winds of *perestroika*, so strong in Eastern Europe, have not reached South Africa: According to Joe Slovo, head of the ANC's close ally, the South African Communist Party, socialism–despite having failed everywhere else in the world–will be built correctly for the first time in South Africa.

As the political parties–both black and white–now prepare to hammer out a new constitution based on one man, one vote, three possible futures await South Africa.

The Scenarios

The first, and most optimistic, scenario is that the future South Africa will be something like Germany–that is, the developed part of the country will peacefully absorb the less developed part and, while suffering a temporary drop in living standards, will ultimately bring it up to its level. At the opposite end of the spectrum is the nightmare of Lebanon, with uncontrolled civil strife and violence among South Africa's ethnic populations. In between is a Latin American model where decline is not so much political as economic: massive increases in public spending followed by hyperinflation, leading to a situation like that of Brazil (if one is optimistic) or Peru (if one is pessimistic).

Of these different futures, the least probable is the German model. Indeed, the Germans themselves are discovering that absorbing their formerly communist neighbors, who share a common language, ethnicity, and culture, is going to be far more costly and difficult than they initially thought. South Africa's five million whites simply do not have the resources to bring 39 million blacks up to the level of a modern First World country.

The current township violence suggests that the second scenario is more likely–that South Africa will come to resemble Lebanon. This is the fate that has befallen Southern Africa's two most recent ex-colonies, Angola and Mozambique, with truly horrific results. Though many of the same ingredients exist in South Africa, many South African whites are surprisingly confident that they can avoid the political free-fall that characterized Angola and Mozambique.

First, the whites know that they are the best-armed and most cohesive tribe in Southern Africa; if push comes to shove, they are positioned to defend themselves and could send the black economy into a rapid and abysmal tail-spin. Following the collapse of communism, the international climate is also much more favorable for a peaceful transition than when Angola and Mozambique gained their independence in the 1970s. And third, many white South Africans are confident that, despite the troubling policy positions taken by the ANC, there is a flexibility and lack of fanaticism in black political culture that will make it possible for the radicals to be "brought along" to support a core of Western liberal economic and political institutions.

If it will resemble neither Germany nor Lebanon, and if its economy remains too strong for it to sink into African poverty in the short-run, the question then becomes which Latin American country it will take after.

If a future South Africa will resemble neither Germany nor Lebanon, and if its economy remains too strong for it to sink into African poverty in the short-run, the question then becomes which Latin American country it will take after. For if it seems just possible that South Africa can skirt a political maelstrom of instability and violence, it is hard to see how it can avoid a long-term economic deterioration. The starting point for this deterioration is the undeniable need for the redistribution of wealth within the country. The problem is that any large-scale attempt to right this economic wrong over a short period of time would undermine the basis for wealth creation that is the only hope for black South Africa itself.

Were the ANC to attempt to implement its current economic program today, it would begin by massively increasing public spending on precisely those social services that were so lacking for blacks in apartheid South Africa. The ANC has a rather naive belief in how much foreign capital it can attract, based in part on overzealous promises by Western sympathizers. Like others around the world, its leaders believe in the Cargo Cult of the 1990s, the mythical "Japanese investor" or American foundation that will bring capital to South Africa once its industries have been "democratized." In fact, financing would have to be largely internal.

One of the most urgent tasks for the ANC or any future black government of South Africa will be to prevent an exodus of skills. However unfair the current degree of white property ownership, and however insulted and injured the black population has been by the apartheid system, the future economic prospects of South Africa will depend to a very large extent on whether the whites can be persuaded to stay on in a nonracial, post-apartheid democracy. The same sort of bitter irony also characterizes the Soviet Union and Eastern Europe, where former communist managers and party bosses are ending up as the entrepreneurs and businessmen of the region's marketizing economies, as they have the know-how necessary to make the economy work. The whites will not be persuaded to stay unless the new government undertakes to protect their property rights and to ensure their physical security.

It is hard to overstate the potential economic disaster for South Africa were a white exodus to occur. The rest of sub-Saharan Africa has been moving backward economically at a breathtaking pace for most of the past decade. While South African per-capita gross national product has also been falling, the rate of decline is nowhere near that of the rest of the continent; absolute GNP for the six most populous economies of sub-Saharan Africa fell at an average rate of 0.8% a year between 1981 and 1987, while per-capita GNP fell at a rate of about 4% a year. Africa's cities have been de-industrializing, its roads and communications systems collapsing, and its environment undergoing rapid degradation. All of this region's 450 million people now produce about as much wealth as Belgium's 10 million, and many parts of Africa are poorer than when they gained their independence.

Sadly, it would appear that colonialism, far from having been responsible for Africa's poverty, was in fact a major source of skills and infrastructure, and that the region has become worse off economically the further from colonialism it has moved. This is not meant to justify either colonialism or apartheid, but only to be realistic about the economic dangers facing this part of Africa. Brazilians say of themselves that their land has such natural plenty that they can repeatedly mess up economic policy and still not starve; South Africa, for all of its mineral wealth, does not have this kind of margin for error.

The best long-term guarantee for stable democracy in a future South Africa would be for the black population to undergo the same process of social evolution that the Afrikaners experienced earlier in the century–from poor, illiterate farmers to literate blue-collar industrial workers to college-educated white-collar managers and professionals. South Africa's problem is that the forces of economic modernization have only begun to operate on the much larger black community, whose starting point was in any case considerably behind that of the Afrikaners. In many townships, it is impossible to re-create even the sweatshops of Hong Kong, since potential seamstresses cannot read the instructions on their sewing machines.

The architects of the apartheid system have themselves to blame for much of this state of affairs, since apartheid sought to obstruct the social modernization of the black community. This bad situation was made much worse, however, by the politicization of the past 15 years. Blacks have retreated significantly in social terms: There is an entire generation of township "comrades" who refused what education they were offered and are now part of a semi-criminal underclass. For this, the ANC must share the blame.

A Social Revolution

The main obstacle to black social modernization in the future may well be the belief in socialism on the part of the ANC and its communist allies. Capitalism, if left to itself under a system of truly equal political rights, will tend to modernize South African society and bring about what Tocqueville called an "equality of condition." Unplanned and without resort to coercion, capitalism fosters an enormous social revolution, tearing people away from traditional attachments and forms of authority, and bringing about a new order in which education, skill and work rather than race or tribe determine a person's status.

Socialism has always presented itself as a higher and more progressive form of social organization than capitalism. But in the contemporary world, socialism has been revealed to be an obstacle to social and economic modernization–the hallmark of a certain kind of backwardness that needs to be overcome just like illiteracy and superstition. The countries of Eastern Europe are now moving rapidly backward into the future, undoing the legacy of 40 years of dictatorship and socialist planning. Let us hope that South Africa, as it makes the necessary transition to democracy, does not move forward into the past.

Mr. Fukuyama, formerly with the State Department, is the author of "The End of History and the Last Man," out in January from Free Press. This article is excerpted from the summer issue of The National Interest.

LOS ANGELES April 17, 1991

Waiting in the Wings: Economic Apartheid

■ **South Africa:** Eliminating law-based racism isn't enough. Sanctions must hold until whites end their monopoly on industry.

By GERALD HORNE

Cape Town, South Africa, bears more than a passing resemblance to Southern California. Towering mountains, ocean waves, sunshine and eclectic architecture are just a few of the commonalities.

If the white-minority regime in Pretoria prevails, the resemblances between South Africa and America will be carried a step further. For just as America moved from *de jure* to *de facto* segregation after Brown vs. Board of Education in 1954, South Africa now seems to be moving from *de jure* to *de facto* apartheid: Race-based laws will be removed from the books but horrendous inequalities will remain. This presents a formidable challenge to the Bush Administration, which is moving to lift sanctions and to the anti-apartheid movement in this country, which is resisting such a move. The question is: Were sanctions aimed simply at removing certain racist laws, or were they designed to have a wider, transforming impact on South Africa?

These were some of the concerns raised during debate by a 30-member delegation of American lawyers and legal scholars invited by the National Assn. of Democratic Lawyers in South Africa and the African National Congress to consult in Cape Town on a post-apartheid constitutional order.

We were invited to South Africa because of our unique perspective and experience in grappling with *de facto* segregation. Certainly, the analogy between American segregation and South Africa apartheid is strained. Martin Luther King Jr. was the apostle of nonviolence. Nelson Mandela, while jailed for 27 years, stoutly refused to repudiate armed struggle. Yet the post-apartheid constitutional order envisioned by President Frederik W. de Klerk bears more than a coincidental similarity to the kind of legal obstacles that have ensnared the civil-rights movement in this nation.

Take the recent white paper on land reform. It would abolish the Land Acts and the Group Areas Act and eliminate all racial restrictions on land tenure. Such measures—combined with fraud, force and intimidation—have given the white minority control over about 87% of the land and dispossessed the black majority.

Just as King complained bitterly about African-Americans gaining the right to eat at a lunch counter but not necessarily having the money to buy a hamburger, the De Klerk plan does not envision assistance to an overwhelmingly penniless black majority in regaining control of what once was theirs. Indeed, the land proposal sets the tone for most of De Klerk's "reforms" (that is, "let bygones be bygones") and does not really address the ravages of 40 years of apartheid and 350 years of racism.

The De Klerk regime does not envision "affirmative action" to redress discrimination. This is even more ironic in light of the fact that after World War I, his "tribe," the Afrikaners, enacted one of the most successful affirmative-action plans in history in an attempt to catch up with white South Africans of British descent.

This involved the building up of one of the most formidable state sectors in the world—including broadcasting, an arms industry and an iron and steel industry—and placing Afrikaners in key areas of government and the economy.

But now Pretoria is engaging in born-again Reaganomics and busily privatizing the state sector, which could mean that a black-majority government will not have the resources to address the needs of a long-suffering population.

This is designed to lead to a post-apartheid scenario in which economic power is concentrated in the hands of a few whites and political power is fragmented to the point that a strong central government would be unable to redistribute the wealth through confiscatory taxes and other means, as promised by the ANC.

Moreover, it seems that the post-apartheid legal order will involve some of the same sticky legal questions and prolonged battles that have consumed American courts for the past 35 years. For example, with the demise of the Separate Amenities Act, which facilitated apartheid in public accommodations, many towns in South Africa are now charging fees to use libraries and swimming pools, among other things. Again, the poverty-stricken black majority still does not have the means to use these facilities. In effect, *de jure* apartheid has been replaced by *de facto* apartheid, exclusion on the basis of race has been replaced by exclusion on the basis of economics.

There are those in Pretoria who would like to imitate the United States. The lifting of sanctions by the European Community on Tuesday (and the rush to do so by International Olympic Committee and, presumably, the White House) suggests that Pretoria's plan may work. But Pretoria has to contend with a population that has been thoroughly radicalized by the degradation of apartheid and a leadership loath to accept half a loaf. This may ultimately derail the plan to install *de facto* apartheid.

Gerald Horne is chairman of the Black Studies Department at UC Santa Barbara.

233

Business Prospects Brighten in Southern Africa

By Stephen Lamar, Office of Africa
U.S. Department of Commerce

The ten member countries of the Southern African Development Coordination Conference (SADCC)—Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Zambia, and Zimbabwe—provide increasingly attractive business opportunities for U.S. firms. Economic reform and a renewed interest in private sector-led growth helped the SADCC economies expand by about 4 percent, bringing combined GDP to more than $30 billion in 1990. With a total annual import bill of about $10 billion and a population exceeding 80 million, the SADCC countries represent a definite market for American goods and services.

Economic reform will greatly expand the commercial potential of the SADCC region. Recognizing the failures of the state-dominated economic model, many of the SADCC governments have embraced comprehensive programs to liberalize their economies and deregulate their domestic markets. Even relatively free-market economies, such as the BLS countries (Botswana, Lesotho, and Swaziland), have adopted measures to reduce government regulations and stimulate private initiative. By eliminating bureaucratic controls and encouraging private competition, these reform programs are setting the stage for long-term economic growth and creating a host of commercial opportunities.

A key measure of economic reform in southern Africa has been trade liberalization. SADCC governments have become increasingly aware of the role that exports and imports play in economic development and have started to dismantle barriers to trade, both with each other and the rest of the world. Namibia and the BLS countries, together with South Africa, constitute the Southern African Customs Union (SACU), which allows duty-free trade among the member countries. Seven of the SADCC countries belong to the Preferential Trade Area of Eastern and Southern Africa (PTA), which is dedicated to the reduction of tariffs and expansion of trade between member countries. Finally, a number of SADCC states have negotiated special bilateral trade arrangements to reduce duties on selected goods.

More recently, SADCC countries have begun to ease restrictions on the allocation of foreign exchange for the purchase of imports. Many SADCC governments have established or expanded open general import license (OGIL) schemes, under which foreign exchange is automatically available—usually through applications to commercial banks—to import a wide range of high priority goods. Zambia, Malawi, and Tanzania have already expanded their OGIL facilities so that they now list about 85-90 percent of total imports. Zimbabwe expects to have 85 percent of all imports listed on its OGIL by 1995.

Mozambique is trying to perfect a "non-administrative" system to make foreign exchange available for imports and, along with Zambia, has established a dual exchange rate so that some foreign exchange transactions can react to market forces. Botswana maintains a convertible currency (the pula) while Lesotho, Namibia, and Swaziland, as members of the Common Monetary Area (CMA), guarantee convertibility to the South African rand.

Eased foreign exchange controls are also key for renewed investment promotion efforts. The BLS states already boast relatively liberal foreign exchange regimes for profit and dividend repatriation. Namibia's new investment code allows for free profit and capital repatriation. Malawi recently eased its regulations to allow for 100 percent profit and capital repatriation, while Zimbabwe just announced 100 percent dividend repatriation for export-oriented ventures. Tanzania and Zambia both allow for profit and dividend repatriation through export retention schemes, under which exporters are permitted to retain control of a portion of the foreign exchange they generate. Mozambique currently allows for repatriation of profits, subject to availability of foreign exchange.

In addition, the SADCC governments have recently enacted other measures to encourage foreign direct investment. During the past several years, Mozambique, Tanzania, and Zimbabwe have implemented new investment guidelines that provide for guarantees against expropriation, spell out tax incentives, and establish one-stop investment centers. Malawi, Namibia, and Zambia have articulated new investment policies with many of these features and expect to announce specific guidelines during the coming months. The BLS states already boast liberal investment climates, which feature tax holidays, financial packages, and other inducements. Most SADCC governments are either signatories to the World Bank Multilateral Investment Guarantee Agency (MIGA) or have an OPIC agreement.

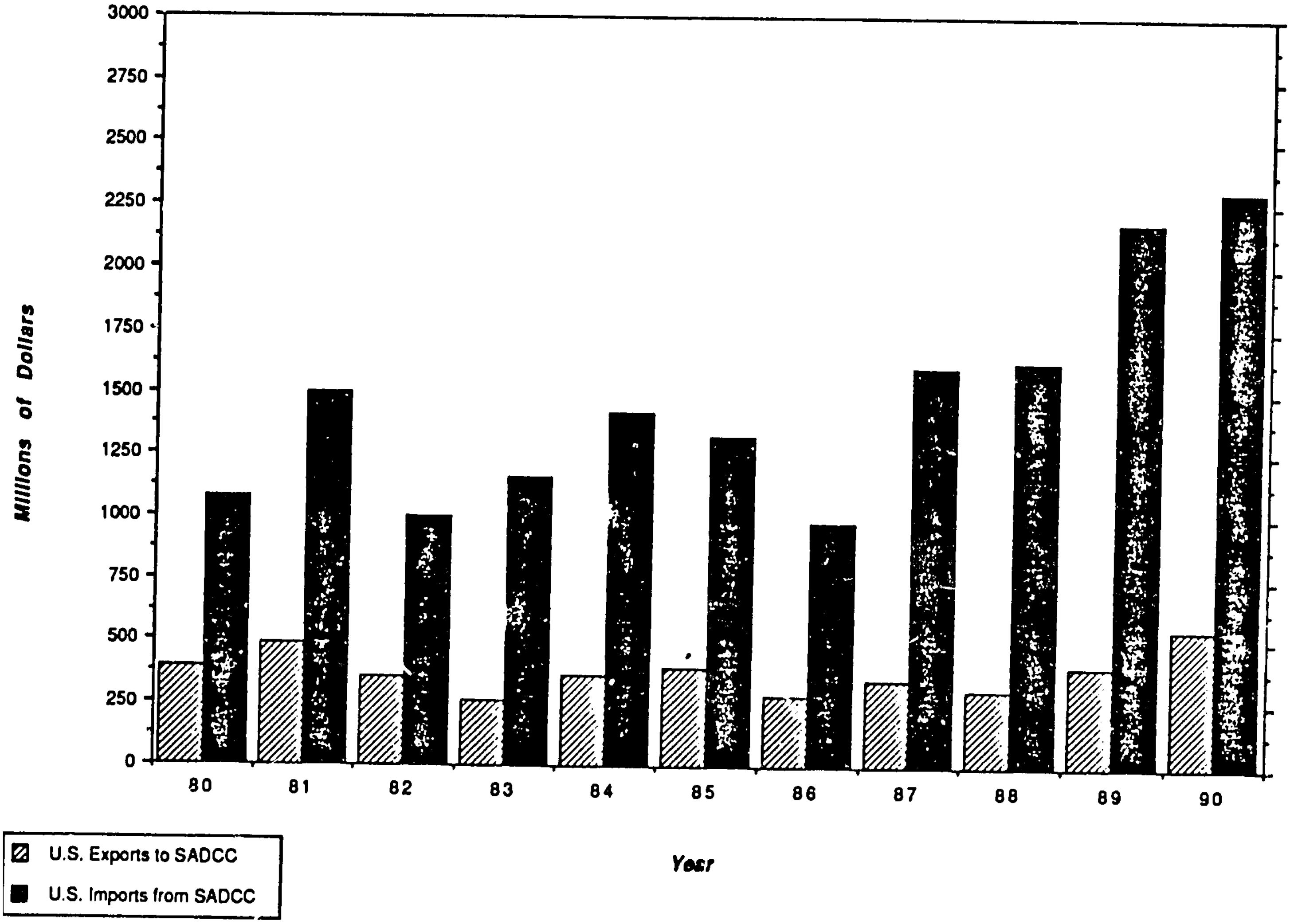
Concurrent with specific trade and investment reforms, the SADCC governments are taking steps to decontrol their economies and improve economic management. Government budget deficits have been reduced. Redundant civil servants are being removed from government payrolls and retrained for the private sector. Price controls have been relaxed or scrapped. Nominal interest rates have been allowed to rise to establish positive real interest rates. Government monopolies are being dismantled and parastatals are being weaned from costly government subsidies. In many cases, parastatals will be dissolved or privatized.

Prospects for U.S. Business

U.S. firms should see numerous opportunities as SADCC businesses and governments respond to these deregulated markets. Eased foreign exchange regulations will provide local businesses with the ability to import spare parts and machinery necessary to rebuild and retool out-of-date production processes. SADCC governments will continue ambitious programs to rehabilitate and expand telecommunications networks, electrical generation and transmission capabilities, rail and road transport systems, airports, harbors, schools, and hospitals. More outward-looking export policies will encourage the local business community to seek new technologies and capital from abroad in order to become globally competitive. Finally, new investment incentives will help create a new generation of downstream industries to process and add value to traditional mining and agricultural exports.

Economic reform and the improving commercial climate have already benefited U.S. exporters. After remaining stagnant for the first half of the 1980s, U.S. exports to SADCC countries soared by over 90 percent during the past five years. In 1990, U.S. exports totaled

U.S./SADCC TRADE (1980 - 1990)



Source: U.S. Department of Commerce

$550 million, accounting for just over 5 percent of all imports into the SADCC region. Principal exports include aircraft and parts, oil and gas field equipment (going primarily to Angola), railroad equipment, chemicals, construction equipment, telecommunications devices and navigational aids, heavy vehicles and parts, computers and business equipment, and agricultural machinery.

U.S. direct investment has also expanded during the past several years, and is set to grow further during the coming decade. Currently, over 100 U.S. firms maintain a presence in one or more southern African country through subsidiaries, agents, or partnerships. Aided by a series of OPIC and AID investment missions, more U.S. firms are taking serious looks at projects in the region. Preferential trade arrangements with the European Community through the Lome Convention, combined with a wide variety of export production inducements, make investments in certain export-oriented industries particularly attractive. Substantial opportunities exist for joint and foreign-owned ventures in agribusiness, assembly and manufacturing, food processing, and tourism.

For several of the SADCC countries—such as Mozambique, Tanzania, and Zambia—commercial opportunities will still depend largely upon flows of bilateral and multilateral official development assistance. Foreign exchange provided for specific major projects, as well as funds to support non-project imports, will be available to purchase a variety of goods and services. U.S. firms can take advantage of procurement opportunities through a variety of multilateral and bilateral sources, especially the World Bank, the African Development Bank (AfDB), and U.S. AID.

U.S. firms should also be aware that, despite the improving commercial climate, some obstacles remain. Progress in implementing economic reform varies among the different countries. Many of the reforms are still highly susceptible to external events—such as rainfall, world commodity prices, and stability in the Persian Gulf—while others are influenced by domestic political events. The poor security situation in Mozambique continues to restrict commercial opportunities in many areas of that country. The recent announcement of a ceasefire in Angola, however, will hopefully lead to national reconciliation and the eventual removal of U.S. government restrictions on doing business in Angola.

There are several ways for U.S. firms to introduce their products to the SADCC region. A number of the American embassies in the SADCC countries—including Malawi, Mozambique, and Zimbabwe—regularly host U.S. pavilions in the national trade fairs. The U.S. Department of Commerce has also sponsored several catalog shows in the SADCC region for such sectors as agricultural machinery, construction equipment, and health devices. Through Commerce's Agent/Distributor Service, accessed through the Commerce district offices, U.S. firms can locate local companies to acts as agents or representatives.

In addition, U.S. firms can actively monitor a variety of sources to learn about commercial developments and specific opportunities. The AfDB, World Bank, and U.S. AID publish periodic operational summaries and project announcements to alert firms to contract opportunities. The SADCC secretariat itself (see box on page 17), which identifies and coordinates regional development projects, is another source of project and business information. The Commerce Department operates a Trade Opportunities Program to disseminate a wide variety of private and government sales opportunities. Potential investment opportunities are circulated through the OPIC investors' database. Finally, a number of international and African publications regularly report on general commercial developments and business opportunities in SADCC and the entire African continent.

For more information on commercial opportunities in southern Africa or on the business climate in specific SADCC countries, U.S. firms should contact the SADCC Desk Officer, Office of Africa, Room 3317, International Trade Administration, U.S. Department of Commerce, Washington, D.C. 20230; tel. (202) 377-5148, fax (202) 377-5330.

FINANCIAL TIMES May 1st, 1991

Making peace in southern Africa

THERE is a thread of mutual self-interest that links the complex developments under way in southern Africa. The current Angolan peace initiative is as critical to the welfare of the region as efforts to curb political violence in South Africa.

If President F W de Klerk, Mr Nelson Mandela and Chief Mangosuthu Buthelezi fail to end the bloodshed the implications for South Africa are bad enough. It would also mean disaster for its neighbours, for whom trade ties with Pretoria are vital.

At the same time, successful negotiations to end civil wars in Angola and Mozambique will count for little if the region's military and industrial giant is in its death throes. And if those negotiations should fail, South Africa will be among the losers. President de Klerk's vision of post-apartheid South Africa emerging from recession, acting as a regional magnet for foreign investors, is dependent on stability in southern Africa as a whole.

There are two ways in which the outside world can contribute to this symbiotic peace process. South Africa can be assisted by the lifting of all sanctions (except the arms embargo) and the restoration of sporting contacts. Continuing economic decline can only fuel political tensions. But at this stage at least, there is little further part for outsiders to play: the country has the capacity, whether in the form of political leaders or infrastructure, to preside over its transition to democracy.

Elusive peace

The same thing, however, cannot be said of the two other countries critical to southern Africa's stability.

Mozambique's peace process is in jeopardy. The Renamo rebel movement is motivated by banditry as much as ideology; the government, which has agreed to a multi-party system and is ending state control of the economy, has nowhere else to turn. And three decades of war have devastated the economy and communications.

The need for outside help was acknowledged by government and rebels alike when they accepted multinational monitoring of a partial ceasefire. But it is increasingly clear that without further substantial international involvement, peace in Mozambique will remain elusive.

Angola, with much greater economic potential, offers more hope. The rival leaders, President Eduardo dos Santos, leader of the MPLA party, and Mr Jonas Savimbi, head of the Unita guerrilla movement, are in control of their respective organisations.

The settlement terms outlined this week by Mr Savimbi suggest that both men have given ground in talks to end a 16-year war that has cost hundreds of thousands of lives.

Outside involvement

But the level of outside involvement needed if the settlement is to succeed is substantial, and it is not yet clear whether the United States, the Soviet Union and the United Nations are prepared to provide the personnel and resources for monitoring the cease-fire and multi-party elections on the scale required.

No estimate appears to have been made. But one only has to recall that UN monitoring of the Namibian settlement required a 7,600 strong force and cost several hundred million dollars to realise that it will be expensive. Namibia's population is a little more than a million, and its infrastructure was intact. Angola has 10m people, and its infrastructure has been largely destroyed.

Any call for assistance nevertheless deserves a generous response from the international community, above all from the superpowers.

The long term solution to Africa's horrific famine requires an end to its wars. Conflict in the Horn may seem intractable. But in southern Africa at least, Mozambique and Angola have a framework for peace.

It was, after all, superpower rapprochement which helped undo southern Africa's political logjam, bringing about Namibia's independence and ending Pretoria's military support for Unita in return for Cuban troops leaving Angola. The superpowers, backed by the broader international community, have an important role to play.

Ghana: devaluation brings little gain

Ghana has been hailed in recent years as a model of successful structural adjustment. Since 1983, the government has tried to transform the economic environment with wide-ranging reforms. The results, however, have been mixed. While exports have risen and gross domestic product has grown by more than 4 per cent a year, roughly half the population lives in absolute poverty. The International Monetary Fund describes the economy as "fragile", and the World Bank says Ghana is still in crucial need of high levels of concessional external financing. Devaluation has been central to the reform programme, but its expected benefits have been eroded by Ghana's worsening terms of trade and other constraints linked to adjustment. Ghana's experience with devaluation suggests that changing real prices must go hand in hand with other policies which promote structural development.

By Adotey Bing

When the Provisional National Defence Council (PNDC) came to power in December 1981, Ghana had just recorded the biggest trade and current account deficits in its history. Individual incomes had fallen 30 per cent between 1970 and 1982, imports had fallen in volume by one-third, while export earnings were down more than half.

Pineapples are one of the non-traditional exports the government has tried to encourage.

The new government saw its immediate task as stabilizing the economy, before attempting to restore growth and development. With strong encouragement from the World Bank and the International Monetary Fund (IMF), devaluation of the cedi was made a central instrument of an Economic Recovery Programme (ERP) launched in 1983.

There followed a drastic series of devaluations, aimed at setting up a "self-administered, floating exchange rate." In only 27 months, from October 1983 to January 1986, the cedi was devalued in downward leaps by 96.9 per cent in dollar terms, moving from C2.75 to C90 for one dollar. Since September 1986, the pace of devaluation has been influenced more directly by market forces, through foreign exchange auctions, and later also through licensed foreign exchange bureaux. By April 1991, the cedi had depreciated further, past C360 to the dollar.

Devaluation, by realigning domestic prices to international prices so as to make imports more expensive and increase cedi earnings on exports, was firstly aimed at transforming Ghana's balance of trade. By encouraging 'expenditure-switching' — into new export lines and into competitive import-substitutes — devaluation was also expected to help diversify Ghana's economy and make it more competitive.

Devaluation was, therefore, a crucial part of the structural adjustment reforms required to influence production decisions in a new economic environment. Other fundamental parts of the programme were the contraction of state activities and expenditure, and commensurate encouragement of the private sector and market forces. The government duly lifted nearly all price controls in 1984, and pushed towards full trade liberalization, and the restructuring of the public and financial sectors.

Internal prices and production

Devaluation's goal of boosting exports was successful, as cedi export revenues rose faster than local production costs. This was particularly true for Ghana's export mainstay, cocoa, which accounts for over 60 per cent of export receipts. Devaluation enabled the government to raise the cocoa producer price substantially, from C12,000 per tonne in 1982/83 to C224,000 in the 1990/91 season. The positive supply response saw cocoa output moving from 159,000 tonnes in 1983/84 to 300,000 tonnes in 1988/89, its highest level since 1977.

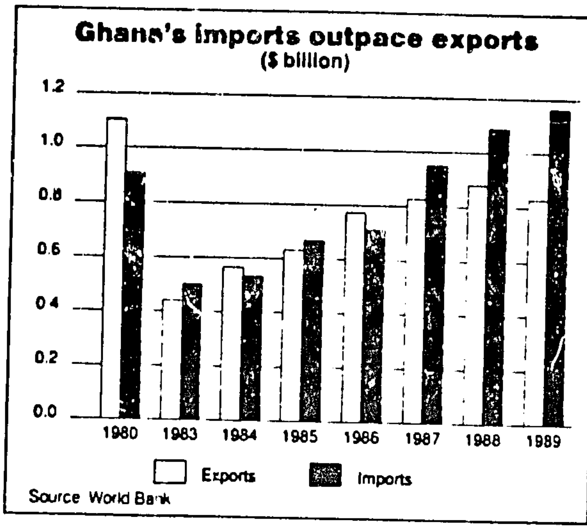
Devaluation also improved operating margins in the gold sector, and exports rose from 289,000 ounces to 410,000 ounces between 1984 and 1988. The restored profitability of gold mining, underpinned by new mining legislation in 1986, has resulted in an upsurge of new investment, partly by the major producer, Ashanti Goldfields Corporation, and especially by new ventures involving foreign interests. Total gold output is now expected to rise within the next few years towards 900,000 ounces a year, to levels unmatched since 1960.

Timber, another major export earner, also progressed, with output rising from 147,000 cubic metres to 413,000 cubic metres between 1984 and 1987. However, rapid deforestation has aroused increasing concern.

Devaluation also helped to stimulate "non-traditional" exports, such as pineapples, kola nuts, and semi-processed goods. The Ghana Export Promotion Council is hoping that non-traditional exports will soon account for 15 per cent of total export earnings, a substantial rise from current levels of around 5 per cent.

For devaluation to succeed in sustaining its impact on domestic prices and investment decisions, exchange rate adjustments after the initial devaluation should reflect

Adotey Bing is a writer on African economic and political affairs.



changes in domestic and international inflation. Since 1986, the average annual rate of cedi depreciation has generally kept pace with the net movement of internal and external prices of goods and of the dollar, but without producing the same level of response in the Ghanaian economy. Among the reasons are Ghana's worsening terms of trade, alongside internal constraints linked to other adjustment policies.

For example, inflation was reduced from the triple digits of 1982-83, but actual targets have almost never been met. The pursuit of lower inflation nevertheless required policies which curbed demand, affecting those least able to withstand the pain. Such policies included a sharp reduction in government spending to eliminate fiscal deficits, and reduce demand for government goods and services. Although after 1986, the government was unable to hold down the level of real wages, overall spending cuts have had a major, adverse impact on jobs and real incomes, as well as on production, investment and consumption.

External prices and earnings

Stimulated by the shift in relative prices, the share of exports in Ghana's expanding GDP rose from 2.4 per cent in 1983 to 19.6 per cent in 1988. But the expected benefits were severely eroded by falling prices in world commodity markets. For while Ghana was busy increasing its output, world cocoa prices were plunging to their lowest levels ever in real terms, while gold prices also weakened considerably in the later 1980s. Between 1986-89 cocoa prices fell by a cumulative 48 per cent, and Ghana's loss on potential earnings totalled some $300 mn in 1988-89. At the same time imports were rising, in volume as well as in terms of their dollar and cedi values. The World Bank calculates that Ghana's terms of trade deteriorated by 30 per cent in the 1987-1990 period alone.

Ghana at a glance: 1989

Population:	14.6 million
Population growth rate:	3.1%
GNP per capita:	$390
Currency:	Cedi (C270=US$1)
Gross domestic product:	C1421.07 bn ($5.2 bn)
of which: agriculture	48.9%
manufacturing	10.5%
Total external debt:	$3.1 bn
Debt service ratio:	49.2%
Life expectancy at birth:	55 years
Infant mortality rate:	87 per 1,000 births
Adult literacy rate:	*53%

Sources UN Fund for Population Activities, International Monetary Fund, World Bank, UNICEF
* 1985

Among the reasons for the failure of devaluation to brake import growth were the aid-funded inputs for rehabilitation of production for export. But the failure also reflected Ghana's heavy-import dependence.

The result was disappointing figures for Ghana's balance of trade. While exports rose in dollar value by 55 per cent between 1984 and 1988, imports rose by 104 per cent. Apart from modest surpluses in 1984 and 1986, the trade deficit deepened from $60.6 mn in 1983 to $334 mn in 1989.

While Ghana managed to declare an overall surplus in its balance of payments since 1987, this has been due to the high net inflows of foreign aid — annual pledging sessions organized by the World Bank since 1983 raised average commitments of $740 mn in 1987-1989 — rather than the net benefits of devaluation.

These inflows have been vital in helping Ghana service its international debts, aided by debt cancellations amounting to over $425 mn in 1989 and at least $87.5 mn in 1990. Nevertheless, the debt-service ratio of 15 per cent in 1982, rose to a peak of 56 per cent in 1988, and was a still onerous 49.2 per cent in 1989. Out of a total debt of $3 bn (up from $1.1 bn in 1981), Ghana owes more than $700 mn to the IMF, which cannot be rescheduled, and the repayment burden therefore remains heavy despite all the recent sacrifices. By 1990 the government was able to eliminate arrears on debt payments which stood at $600 mn in 1983. But this policy of attaining international creditworthiness — made possible by devaluation — has been achieved by diverting considerable resources from domestic consumption and investment needs.

Internal adjustments

Eight years of devaluation and adjustment policies have failed to promote a major shift to production for the local market. While the share of manufacturing in GDP may have risen to slightly over 10 per cent by 1989, this was still below its 1973 level, according to the World Bank.

Two facets of adjustment policy have played a part in this: the combination of tight credit limits and high interest rates used for curbing demand, and import liberalization. The government's pursuit of positive real interest rates pushed the cost of commercial loans beyond 26 per cent, even as credit availability shrank. This made borrowing to do business very expensive. While local costs rose, trade liberalization opened the door to more imports. A surge in second-hand clothing imports, for example, forced closures in Ghana's textile and garments industry.

In agriculture, good rains and improved infrastructure for production and marketing have helped boost output in recent years. But local rice has accumulated in silos, unable to compete against subsidized imports. Producers of vegetable oils, tobacco, cotton, and canned tomatos have all complained about the pressure of imports. Even the state-owned *Daily Graphic* newspaper warned that trade

Ghana: economic indicators

	1980	1983	1984	1985	1986	1987	1988	1989
GDP at current market prices (C bn)	48.2	184.0	270.6	343.0	511.4	746.0	1057.9	1421.07
Real GDP growth (%)	0.5	-4.6	8.6	5.1	5.2	4.8	5.6	5.1
Merchandise exports ($mn)	1103.6	439.1	565.9	632.4	773.4	826.8	881.0	830
Merchandise imports ($mn)	908	500	533	669	713	952	1091	1164
Current account balance ($mn)	29	-174.1	-38.8	-134.2	-43.0	-96.9	-68.0	-98
Government deficit/GDP (%)	4.2	2.7	1.8	2.2	0.56	0.54	0.3	n.a.
Gross investment/GDP (%)	5.6	3.7	6.9	9.6	9.7	10.8	12.3	n.a.
Total external debt ($mn)	1314	1598	1898	2174	2652	3134	3113	3078
Debt service ratio (%)	12.5	30.5	23.3	24.0	28.5	46.6	56.0	49.2
Official development assistance ($mn)[1]	192.5	109.8	216	203.1	371.5	372.6	474.4	553.3
Cocoa production ('000 tonnes)[2]	285	178	159	175	219	228	188	300
Food production per capita(1979-81=100)	101	79	102	97	98	94	108	111
Foreign res. (months import coverage)	2.3	3.5	6.8	8.6	8.6	2.8	2.4	3.6
Inflation rate (%)	50	123	40	10	25	40	31	25
Exchange rate (average cedis per dollar)	2.75	8.83	35.99	54.37	89.20	153.73	202.35	270.27

Sources: Ghana government, IMF, World Bank, OECD, UNICEF, Gill and Duffus 1. Net disbursements, from all sources. 2. Crop years 1979/80 to 1988/89.

liberalization could become "more of a cancer than a panacea for our economic woes", and called for curbs to the "freewheeling dependent importation" which threatened production and jobs.

One side-effect of these closures and constraints was to raise the rate of capacity utilization in manufacturing towards 50 per cent from around 30 per cent in 1983. In this sense, the devaluation has helped make local production more efficient, but at the expense of diversification in the range of goods produced.

The government has indicated willingness to help rescue companies that can produce exportable goods or import-substitutes at competitive prices, on condition that they fulfill strict performance criteria. There are also plans to set up a finance company with Bank of Ghana participation to ease access to credit for selected companies.

Another key factor in the reform programme, raising investment levels, has not been helped by demand management. Rehabilitation of economic infrastructure has been largely funded externally, and while domestic investment has risen from the pitifully low levels of the 1970s, it remains, at around 12 per cent of GDP, still too low for Ghana's needs.

Severe external shocks made the year 1990 "perhaps our most difficult since the Recovery Programme began."

Kwesi Botchwey
Secretary for Finance and Economic Planning

By keeping down the dollar value of the local wage and other costs, especially for exports, devaluation has been used in Ghana to attract foreign investment. The minimum daily wage fell from the equivalent of $1.46 in 1984 to 60 cents in 1988. The average monthly wage in industries with more than 10 employees in turn fell from $374.12 in 1983 to $72.95 in 1987.

However, net foreign direct investment (FDI) has been slow in coming, a reminder that changing relative prices through devaluation is not enough. Having plunged between 1981 and 1983, net FDI recovered to $6 mn in 1986, then leaped to some $15 mn in 1988. However, even this level was lower than that of 1981, and concentrated in the booming gold sector, it helped the payments balance without broad benefits to the wider economy.

Political uncertainty, another important factor in investment decisions, has also made foreign investors reluctant. Particularly evident in the steep FDI downturn of the early 1980s, this reticence has not been changed by the slow progress in restructuring state enterprises. The government published a new investment code in 1985, launched a privatization programme in 1988, and hosted a major investment promotion conference in 1990 with the World Bank's Multilateral Investment Guarantee Agency. But out of an original offer of 32 parastatals advertized in 1988, the PNDC had approved the sale of only seven by March 1991, 19 others had been liquidated, and negotiations were completed for the sale of the remaining six. Among the acknowledged problems were those of revaluation of assets in the post-devaluation environment, and the burden of termination benefits for workers — the cost of laying off a single worker rose from C200,000 in 1985-87 to C1 mn in 1991.

The social impact

The drive to curtail domestic demand — the necessary expenditure-reducing complement to devaluation — has been most evident in public spending cuts, through elimination of subsidies, and of public sector jobs.

Between 1985 and 1987, over 26,000 public workers were laid off, and the subsequent target has been 15,000 a year. While these job losses have enabled the government to raise nominal wages substantially — especially to widen differentials between senior and other civil servants — there remains a wide gap between real incomes and the cost of living. For example, at the time a new minimum daily wage of C218 was announced in 1990, the Trades Union Congress calculated that an average family needed C2,000 a day for food alone.

There is also acute poverty in Ghana's rural areas, particularly in the north, indicating that if adjustment policies have managed to shift resources to such areas, the benefits have been very unevenly distributed. Among cocoa farmers, for example, incomes increased overall, but a 1987 survey of four representative Ashanti villages by the UK's Overseas Development Institute and the University of Ghana found that 32 per cent of the farmers got 94 per cent of gross cocoa income.

Devaluation in the context of such countries as Ghana has serious limitations as an instrument of even short-term structural change, and the policy emphasis must move beyond short-term financial considerations.

Government spending cuts have also had a serious impact on health and education. While there was already evidence of regression in some social indicators by the early 1980s, devaluation and structural adjustment may have strengthened that trend. The Ghana Living Standards Survey (LSS) released in 1990 shows rising levels of malnutrition, and over 51 per cent of Ghanaian children underweight in 1985. This marked increase from the 1980 figure of 33 per cent was expected to have risen further by the end of the 1980s. Adult illiteracy is also on the rise, particularly in rural areas. And while just over half of the 25-34 year age group was illiterate, fully 89 per cent of 9-14 year olds were illiterate, the Survey found.

Some predictable lessons

Devaluation and structural adjustment have brought Ghana fewer gains than originally expected in some quarters. This is due to an increasingly hostile external environment, as well as to rigidities in the domestic economy, a structural problem which has not been resolved.

Indeed, some adjustment policies have deepened the problems. Trade liberalization, for example, has exposed Ghana to unequal, and often subsidized, international competition, while high interest rates and low credit ceilings have made local production both difficult and costly.

Furthermore, production linkages between different sectors of the economy have hardly been strengthened. The plight of the textile and garments sector is an example of frustrated potential: cheap imported clothing has flooded in while the unprotected local industry has been unable to take full advantage of local cotton production which had grown to meet more than half of national needs by early 1991. And while the mining sector boom is good for export revenue, other industries may be more important for Ghana's long-term development. Investment must therefore be guided not only into sectors that are at present relatively efficient, but also to sectors with potentially strong linkages to other parts of the economy.

It is now widely acknowledged that investment in the quantity and quality of human capital is also crucial to long-term growth. However, the practice of charging user-fees in Ghana's health and education systems is almost certain to reduce the number of users, with likely adverse implications for future economic performance.

To say that the situation would be even worse without devaluation brings little comfort and few clues to future policy. Clearly, however, the emphasis on commodity export-led growth, and on generating domestic surpluses to maintain international creditworthiness, has led to little progress in addressing structural problems.

These outcomes of using devaluation as a central tool of adjustment have long been predicted, as external demand for raw material exporters like Ghana does not necessarily increase as a result of lowering the dollar price of their exports through devaluation. Indeed, when devaluation helps boost production for export, the increased supply to the world market tends to bring that commodity's prices down. Thus, devaluation may not lead to increased export revenue in dollar terms. Such countries also have few competitive industries, which often cannot take full advantage of the relative price changes brought about by devaluation to reduce imports. If devaluation goes hand in hand with liberalization, industries in countries such as Ghana are likely to be swamped by imports, and the trade and current account deficits may worsen.

Child immunization — aided here by Head of State Jerry Rawlings — has progressed, although other health indicators worsened in the 1980s.

Ghana Ministry of Information

This would have been the Ghanaian experience, but for the exceptional bilateral support it has received. However, not all countries can count on such support, and nor can Ghana indefinitely. Therefore, devaluation in this context has serious limitations as an instrument of even short-term structural change, and the policy emphasis must move beyond short-term financial considerations. Countries like Ghana must refuse to accept the world economic order as it is, and instead seek to change it by pursuing long-term structural transformation within the context of regional integration. ■

Burkina secures adjustment deal

By Ernest Harsch

By this June the final pieces should be in place for funding Burkina Faso's first ever structural adjustment programme. The World Bank is expected to approve an $80 mn structural adjustment credit that month. At the end of May donors are meeting in Geneva for a Round Table session organized by the UN Development Programme (UNDP), at which it is hoped that an equivalent amount in balance of payments support and other funding will be pledged for 1991.

Already in place is a three-year SDR22.1 mn (US$31 mn) structural adjustment facility (SAF) from the International Monetary Fund (IMF), approved in March. The government also had $60.7 mn of debt rescheduled at a 15 March meeting of the Paris Club of official creditors.


Margaret Novicki

Potato cooperative in Diédougou. Despite cuts in investment, agriculture will retain a high priority.

The funding package is designed to cover an estimated $170 mn financing gap for this year and support an extensive series of economic reforms, which will affect most parts of the economy over the next two-to-three years. The government's priorities are to increase agricultural production, including for export; develop the private sector; improve management of the public enterprises; and strengthen basic education and essential health services.

External support for Burkina's development efforts has been underway for some time, but became more urgent after 1989 in face of a slowdown in economic growth and a deterioration in public sector finances.

As one of Africa's poorest countries, with a per capita gross domestic product (GDP) of just $350 in 1990 and a very small tax base, Burkina's sources of domestic financing are extremely limited. Its capacity for earning foreign exchange is likewise constrained, with total exports of goods and services in 1989 of some $254 mn — with cotton traditionally the largest single export — far outstripped by an import bill of $721 mn. Despite total earnings being boosted by remittances from the large number of migrant workers in neighbouring states, especially Côte d'Ivoire, a large portion of Burkina's imports, public investments and development projects has traditionally been supported by donors (most notably France). Aid per capita during much of the 1980s averaged $29.5, slightly above the average for sub-Saharan Africa, excluding Nigeria, of $28 in 1989.

Despite its high dependence on a fragile agricultural sector, Burkina's economic growth in recent years has been above the Africa-wide average. The World Bank estimates that Burkina's real GDP grew an average of 7.8 per cent a year over 1984-89, as did agricultural output. Burkina government figures indicate an average GDP growth rate over 1986-90 of 4 per cent a year.

Generally favourable rains were one key factor in Burkina's relatively up-beat performance. Another, as the World Bank acknowledged in its 1989 annual report, is the fact that since 1984 the government has been undertaking a number of adjustment measures of its own devising which "are beginning to bear fruit."

In addition, the country's external debt was kept within manageable limits, reaching $756 mn in 1989, according to the World Bank — equal to $86 per person, against an all-Africa average of $437. Similarly, long-term debt servicing obligations in 1990 amounted to just 11 per cent of export earnings, well below the sub-Saharan average of 43 per cent.

Deterioration in finances

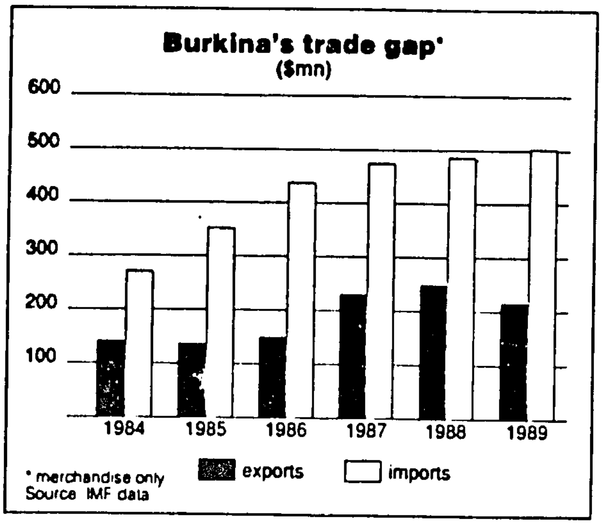
Nevertheless, since around 1986 Burkina's public finance position has worsened. Due in part to shortfalls in tax collection and problems in the management of some publically-owned enterprises the government has run a large budget deficit in the second half of the 1980s (see graph). Payment arrears steadily mounted, taking a dramatic leap in 1989 when the government assumed the outstanding obligations of Régie Abidjan-Niger (RAN), the joint railway venture with Côte d'Ivoire, which was liquidated that year. By the end of 1990 domestic and external arrears were estimated to have risen to nearly $300 mn, with slightly over half owed to foreign creditors, mainly Côte d'Ivoire.

The government's economic programme for 1991-93, which has served as the basis for negotiations with the IMF and World Bank, aims to reduce such financial imbalances while promoting continued economic growth. One area that is to receive particular attention is the public sector, which comprises 96 enterprises and accounts for a significant portion of Burkina's industrial and commercial activity. Although Burkinabè officials maintain that the country's parastatals are relatively better managed than in some other countries in the region, several are experiencing difficulties, including the Sosuco sugar enterprise, the Soremib gold mining operation and the Faso Fani textiles enterprise. In 1989 a survey of 30 parastatals revealed overall operating losses totalling some $24 mn.

The government is planning to progressively reduce its involvement in such enterprises, liquidating those it considers unviable and fully or partially privatizing many others. As a target the government expects to limit its holding in most commercial enterprises to 25 per cent.

Cautious measures are also being projected to reduce the public sector wage bill by bringing down staffing levels through a policy of attrition. This is designed to reduce

240



personnel costs from 64 to 60 per cent of the recurrent budget by 1993.

Limiting new investment

Overall, government capital expenditures will be limited to priority projects selected in agreement with the World Bank. When Burkina's National Planning Council revealed its second five-year development plan on 23 March, the amount of investments totalled CFA508 bn ($1.8 bn), just half of the originally projected expenditure of CFA1,000 bn ($3.6 bn). Since the first five-year plan for 1986-90, slated at CFA630 bn ($2.25 bn), was only able to secure 68 per cent of its required financing, the scaling back of the second plan is an expression of "realism," according to Planning and Cooperation Minister Frédéric Korsaga, reflecting both a sober assessment of Burkina's external financing prospects and the constraints of the adjustment programme.

Capital spending will be limited to projects agreed with the World Bank. Investments have been scaled back in the latest five-year development plan.

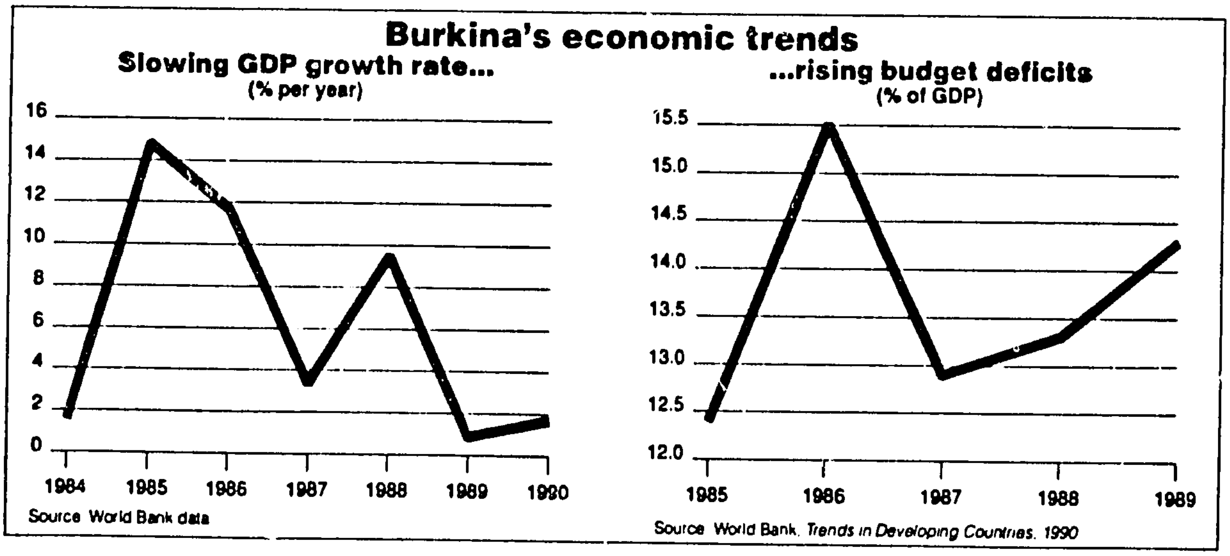
The 1991 Public Investment Programme allocates 17.8 per cent of its investments directly to agriculture and another 28 per cent to water resources development. A separate $28 mn agricultural sector loan is currently being negotiated with the World Bank, as is a transport credit for $36 mn, part of which will go toward improvement of the rural road network.

A range of reform measures is projected to promote greater private investment. These include trade liberalization, both international and domestic, with the latter linked to the elimination of most price controls; rehabilitation and restructuring of the banking sector; the easing of investment procedures; and revision of the labour code — a potentially sensitive issue for Burkina's trade unions.

Washington sources note that the design of Burkina's structural adjustment programme drew on lessons learned from similar programmes elsewhere in Africa, in particular on the need to take into account the potential social impact of the adjustment process. This, combined with Burkina's own strong emphasis on social development, has translated into a specific earmarking of financial resources for health, education and other vital social needs.

Plans are being laid to strengthen the health infrastructure, especially in the rural areas. Budget appropriations project recruiting about 950 additional primary school teachers each year, with the aim of increasing primary school enrollment from 28 per cent in 1988 to at least 40 per cent of eligible children by 1996. Efforts will also be made to reduce the adult illiteracy rate, now at more than 90 per cent, one of the highest rates in Africa. To contain direct government spending in these areas, health-care users will be asked to pay some of the costs, while local communities will be urged to participate in school construction.

Given Burkina's vulnerability to drought and desertification, one particular feature of the adjustment programme will be to maintain — and expand — efforts to protect the environment. A larger share of public expenditures is to be allocated to environmental conservation (more than $11 mn in 1991), and each development project must now include an environmental impact study. A national environmental action plan is under preparation with the support of major donors. Plans are well underway for the surveying of village lands, so that the Burkinabè authorities, in consultation with local communities, can more systematically allocate land use according to whether it is to be employed for agriculture, livestock or conservation purposes. ■



241

Education in a Declining Economy
The Case of Zambia, 1975-1985

By: Michael J. Kelly

Summary

Economic Development Institute
of The World Bank
EDI Development Policy Case Series
Analytical Case Studies No. 8

In 1975 falling copper prices plunged Zambia into deep and serious economic difficulties. These difficulties continued during the ensuing years and quickly assumed crisis proportions. Notwithstanding the various measures taken during the past 12 years to arrest the deterioration, Zambia's economy has experienced a sustained, rapid, and substantial decline that has adversely affected all areas and sectors of life. This study examines the impact of this economic decline on the provision of formal education during the decade 1975 to 1985.

To set educational provision in its historical context, the study provides an overview of the development of education before 1975 and highlights the fact that, although the economic crisis may have imposed new constraints on providing adequate and relevant education, several of the problems currently being experienced have accompanied the development of the education system since its inception in the mid-1920s. Several issues that have a modern ring actually have a relatively long history, such as concern about the system's coverage, about the quality of the education being provided, and its suitability in preparing young people to face a world where the number of formal sector job opportunities is severely limited; about the ability to continue financing the system; and about generating the managerial capacity needed by a rapidly expanding educational network. Both the economic decline that gathered momentum after 1975 and the accelerating rate of population growth aggravated these and other problems. Drawing on the findings of the 1980 population census, the study brings together some findings on the interaction between level of education and such population variables as fertility, age at first marriage, and child mortality.

The general picture of resource allocation to education during the period 1975 to 1985 shows efforts to maintain and increase the level of educational spending. Relative to other sectors in the economy, the share allocated to education showed some tendency to increase, but the gain was slight, and its impact was nullified by the rapid population growth. Consequently, there was a substantial reduction in expenditure per student, resulting in steadily diminishing funds for educational materials and supplies; a depreciation of the real incomes of teachers to about 40 percent of their 1975 value; a greater reliance on the community for building and equipping schools; and increased calls on the private sector to participate in the provision of education. The decade also saw growing dependence on foreign aid for support to the education sector.

242

Within the education sector, resources tended to be diverted away from the primary, secondary, teacher training, and technical education levels and toward the university. Unit costs at the primary level fell by over 25 percent and by over 50 percent at the secondary level, but at the university they rose by more than 40 percent.

Such a large proportion of available resources was spent on teachers' salaries, especially at the primary level, that little remained to purchase essential educational materials. The study investigated the current supply situation in a sample of primary and secondary schools throughout the country and found a critical shortage of textbooks and teaching materials. At both the primary and secondary levels, a significant number of pupils appeared to lack essential writing materials. An examination of the actual production figures showed that the output always fell short of requirements. Technical production problems, marketing and distribution difficulties, and the chronic shortage of finance appeared to underlie these shortfalls. At the same time, however, large sums were being devoted each year to transfer payments, with the amount increasing at an average annual rate of more than 10 percent in real terms.

In general, therefore, the study found evidence of serious structural imbalances in the financing of education in Zambia that became more marked during the years of economic difficulty. These imbalances occur at two principal levels: in the allocation of resources between educational levels, and within each level, between functions: too much was devoted to the refined needs of too few at the higher level, and too little to the general needs of too many at the lower level. Moreover, too much was being devoted to personnel and to student subsidies and too little to more directly educational purposes. Policymakers' awareness of these problems appeared to be growing, hence the economic crisis is seen as having the positive outcome of promoting the establishment of a clear order of priorities and of fostering their translation into practice.

Notwithstanding the severe financial problems, the decade saw a sustained and rapid expansion of the school system at both the primary and secondary levels. During the first few years of economic difficulties there was some faltering, but since 1980 growth rates have picked up and have accelerated, in many instances to levels higher than the comparable rates for the population as a whole. Accompanying this increased numerical coverage by the system, the proportion of girls who completed the full primary cycle increased. Little improvement was observed, however, in the proportion of girls participating in secondary education, while at the university level the proportion actually declined.

The growth in numbers was not matched, however, by any corresponding improvement in the relevance or quality of the education provided. Although a decade of efforts was put into the process of educational reform, current educational provision is no more successful in responding to students' real needs than during colonial times. A mainly academic program, deriving almost exclusively from a knowledge-based curriculum, aims primarily at allowing students to progress further within the education system, and ultimately to gain wage employment. The system gives no consideration to the special learning needs of the large majority who must seek employment in the informal sector.

Although the evaluation of educational quality is problematic, Zambia's showing is negative on a number of indicators that are found to relate consistently to improved academic achievement. These indicators include per capita expenditures, the availability of instructional materials, the availability of library facilities, the number of hours actually spent in classroom teaching, the

243

availability of school furnishings, and the nutritional status of students. Concern has also been expressed about the quality of many university graduates and about their ability to respond competently and flexibly to the responsibilities that are placed on their shoulders. This latter problem may reflect the imbalance in the allocation of resources by the university toward administrative needs and away from those more directly concerned with teaching and research.

To the extent that performance in public examinations is indicative of educational achievement, the picture is mixed. That the examination system remained in place was perhaps a significant achievement in its own right. As to student performance, an analysis of raw scores suggests that performance deteriorated somewhat in the terminal primary school examination. Some deterioration was also apparent at higher levels, particularly in mathematics and science. A notable feature in all examinations was the consistency with which boys' performance surpassed that of girls.

Teachers were the most affected by the economic problems. To a large extent they were denied the resources needed for the professional discharge of their responsibilities. Moreover, although their educational background improved steadily, their salaries declined sharply in real terms. Yet despite dissatisfaction with their salaries, the numbers entering and remaining in teaching increased. This was almost certainly due to the absence of employment opportunities in other sectors of the faltering economy. But although there was a substantial improvement in the retention of graduate secondary teachers, teachers in key areas such as English, mathematics, and science were still in short supply.

The study attempted to assess whether teachers endeavored to supplement their incomes by undertaking commercial activities concurrently with their educational commitments. Although the evidence is not conclusive, many teachers do apparently undertake such activities, devoting some of their official school time to such undertakings. This practice is on the increase, and some teachers use the labors of school pupils for these activities during school hours. However, a number of indications showed that the teaching force, at both primary and secondary levels, was becoming more professional, more highly motivated, and more confident of its ability to master the adverse circumstances that beset it. In an almost perverse manner, the financial crisis appears to have boosted teachers' morale and provided a climate in which teachers as a group have advanced to a new stage of professional maturity.

The study also examined a number of other areas. These include the educational reform movement that occupied so central a place in educational thinking during the decade; continuing education, which was seen as the cinderella of education, with its programs being perceived principally as providing a parallel, second best route to educational qualifications; the University of Zambia, where it appeared that available resources could be used more effectively for the institution's teaching and research responsibilities and for the development of good quality postgraduate and research work; and the population's low general educational and literacy level.

In conclusion, the study reflected on how the more vulnerable areas—primary schools, teacher education, out-of-school youth, literacy—experienced the economic constraints more severely, whereas such improvements as occurred were enjoyed by the more prestigious and powerful areas: the university and some aspects of secondary provision. It also noted the tendency to show more concern with getting children into educational institutions than with providing the resources needed for them to make solid progress after their admission. Nevertheless, despite the

244

difficulties experienced the education system displayed considerable robustness. Not only did it continue to operate and even to expand, but it became more aware of the need to provide children with a better and more relevant form of education. In particular, the strength of the social demand for education was noted. The study suggests that to capitalize on these positive aspects

- there should be closer integration between the school and community, so that where financing is shared, responsibility could likewise be shared;
- the importance of every child receiving seven years of good quality primary education should be recognized and given top priority;
- the education system should generate more information about itself and process this information for the guidance of policymakers;
- education should be financed in ways not practiced to date and be offered in ways not hitherto conventional.

245

INTERNATIONAL MONETARY FUND

PRESS RELEASE NO. 91/20

FOR IMMEDIATE RELEASE
April 17, 1991

The International Monetary Fund has endorsed Zambia's three-year economic and financial program and approved the accumulation of "rights" for Zambia for up to a maximum of SDR 836.9 million (about US$1,138.0 million), the level of its arrears to the IMF as of July 1, 1990. Upon successful implementation of this program and prior clearance of its arrears to the IMF, Zambia would be eligible to "encash" the accumulated rights under a successor IMF-supported program.

The accumulation of rights for Zambia is the first approved by the IMF under the rights approach endorsed by the IMF Interim Committee at its May 1990 meeting. Through this procedure, a member with protracted arrears to the IMF at end-1989 can earn rights based on its performance under an IMF-monitored adjustment program. The accumulated rights would then be encashed as the first disbursement under a successor IMF-supported program financed from the IMF's general resources or, for eligible countries such as Zambia, partially from concessional SAF and ESAF resources,1/ or a blend of the two.

For the first year of the program, through March 31, 1992, Zambia may accumulate rights up to the equivalent of SDR 279 million (about US$379 million). The remaining rights will be phased over the two subsequent years of the program. Zambia has recently cleared its arrears to the World Bank and intends under the present program to meet fully all obligations due to both the Bank and the IMF.

In mid-1989, Zambia began to implement a series of major financial and economic reforms with technical support from the IMF and the World Bank. During 1990, these reforms were placed in the framework of an economic and financial program monitored by the IMF. The program sought to achieve a stable financial environment, moving toward a more market-oriented system that provides a sound basis for economic decision making and a wider scope for private sector activity. All prices except those for maize and fertilizers were decontrolled, and the Government liberalized the import and export systems, eliminated certain monopolies, and encouraged the creation of small-scale enterprises. On the macroeconomic front, substantial, albeit uneven, progress was made in bringing down the budget deficit, money supply growth, and the rate of inflation.

- over -

1/ SAF and ESAF (Structural Adjustment Facility and Enhanced Structural Adjustment Facility) are IMF lending windows under which loans are made to eligible low-income members at a rate of interest of 0.5 percent, repayable over ten years with a five and a half year grace period. Sixty-two members are presently eligible to apply for loans under these facilities.

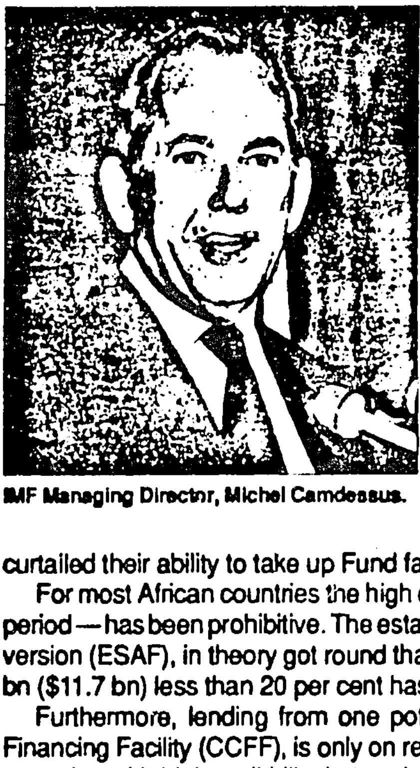
External Relations Department • Washington, D.C. 20431 • Telephone 202-623-7100

The program for 1991 aims for a 3 percent increase in real gross domestic product (GDP) and a reduction in inflation to 40 percent from about 100 percent in 1990. This is to be achieved by implementation of a package of fiscal measures to reduce the primary budget deficit, excluding grants, by 3.6 percentage points of GDP, and cut by half the growth of the money supply from its 1990 level. An active and flexible interest rate policy to achieve positive real interest rates early in the program period will be pursued to reduce inflation and encourage private savings. Reform of the exchange system will be largely completed, public enterprises are to be privatized or restructured, and reform of the civil service is under way. A social action program is in place to help alleviate the hardships for the most vulnerable groups through improving the availability of social services, such as health and education, and employment opportunities for the poor.

Zambia's donors have signaled their continued strong support for the program in ensuring adequate balance of payments financing and granting a very comprehensive rescheduling for Zambia's bilateral debts on concessional terms. For 1990, Zambia's donors pledged US$450 million in support of the country's adjustment effort, and for 1991 donors have again signaled their continued strong support by indicating their intention to disburse US$650 million in assistance. Donors affirmed at their most recent meeting their determination to ensure that the program is fully financed and their intention to meet regularly to monitor developments.

Developed for members with protracted arrears to the IMF at the end of 1989, accumulation of rights under IMF-endorsed programs would generally cover a period of three years. An eligible member would be expected with the assistance of donors and creditors to generate the financing needed to meet the requirements of its economic program and to remain current on obligations falling due to the IMF and the World Bank. Rights accumulation would generally be phased evenly throughout the period of the program.

Monitoring of performance, and subsequent accumulation of rights, is conducted on a quarterly basis. If the program goes off track, a member could retain accumulated rights for a period of six months, while efforts are made to bring the program back on track or to formulate a new program. After six months, the previously accumulated rights would begin to lapse at a rate of up to 25 percent of accumulated rights per quarter, or as determined by the Executive Board.



IMF Managing Director, Michel Camdessus.

The IMF's troubled role in Africa

Five years of net transfers from Africa to the IMF lay behind many of the comments in Gaborone on the often troubled relations between Africa and an institution which should be at the centre of the continent's economic recovery efforts. At any given time many of the 30 or so country programmes in place in Africa have been in suspension, suffering from significant delays in disbursement or requiring time-consuming negotiations on the performance criteria, participants observed. The counterpoint to this has been a large pool of monies — some of it highly concessional — waiting to be used by a cash-starved continent.

The Fund continues to play an important role in Africa by offering technical assistance to central banks, an area Mr. Turay would like to see enhanced. According to Mr. Camdessus: "What we need are more countries to come forward with well-designed programmes." But for many African countries, three crucial factors have curtailed their ability to take up Fund facilities — cost, arrears, and conditionality.

For most African countries the high cost of borrowing from the IMF's regular account — 8-9 per cent and a short repayment period — has been prohibitive. The establishment of two soft-loan arms, the structural adjustment facility (SAF) and its enhanced version (ESAF), in theory got round that problem, but as was pointed out in Gaborone, of total resources available of SDR8.7 bn ($11.7 bn) less than 20 per cent has been disbursed after four years of operations.

Furthermore, lending from one potentially important arm of the Fund, the revamped Compensatory and Contingency Financing Facility (CCFF), is only on regular terms. The Fund made changes to the CCFF at the time of the Gulf crisis to help countries with higher oil bills, but to date African countries have not made use of the facility, in part because of its high cost. Making it available on ESAF terms, of course, could transform this situation.

Arrears have also prevented several countries from using the IMF. The new "rights" approach has been devised to solve this problem and Zambia has become the first country to take up such a programme (see page 34). But Mr. Turay, whose country, Sierra Leone, could be next in line, argued that the approach gave no guarantee that countries would secure the amount of quickly disbursed external support needed to keep an adjustment programme on track. And, as Mr. Mistry pointed out, the IMF still demands "unaffordable" annual interest payments.

Finally, conditionality continues to limit the use of Fund resources. IMF officials remain adamant that strong and appropriate programmes must be in place for the Fund to disburse money. Much of the meeting was spent in discussing just what was "strong" and "appropriate." But for many governors, beyond that was a concern over the IMF's time-frame for change. To Mr. Rutihinda even the ESAF "appears to have lost its meaning," because IMF officials always expect quick results. It was this apparent incompatibility between the agreed long-term nature of adjustment efforts and the short-term perspective which is the IMF's traditional brief, that remains a key to the Fund's present dilemma in Africa. While the view was expressed that the Fund's essential function as a provider of short-term balance of payments support made it inappropriate as a central agent in Africa's recovery efforts, many delegates argued that it could play a more positive role in Africa by taking a longer-term view on issues like performance criteria, resource flows and debt.

248

91-489 F
June 18, 1991

CRS Report for Congress
Congressional Research Service • The Library of Congress

Ethiopia: New Thinking in U.S. Policy

Theodore S. Dagne
Analyst in Foreign Affairs
Foreign Affairs and National Defense Division

SUMMARY

U.S.-brokered peace talks on Ethiopia, held in London in late May 1991, ended after the Ethiopian People's Democratic Forces (EPRDF) took power in the Ethiopian capital, pending an all-party conference in July. A provisional government also took power in costal Eritrea, with the blessing of the United States. One week after President Mengistu Haile Mariam resigned and fled Ethiopia to Zimbabwe, the care-taker government of acting President Tesfaye Gebre Kidan collapsed in the face of a sweeping assault on the capital, Addis Ababa, by the EPRDF. Earlier that week, the United States had agreed to mediate peace talks between the Ethiopian government and several rebel groups.

Beginning last year, after over a decade of strained relations with the Mengistu government, Washington became increasingly involved in Ethiopian politics. While Washington's interest on Ethiopia initially focused on the emigration of Ethiopian Jews, more recently the United States has also offered help in ending the decades-old fighting and in shaping of a democratic Ethiopia. Although current U.S. involvement has received praise in some sectors, others have condemned Washington's shift in policy over Eritrea and its endorsement of the takeover of the capital, Addis Ababa, by the EPRDF.

BACKGROUND

Washington had close relations with the government of Emperor Haile Selassie for over three decades. Selassie was overthrown in 1974. The war between Ethiopia and Somalia in the late 1970s led to a realignment of superpower influence with the Soviets switching sides from Somalia to Ethiopia, while Washington was drawn into a relationship with the government of Siad Barre in Somalia.

U.S. relations with the successor Ethiopian regime were strained because of human rights violations and Mengistu's close relations with the Soviet Union. The United States terminated its military assistance to Ethiopia in 1977 after the Mengistu government ordered the closure of the U.S. communication station in Asmera, Eritrea. Development assistance ended two years later. In 1980, the Mengistu government requested the recall of the U.S. Ambassador on grounds of alleged interference in Ethiopia's internal affairs. In mid-1989, the Ethiopian government reportedly requested to upgrade diplomatic relations with Washington. That request was rejected by Washington because of Ethiopia's human rights record. Relations between Washington and Addis began to improve beginning early 1990, due to political moderation by the Mengistu government and Ethiopia's support for the emigration of Ethiopian Jews to Israel.

The active U.S. role in Ethiopia could be traced in part to Washington's interest in the emigration of Ethiopian Jews to Israel. While the United States has long expressed its concern about overall human rights conditions in Ethiopia, the emigration of Ethiopian Jews has been the leading human rights priority in Ethiopia for Washington. No issue has reached as high a level of attention in the Reagan and Bush Administrations as the Ethiopian Jews' emigration. Ethiopian delegations to Washington were able to get access to high level U.S. officials because of U.S. interest on the emigration issue. Congress has also monitored the conditions of Ethiopian Jews with considerable interest for many years. In 1986, Congress formed the Congressional Caucus for Ethiopian Jews primarily to promote the reunification of Ethiopian Jews with their families in Israel. The caucus has over 150 members.

Humanitarian suffering in Ethiopia has also been a key issue over many years. The United States has repeatedly assisted Ethiopia, especially throughout the 1980s, during the country's deadly famines, which have been exacerbated by armed conflicts involving several resistance movements. In fiscal year 1990, the United States provided $71 million in food aid to Ethiopia. In response to the most recent famine threat, the United States has pledged to provide one-third of Ethiopia's total food needs. Despite U.S dislike of the Mengistu government, Washington did not shy away from assisting the people of Ethiopia including Ethiopians in rebel-controlled territories. The United States has refrained from offering military support to the various rebels in the country. The Marxist ideological positions of the major rebel groups in Ethiopia in the past have discouraged such support. Moreover, the United States has historically supported of a united Ethiopia.

PAST U.S. ROLE IN MEDIATION

Former President Jimmy Carter organized the first round of talks between the Mengistu government and the Eritrean resistance movement (the Eritrean Peoples' Liberation Front or EPLF) in Atlanta in September 1989. This led to a second round of negotiations, again under Carter's auspices, in Nairobi, Kenya, at the end of November 1989. In October 1990, a Washington initiative led to a meeting of representatives of the EPLF and the Mengistu government at the State Department. Peace talks between the Ethiopian government and the EPLF, which were mediated by Assistant Secretary of State Herman Cohen, on February 22-23 in Washington, ended with no significant breakthroughs, although both sides agreed to meet again. At the end of the talks the State Department announced that there were "significant differences" between the two

252

warring parties, although both sides agreed on the need to end the decades old war by peaceful means.

According to press reports and members of the Ethiopian delegation, the Ethiopian government proposed to grant Eritrea broader autonomy in which Eritreans could establish their own local governments. It also agreed to international guarantees for such an arrangement. The Eritrean delegation reportedly pressed for a referendum, to include the option of independence, to decide the future of Eritrea and in effect rejected the Ethiopian proposal. Prior to the talks in February, the State Department presented both the Ethiopian government and the EPLF a working paper that reportedly outlined a framework for peace talks. The working paper reportedly proposed a federal status for Eritrea with international guarantees and the creation of local Eritrean governments, followed by a referendum after several years.

THE LONDON PEACE TALKS -- U.S. ROLE

In May 1991, an agreement was reached to hold peace talks in London between the Ethiopian government and the EPLF, the Tigray Peoples' Liberation Front (TPLF), and Oromo Liberation Front (OLF) to be mediated by the United States. Initially the talks were scheduled to take place on May 22, but were postponed at the rebels' request to May 28. The resistance forces allegedly sought to put more military pressure on the government to force its collapse. Whether or not the rebels intended to move into the capital, Addis Ababa, is uncertain. The London peace talks were compromised in large part by the military situation on the ground. The talks were intended to establish a transitional government and to pave the way for a democratic rule in Ethiopia. The proposed peace talks between the government and the rebels did not take place as intended; instead, Assistant Secretary of State Herman Cohen engaged in separate talks with the rebel representatives and the government. According to some observers, the Ethiopian delegation and the OLF were in large part left out of major decisions that led to the takeover of the capital.

In the face of fighting within the military and growing concern as to the ability of the care-taker government to maintain law and order in the capital, Assistant Secretary of State Cohen announced that "in order to reduce uncertainties and eliminate tensions in the city, the U.S. Government recommends that the forces of the EPRDF enter the capital as soon as possible to stabilize the situation." This announcement came shortly after the acting President of Ethiopia stated that he had lost control of the military and declared a unilateral ceasefire. The London talks were also significant because of the U.S. announcement of support for a referendum and self-determination for Eritrea, shortly after the EPLF stated that it would establish its own provisional government in Eritrea. Mr. Cohen's statement, in effect, reversed long-standing U.S. policy over Eritrea by announcing that the United States would support the outcome of a referendum which would include the option of independence.

Soon after the United States endorsed the EPRDF takeover of the capital, the Ethiopian delegation announced that it would not take part in the London talks. The OLF also expressed its unhappiness with the U.S. decision on the EPRDF takeover of Addis Ababa but indicated that it would participate in the proposed all party conference in July 1991. Many Ethiopians, including the large exile community in the United States and elsewhere, saw Washington's role in the London peace talks as a "sellout" and "betrayal" of the Ethiopian people. Some of the leading concerns expressed in a series of demonstrations in and outside Ethiopia include the possible fragmentation of Ethiopia along ethnic and regional lines and the uncertain political future of Ethiopia under the EPRDF. The Amharas, who have been the dominant group in Ethiopia until recently, are also concerned about the political future and safety of their people.

Anti-U.S. demonstrations in Addis Ababa resulted in the death of at least ten protestors, while the Ethiopian exile community echoed the same anti-U.S. sentiments in several U.S. cities and European capitals. Lack of information or understanding of the U.S. role in recent weeks may have fueled the anti-U.S. protests. Those who support Cohen's actions maintain that the U.S. endorsement of the EPRDF takeover was morally and practically defensible, especially in light of the chaotic situation that prevailed in the capital a few days prior to the takeover. The driving force of U.S. thinking and policy has been to avoid anarchy and to avert other situations comparable to recent chaos in the capitals of Liberia and Somalia.

The United States explicitly conditioned its support for an EPRDF interim government on the establishment of a broad-based transitional government and a move towards democratic rule in Ethiopia. Washington's commitment to democratic rule in exchange for its cooperation has much to commend it, assert some observers. The general mistrust and dislike of the Tigrean-dominated EPRDF by some Ethiopians appears to have led to a reflexive condemnation of the United States, they argue. Ethiopians should remember, according to this point of view, that the EPRDF is not the creation of Washington. Rather it is in considerable part the creation of years of repression by successive governments in Ethiopia.

Washington's position in the current political equation is evolutionary and reactive in important respects. In an effort to minimize the probability of more confrontations among the various ethnic-based groups, the United States will probably continue to exert pressure on the EPRDF to carry out the proposed transitional program. Washington's influence is well recognized even by Marxist-oriented EPRDF members, some of whom are thought to be waiting on the sideline to make their move against the more moderate elements. If Ethiopia is to avoid another round of violent confrontations, many analysts believe, it will need to be an inclusive democracy. The United States is banking on the EPRDF promise to form a transitional government and hold elections within a year. Possible instruments of leverage include U.S. recognition and much needed economic aid for the new government in Ethiopia. Many observers urge caution because of EPRDF's past ideology and the undemocratic nature of the organization. In any event, U.S. policy will depend heavily on EPRDF actions.

The Eritrean question remains a contentious issue in Ethiopia and a difficult one for Washington. The territory's Red Sea location gives it some strategic importance, and the EPLF's relations with some Arab governments could cause worry in Israel. U.S. policy concerning Eritrean separatism will no doubt take into consideration the potential economic and political implications for Ethiopia of losing its coastal province, and the impact on independence-minded movements elsewhere in Africa. The political identity of Eritrea has been settled temporarily on the battlefield. But permanent peace for Eritrea may only come about through negotiations in which both the Ethiopian and Eritrean leaders address the concerns of the peoples of Eritrea and Ethiopia.

Ending War and Famine in the Horn of Africa Through Grassroots Initiatives

by Sharon Pauling, BFW Policy Analyst

In the midst of a brutal war, many Sudanese continue to flock to the town of Juba, a government-controlled town under siege, seeking food and safety. Mrs. Toma Aboi, along with five other women in Juba, were determined to provide their families with an adequate diet. Mrs. Aboi submitted a funding proposal to the ***AMUPE Project,*** *a local grassroots self-help organization, to create a small enterprise. By selling groundnuts through a local business, the women believed they could improve their standard of living. The project was approved and funded by the Trickle Up Program, an international private organization, and at the end of three months eight women earned a profit of $166—benefiting 16 others in their families—and invested 20 percent into the burgeoning groundnuts business.*

According to the women, the project enabled them to meet their daily demands, particularly for food which is very expensive. Furthermore, they could afford better health care, learned basic business skills, and felt better about their future.

In Somalia, the ***Himilo Cooperative Society*** *members harvest and market natural gum resin, which is used in medicine, and engage in traditional livestock herding. There are 240 members, including 30 displaced nomads and victims of the drought. By getting funding through the African Development Foundation, a U.S. funding agency, they were able to strengthen and upgrade their gum resin harvesting and marketing capacity. Cooperative members have since established a reliable market outlet for their produce which has, in turn, increased livestock trading. Nomads who previously depended primarily on animal milk for food can now sell their animals to purchase more varied food provisions. With the increased income, the group helped rehabilitate five abandoned reservoirs, thereby increasing the availability of water to livestock and trees in the surrounding area. The success of the gum resin harvesting also provides an incentive to protect the indigenous trees producing the resin, thus reducing deforestation.*

These examples of self-help initiatives in Sudan and Somalia are more than individual success stories; they hold the key to reversing the cycle of famine and war in the Horn of Africa.

* * *

Since 1985, war and famine have killed two million people in the Horn of Africa in Ethiopia, Somalia and Sudan and displaced another 14 million people from their homes. At least 16 million people are currently living on the brink of starvation and, with millions of others, are trapped in a cycle of underdevelopment.

In the Horn of Africa, there is a crisis of devastating proportions from declining food security for local consumers, deforestation, soil erosion, desertification, over grazing, poor management of land and water resources leaving the environment unable to sustain growing populations, illiteracy, health problems and overcentralized and unrepresentative political systems.

To end the crisis, the entire international community must join in promoting grassroots development initiatives in this war-torn and famine-plagued region. Why do we need this response? First, war is so widespread and costly in Horn countries that sound national development strategies are not effectively pursued by governments, although people at the local level are continuing to pursue development. Second, lasting peace based on equitable, participatory and environmentally sound development cannot simply be negotiated from the top down, but must be built from the bottom up. Third, the crisis is of such magnitude that without prompt action supporting local efforts to stabilize the environment and carry out other essential development activities, such as agricultural production, water resource management, reforestation and education, reversing the decline may be impossible.

The causes of war, famine and underdevelopment are all rooted in inequitable control over resources and decision making. This paper will address the much neglected role of

254

grassroots and indigenous nongovernmental organizations. The paper will present an alternative to the top down and usually inequitable approach to addressing famine, war and sustainable development in that region. (For a description of the conflicts in the Horn of Africa and a broader discussion of their causes, see BFW background paper No. 118.)

The Case for a New Model

For too long, international donors and governments in the Horn of Africa have overlooked grassroots and indigenous nongovernmental organizations, despite these organizations' legitimacy as local agents of development, relief and rehabilitation in the war- and drought-ravaged communities they serve. In many instances this neglect has undermined the formation of grassroots institutions, and thus impeded the overall development process. On the other hand, this neglect has sometimes given them autonomy to emerge, grow and define their issues, and work with constituents. In recent years, international organizations such as OXFAM America and Save the Children Federation have come to recognize the crucial role grassroots organizations play in sustaining development efforts. Some have demonstrated this by channeling funds to existing grassroots organizations and supporting the emergence of others.

"Development is not just a matter of producing food and building houses," cautions Paolos Tesfagiorgis, former chairman of the Eritrean Relief Association (ERA), an indigenous nongovernmental organization working in opposition-controlled Eritrea. Paolos goes on to say that "development is a long-term and gradual process in which people participating through their groups and communities are empowered to determine their needs, implement programs, and decide how to control their environment." Paolos says his group can only be effective if people are taking part in activities through peasants, youth and womens' associations.

In Ethiopia, Somalia and Sudan, successive regimes have made economic and political decisions through highly centralized processes that have largely benefited a small segment of the population, such as the military, large landholders, investors and merchants. Contrary to claims of the successive governments in power, the vast majority of the people, especially women, small-scale farmers, pastoralists, landless people, and the urban poor, are not represented in policy decisions and receive few benefits. The impact of these decisions has led the majority of people to oppose the governments. To suppress protests, the governments have used force and committed human rights abuses, such as killing and detention. The result is further alienation and political instability.

The Horn needs alternatives to these centralized economies and government-controlled development processes. At the International Conference on Popular Participation (Arusha, Tanzania, 1990), Hassan A. Sunmonu, secretary-general of the Organization of African Trade Union Unity said, "In order to bring about recovery and development..., there is the essential need to involve the participation of the people, the workers, trade unions and other grassroots organizations in all aspects of planning, implementation, management and monitoring of development programs." Strengthening the capacity of existing and emerging nongovernmental organizations to meet this need for participation is a prerequisite to development and peace in the Horn of Africa.

The Growth of Indigenous NGOs

There exists at the local level in the Horn of Africa the experience, expertise and capacity to carry out relief and recovery activities.

In Somalia, prior to the colonial era (1886-1960), indigenous institutions and leadership provided management of agricultural and grazing resources. Crop rotation, pasture management, food storage and water allocation were the responsibility of local sheikhs, herdsmen and elders. During the colonial era in Sudan and Somalia (late 1800s to mid 1950s), indigenous institutions were virtually destroyed as centralized institutions, designed to assure European control over the nations' wealth, were substituted in their places. The colonial structures were retained after independence.

For centuries, people in Ethiopia have acted together to pool skills, knowledge and resources for the good of the community as a whole.

Indigenous nongovernmental organizations began emerging in the 1960s and 1970s throughout the Horn. Many formed in response to the recurring famines, wars and drought. In some cases these local groups emerged to fill the gaps created by the initiatives of governments and donor agencies. While these NGOs vary in services provided in both government- and opposition-controlled areas of Horn countries, they all share the following strengths:

- They provide vehicles for people-led development where strategies are conceived and implemented by local people—the key to decentralizing the decision-making process.

- They are often engaged in a more self reliant, participatory and cost effective development process than government departments or outside donor agencies.

- They act as points of communication between the government, donor agencies and the target community.

In Sudan, one such organization is **Sudanaid**, the relief and development arm of the Sudan Bishops' Conference, which was formed in 1972. In 1985, Sudanaid was among the first agencies to call attention to the growing food shortages in southern Sudan. Along with the **Sudan Council of Churches**, an ecumenical organization, it established local relief camp committees in the Khartoum area in the North that would later become relief arms. Sudanaid had traditionally supported both development and relief projects proposed by local leaders of grassroots organizations throughout Sudan.

The recent crises have forced the organization to devote more resources to relief activities, but not to the complete exclusion of development projects. Nutritional monitoring, food, blankets, medicine, vehicles and spare parts distribution comprise much of the activity. Thousands who fled the South seeking some normality for their children depend on Sudanaid's child and adult education centers operating in the Khartoum region.

The **New Sudan Council of Churches** was founded by two Sudanese Catholic and Episcopal bishops to address the needs of civilians in the opposition-controlled southern provinces of Equatoria and Upper Nile. The **Sudan Council of Churches**, by political necessity, limits its activities to government-controlled areas.

The **Sudan Council of Voluntary Agencies** is a consortium of indigenous groups including the **Family Planning Association, Child and Mother Care Society,** and the **Sudanese Society for the Protection of the Environment.** These groups carry out activities in health care, women's development and leadership, and environmental restoration.

The **Islamic African Relief Agency (IARA)** and the **Sudanese Red Crescent Society** have earned good reputations for their work in providing services in maternal and child health as well as for their relief and support activities to displaced people throughout government-controlled Sudan.

The Sudan Relief and Rehabilitation Association (SRRA) is working to meet food needs and achieve self-sufficiency for the millions of people living in the opposition-controlled South, many of whom have been displaced by the war. Hundreds of thousands of children have lost seven years of school; fatal diseases are prevalent in rural areas where health care workers are few. To meet the challenge, SRRA local committees have developed plans for literacy programs, primary health care and elementary forms of water management.

The **Eritrean Relief Association** has an excellent record of providing relief services as well as carrying out development activities in Eritrea and ranks as one of the most independent nongovernmental organizations. ERA welcomes partnerships based on respect for local knowledge and participation in decision making. For example, ERA, in partnership with the Eritrea Inter-Agency Consortium (EIAC), a European based group of humanitarian agencies, is implementing the Water Supply Development Program to provide a secure, adequate and safe supply of water. In 1989 more than 30 borehole wells were drilled to provide thousands of people access to safe water. Cisterns, animal troughs and subsurface dams were also constructed. The development of local capacity to manufacture hand pumps for the growing number of wells is stressed. This reduces dependence on imported technology that is more expensive, subject to delivery delays, and not as suitable to the specific conditions in Eritrea.

The **Relief Society of Tigray (REST)** coordinates relief, rehabilitation and development programs in opposition-controlled Tigray and works with refugees in Sudan. One REST worker says that "despite the tasks confronting us, our people have made significant progress in addressing many of the problems. Through the Baitos, or village committees, we have discussions that have enabled the people to identify the problems, find solutions and set priorities. Projects implemented are the result of people determined to work toward overcoming the difficulties brought on by war and drought. We are carrying out a variety of projects designed to help each farmer to produce more food. These include providing locally grown seeds and locally made tools, training, conserving water and preserving the soil and remaining forests."

The **Ethiopian Catholic Secretariat (ECS)** uses local parishes and missions to operate schools, clinics and social welfare centers in government-controlled Ethiopia. It operates 58 medical institutions that provide curative and preventive medical programs as well as feeding programs for the malnourished. Under the umbrella of the Joint Relief Partnership, ECS works with the Ethiopian Evangelical Church Mekane Yesus, the Ethiopian Orthodox Church, Catholic Relief Services and Lutheran World Federation to distribute food to more than one million people and construct water dams needed to provide irrigation water for farmers.

The **Somali Relief and Rehabilitation Association (SORRA)** is working primarily in the opposition-controlled areas of northern Somalia. It is working to assist people displaced by war by providing emergency health care, food distribution, education and animal husbandry.

The Role of the United States

The United States has a poor record of encouraging the role of grassroots groups in the region. Until recently, the United States has, however, been a major source of economic and military aid to the governments in power in the region. Much of this assistance has propped up unpopular military regimes, rather than promoted peace and development.

On the other hand, the United States has responded generously to recurrent famine in the region and recently has assisted people in all areas of the region by increasing its support to cross-border relief operations. But, further improvement in U.S. policy is still needed if the United States wants to help end the wars and promote development.

The causes of war and famine are inextricably linked. Solving famine requires ending war. Sending increasing amounts of food aid to the Horn from famine to famine does not serve the long-term needs of the people. The interests of the United States to promote long-term stability and development are best served by providing resources that both help end the cycle of famine and address the causes of war.

In 1990 the United States halted economic and military aid to Somalia and Sudan, a significant shift in U.S. policy. However, the failure of the United States to provide effective rehabilitation and development assistance over the years has impeded grassroots efforts to help bring an end to wars and to the worst ravages of drought.

Creating True Partnerships

The United States must redefine its involvement in development initiatives in the Horn of Africa. Support for the activities of the poorest citizens and organizations in which they actively participate is essential. One sign of hope is an effort by the African Development Foundation (ADF), a U.S. funding agency, and some private and voluntary organizations. These groups have formed equitable partnerships with grassroots communities in the Horn designed to serve human needs and local interests.

ADF was established by the U.S. Congress to provide assistance to African communities where villagers and disadvantaged urban dwellers are the primary initiators, managers, participants and beneficiaries in self-help development activities. ADF and U.S. PVOs who have successful partnerships provide funds directly to grassroots community groups to manage and implement projects they have designed; involve the organization or community in the assessment of the need for the project, the design of the project, and the control of the management of the project; and institutionalize local control. One example of a successful partnership was the ADF-funded effort of the Himilo Cooperative Society Project described in this paper.

If the United States increased funds for development to ADF and U.S. private and voluntary organizations, they could expand their development activities in the Horn.

The United States Congress is considering legislation that would increase United States funding to indigenous NGOs in the Horn through private and voluntary organizations and the African Development Foundation. These agencies would serve as conduits for the aid because of their demonstrated effectiveness in assisting grassroots organizations and the communities they serve to help themselves and become self-reliant.

As Jalal Abdel-Latif, former Africa Grants Manager of United Support of Artists for Africa, says, "support of local organizations is an important step in promoting the democratization of the development process by decentralizing the decisionmaking process and making women, small-scale farmers, and pastoralists responsible for their own advancement."

BFW policy analyst Diane de Guzman and policy associate Laura Joseph contributed research to this paper.

Julian Ozanne in Nairobi and Michael Holman in London explain why devastation and famine are continuing to afflict Africa

Cry, the unloved continent

Last week a Belgian air force C130 transport aircraft, the only one making daily relief flights from Nairobi of life-saving food and medicines into war-torn Somalia, was transferred to the Kurdish relief effort.

It was a cruel illustration of the marginalisation of sub-Saharan Africa in a world starting to tire of Africa's plight, even before competing demands for attention and resources came from eastern Europe, Kuwait and Iraq, and now Bangladesh.

For every Kurdish refugee facing cold and starvation in Iraq, Iran and Turkey there are at least 15 Africans fighting famine in the drought-devastated lands of Africa.

From Liberia to Mozambique, nearly 30m Africans are estimated to be at risk from starvation. Thousands are dying. The final toll threatens to overtake Ethiopia's losses of up to 1m people in the 1984-85 famine, which prompted Bob Geldof's unprecedented fund-raising drive, Band Aid.

It is, say aid workers, the biggest disaster to threaten sub-Saharan Africa, already debilitated by decades of conflict and mismanagement, and burdened with a $161bn external debt it cannot repay.

Could the suffering have been avoided? Or is Africa doomed to unending crises requiring the world's intervention?

The answer to the first question is a qualified yes, particularly if the United Nations and the west had been prepared to play as assertive a role in Africa as they are now in Iraq. While if current peace efforts succeed, an end could be in sight to at least some of the civil wars which are at the heart of Africa's agony.

For the first time governments and rebel movements are starting seriously to look for solutions at the negotiating table and not on the battlefield. A combination of war weariness, the superpower *rapprochement* that is bringing an end to fighting by proxy, and a surge of support across the continent for multi-party systems,

Governments and rebel movements are starting seriously to look for solutions at the negotiating table

has helped create a climate for talks.

Last week rival parties initialled a settlement of Angola's 15-year-old conflict; this week the Mozambique government and the rebel Renamo movement resume peace talks; US and Soviet officials, once bitter rivals in the Horn of Africa, are currently playing a leading role in efforts to end civil wars in Ethiopia.

But success will come too late for hundreds of thousands caught up in a long-predicted catastrophe. Since last September it has been well known that a serious drought and crop failure was looming across Africa.

African regimes bear much of the responsibility for the suffering of their people. Dictatorships and uncaring rebel groups, blinded by pride and a lust for power, have prepared the ground for the crisis, while war then made a successful relief effort impossible. Inappropriate agricultural and economic policies, corruption, diversion of resources and personnel to the war effort, have all exacerbated the natural disaster of drought.

But outsiders also share the blame for the human catastrophe. Inadequate aid, frustration at a continent where disaster seems never-ending, and putting political considerations above humanitarian obligations have all compounded the crisis.

US patronage of corrupt and authoritarian regimes such as Liberia and Somalia has been matched by Soviet support for Ethiopia, while Angola suffered under the attention of both superpowers.

But wherever the responsibility lies, the world's humanitarian response has been inadequate. Aid workers lay part of the blame on competing demands both on media attention as well as donors' pockets.

But "aid fatigue" is only part of the problem. If any lesson is to be learned from this crisis, say aid workers, it involves a fundamental reassessment of how the international community deals with African regimes which put a president's power ahead of his people's welfare.

Two crucial questions arise, aid workers and diplomats maintain. Does the world place political considerations ahead of the delivery of humanitarian assistance – judging, for example, that aid would simply extend the life of a repugnant regime? And how far should the international community go in overriding a nation's sovereignty when its government has demonstrated it is incapable of feeding its own people.

The cases of two famine-hit African states leaves opinion divided.

In Sudan aid workers are battling to deliver food to 7m people facing starvation. Even with help from the government, reaching most of the people would have been a Herculean task. Roads are poor, the railways and ports inefficient, and the transport fleet is dilapidated.

But help has not been forthcoming. Since last September, donors have had to deal with an extremist Islamic government, with a notorious human rights record, and which belatedly appealed for help too late to avert loss of life.

Khartoum consistently underplayed the disaster as a "mere food gap", harassed aid agencies and denied them travel permits, and labelled talk of famine an attempt to undermine the government.

Complex negotiations about the mechanics of the relief operation – particularly who would distribute the food and how much would go to the rebel-held south – seriously delayed the delivery of food, now beginning to trickle in.

Many aid workers are now asking a painful question: "Should we save 500,000 Sudanese people this year, and give the government another five years of power, where every year there will be another disaster?" said one senior UN official. "Or should we let them die and hope to get rid of the government? Which is the better in the long term?"

Mr Kosti Manibe, deputy general secretary of the Sudan Council of Churches, strongly disagrees with this hard-headed stance: "That is immoral and it may not achieve its purposes.

"The whole question of sovereignty needs to be addressed for Sudan as in Iraq," he said. "If a regime has proved absolutely intransigent, has used food as a political weapon, and is incapable of feeding its own people, the option of the international community should not be abdication and indifference, but intervention. The precedent set in Iraq should be applied to Africa, where the situation is more grave."

The world community, however,

THE STARVING OF AFRICA

	Population	Number at risk	Food needed (tonnes)	Shortfall (tonnes)
SUDAN*	[illegible]	7.7m	1.20m	637,000
ETHIOPIA	48.0m	7.3m	1.15m	54[illegible],000
SOMALIA	5.9m	[illegible]	130,000	[illegible],000
MOZAMBIQUE	15.0m	1.9m	281,000	[illegible]51,000
ANGOLA	9.5m	[illegible]	[illegible]	55,000
NIGER	[illegible]	[illegible]	[illegible],000	30,000
BURKINA FASO	[illegible]	1.5m	100,000	[illegible]0,000
LIBERIA	2.5m	[illegible]	224,000	134,000
MALAWI	8.0m	1.0m	174,000	14,000
Total (sub-Saharan Africa)		29.7m	4.0m	[illegible]

*Sudan plus neighbouring states

Source: World Food Programme

shows no sign of treating the action to save the Kurds as a precedent.

In Somalia, scene of continued warfare between the country's main clans, relief efforts are almost non-existent despite a growing shortage of food and medicine.

When the civil war engulfed the capital in late December, the UN, western governments and all but one of the aid agencies evacuated their personnel.

The absence of a relief effort to date is a sign that the international community's patience has been exhausted by the continued bloody fighting and the lack of a political settlement between the warring parties.

"Frankly the security situation precludes any on-the-ground American official presence," said Mr Jack Davison, director of the US State Department's Office for East African Affairs.

Dr Husein Mursal, the Mogadishu director of the Save the Children fund, disagrees. "Something could have been done in Somalia in the last four months," he says. "If they were worried about the security of UN personnel they could have employed Somalis. At least they could have organised an airdrop of bandaging material and essential drugs to combat measles, malaria and tetanus."

Dr Mursal claims that Unicef, the United Nations children's fund, has been "sitting on millions of dollars, waiting to act. By the time they come in everybody will be dead."

Yet the issue of sovereignty versus what many see as a moral obligation to mount a humanitarian effort is complex. "The problem since the overthrow of (former President) Barre is that the country has divided into three factions" says Mr Fred Eckhart, a UN spokesman: "For the UN to deal with any one of these factions would imply political support from the UN, or international recognition."

"You can't do business like that in Africa," replies Mr Abdul Mohammed, an expert of relief in the Horn of Africa, arguing that the realities on the ground make contact essential.

Further, he argues that the Kurdish relief operation has undermined the whole concept that aid operations must respect sovereignty and require the consent of the recipient country's government. "But in Africa, where there is a greater disaster, the UN still behaves as the last hide-out of sovereignty... manipulated and paralysed by regimes which have no legitimacy or respect from their own people.

"The UN's instinctive reaction to crisis is to evacuate. People are dying and the niceties of international politics should be meaningless to an organisation which is supposed to respond quickly to humanitarian needs."

While no end is in sight to the war in Somalia, Angola's example demonstrates that seemingly intractable conflicts offer hope for peace in Africa and an important prospective role for the international community.

Last week the MPLA government, led by President Eduardo dos Santos, and Dr Jonas Savimbi's Unita rebel movement initialled an agreement paving the way for a ceasefire and multi-party elections in 18 months. Essential to the agreements are provision for international monitoring of the process.

Yet questions about the level of support the outside world will provide have elicited a cautious response from western diplomats. Even without massive assistance, however, in the form of thousands of monitoring personnel, the transition process will be under acute strain. Without outside help, it may well fail.

If the west and the UN are really serious, say an increasing number of Africa's diplomats and politicians, they should play a prominent mediating role in other African conflicts. Outsiders cannot impose solutions, officials say, but they can play a part ranging from honest brokers to neutral monitors of ceasefires and elections.

A negotiated settlement to Africa's wars, they argue, goes to the heart of an anti-famine strategy.

At the same time, the recovery efforts for the rest of the continent, where most governments are implementing economic reform programmes, must be backed by a combination of debt relief and new resources.

These resources should be tied – as many African governments now accept – to what the World Bank calls "better governance" – the introduction of democracy and accountability.

Proposals designed to head off disaster generally meet a sceptical response. Strategic food stockpiles in Africa are difficult to maintain and prone to abuse.

African diplomats acknowledge that all this may be expecting too much from the west – though pointing out that the UN-endorsed mobilisation for the Gulf war and the Kurdish relief effort have shown what can be done if the political will exists.

But the alternative, they warn, is grim. The cost of inaction in Africa will not simply be more famines and more African governments imploding, ceasing to exist as nation states, as in the case of Somalia and Liberia.

It will be an unhealthy Africa, they argue, which ultimately means an unhealthy world. Environmental damage on the continent, further migration into southern Europe from north Africa, the spread of Aids, all have potentially disastrous implications, albeit some years away, for the rest of the world.

"It may well be," said one participant at a recent gathering of aid officials and politicians, "that only when the west fears for the welfare of its own next generation will it be sufficiently motivated to address Africa's disaster."

25

STATEMENT OF LARRY WILLIAMS
WASHINGTON DIRECTOR, INTERNATIONAL PROGRAMS
SIERRA CLUB

BEFORE THE

HOUSE BANKING SUBCOMMITTEE ON
INTERNATIONAL DEVELOPMENT, FINANCE,
TRADE AND MONETARY POLICY

REGARDING THE SIXTH REPLENISHMENT OF THE
AFRICAN DEVELOPMENT FUND AND THE
FIFTH REPLENISHMENT OF THE ASIAN DEVELOPMENT FUND

MAY 30, 1991

Thank you for the opportunity to testify today on behalf of the Sierra Club and the Environmental Defense Fund to provide our assessment of how the African and the Asian Development Banks are doing with regard to protecting the environment. As many of the members of this panel know first hand, the interest and concern expressed by the U.S. Treasury Department and the development banks over the environmental quality of the activities of the MDBs is directly due to the leadership this subcommittee has provided since the early 1980's. As a result, more attention is being paid, by some of the MDBs, to the environmental problems associated with their lending practices.

In 1988, this subcommittee passed an amendment, sponsored by Rep. Nancy Pelosi, to require the banks to provide environmental impact assessments to the Treasury Department and members of the public, 120 days prior to the project coming before the Board of Executive Directors for a vote. As you will recall, the law does not allow Treasury to support the project if an EIA, or a comprehensive summary of the EIA, is not provided in a timely fashion. Wisely, the law gives the banks two years to adjust their policies and procedures. This coming December, the Treasury Department will be obliged to vote against any project which has a significant impact on the environment for which an EIA was not prepared. The 120 day advance rule for the release of an EIA means that any project coming before the Board of Executive Directors after December 19th, 1991 will have to have a completed EIA available to the Treasury Department and the public by the middle of August.

The primary question is this: are the Asian and African Banks going to be able to comply with the EIA requirement? Of the four development banks, the Asian and African Development Banks seem to be having the most difficulty making preparations to meet the requirements of this law.

AFRICAN DEVELOPMENT BANK:

Evidence suggests that the African Development Bank (AfDB) is in far more dire straights, environmentally speaking, than the Asian Bank. On August 23, 1990 Mr. Folsom wrote to the AfDB President, Mr. Babacar N'Diaye urging the AfDB to hire, by June 1991, a least ten "environmental experts to assist in the integration of environmental considerations into all aspects of its lending activities."[2]

The Sierra Club has been in touch with the Bank regarding its effort to hire a director of its environmental division and has tried to be helpful in getting the search process going. I am sorry to say that the hiring process seems to have completely broken down at the most preliminary stage of writing the job description for the environmental director. That puts the AfDB in an even worse position than the Asian Bank which is currently interviewing applicants to fill its environmental director position. As best we can tell, there is a growing faction within the AfDB that is pressing for the environmental director position to be filled by someone within the Bank, preferably a technician, rather than someone who has an international reputation in the environmental field, such as having held an important environmental management position. We interpret this backing off as sign of growing concern among some of the Bank staff that the hiring of a highly visible environmentalist to run the department will get in the way of conducting business as usual. Business as usual, of course, is what needs to change and is the reason for the problems the Bank is currently experiencing.

There are no indications, whatsoever, that the African Development Bank can meet even the spirit of the EIA law any time soon. When the Pelosi amendment was under consideration by this Subcommittee, I met with President Babacar N'Diaye to discuss the problems the Bank might have in meeting the requirements of the law. At that meeting Mr. N'Diaye expressed strong support for the preparation of EIAs for their projects and did not want the Congress to single his bank out in the proposed law for special treatment. The Treasury Department has repeatedly reminded the AfDB to live up to its commitments. The Congress must do the same.

The severity of the environmental problems of the AfDB's lending operations can be seen in the following three examples for which I would like to submit the case studies for the hearing record. Our submissions include: An article and correspondence between the Bank and the Sierra Club regarding a Sawmill project in the Peoples Republic of Congo and two case studies, prepared by the Environmental Defense Fund, regarding a major road construction project which will open up intact rain forests in Southeastern Cameroon to massive logging operations--an area inhabited by several 10's of thousands of pygmies--and the Coastal Road Project in Cote d'Ivoire which threatens to wipe out one the last remaining blocks of rain forests in that country. I hope the members of this Subcommittee will have the opportunity to read these reports because they afford a clear picture of just how bad the environmental management situation is within the Bank.

---

[2]. ibid. pg. 17.

I will not take time to go over each of these projects in our testimony, but do want to call your attention to the Cote d'Ivoire road project as an example of gross environmental mismanagement at the AfDB. When we met with President N'Diaye in September of 1989 to discuss the Pelosi Amendment, Mr. N'Diaye called to my attention this proposed road project, which would pass along the entire coast from Tabou (near the border with Liberia) to Abidjan. Mr. N'Diaye told me that he was very concerned about the environmental impacts this project would have on the region's last remaining rainforest blocks. According to the EIAs commissioned by the AfDB, the area encompasses about 10% of Cote d'Ivoire's remaining elephant population. It also contains most of the remaining pygmy hippopotamus population as well as numerous other mammals and bird species.

I was told by Mr. N'Diaye that the building of the road would not begin until the funds were found to reroute the road away from the most critical wildlife areas. He added that additive funds were needed to ensure that the road would be rerouted. While in Abidjan in November of 1990, Ms. Korinna Horta, of the Washington, D.C. office of the Environmental Defense Fund, was told by officials within the environmental unit of the Bank and the Ivoirien Ministry for Agriculture, Waters and Forests (MINAGREEF) that road construction had not begun because funding for the environmental protection measures had not been located. In her report Ms. Horta notes that "a visit to the field led to a surprising and disheartening discovery: <u>Construction of the road is fully underway and no measures to mitigate its impact have been taken.</u>... The Environmental Unit at the AfDB and representatives of the MINAGREEF in Abidjan were operating under the belief that no actual construction of the road segment has begun, since none of the proposed mitigation measures had been put in place....Information gathered in the region shows that no environmental protection measures are being implemented."

To make matters even worse, reports Ms. Horta, the "AfDB's coastal road project will have a direct impact on at least one of the forest blocks which the World Bank's forestry sector loan seeks to protect, the Dassiekro forest." Altered by EDF the World Bank sent its own mission to Cote d"Ivoire... which confirmed EDF's report. As a result the World Bank temporally suspended dispersement of it forestry sector loan. In response, the AfDB asked the World Bank for a mitigation grant for the road.

What is glaringly apparent from this episode is that the AfDB does not have the capacity, and/or the political will, to ensure that the conditions of its development loans are being properly carried out. In an April 1991 letter to the Sierra Club from Mr. A. Sangowawa, Vice President, Operations, South Region, AfDB tells us that the Bank adopted "a set of general and specific sector environmental policies to guide it in its lending operations. The main objectives of these policies are:

(a) to incorporate environmental considerations into the policy formulation, project design and project implementation processes; and

(b) to help Regional Member Countries improve their environment and sustain their natural resources.

"Concerning forestry projects, the Bank will support such projects only after, among other considerations, there has been an environmental impact assessment and appropriate management plans have been developed." However, there is no indication that the AfDB is willing to live up to its rhetoric. The most recent example is the AfDB's loan proposal for the above mentioned road program in Cameroon which represents a clear violation of the Bank's own environmental policy paper.

Conclusion:

We urge the Subcommittee to focus this year on "putting teeth" in the many good policy directives it has issued in previous years regarding the MDBs and the environment. AfDB and ADB's Bank forestry loans continue to support unsustainable logging programs and other loans continue to finance industrial development and road construction in virgin tropical forests. The Bank are moving far too slowly in implementing the environmental reforms long sought by this Subcommittee.

This year, the Subcommittee should articulate in the replenishment legislation, specific two-year targets in the areas of energy, forest conservation, and environmental assessment. The Subcommittee should press the Banks this year to develop action plans to meet these targets. Bank management, at the urging of the Treasury Department, has already made general commitments in these areas in the replenishment agreements. The Subcommittee should put the Banks on notice that failure to meet specific targets set out in mutually acceptable action plans, by the end of the next replenishment period will affect subsequent funding levels.

We propose that the Subcommittee include the following two-year targets in this year's bill:

- Forest Conservation -- Forestry loans should not directly or indirectly support large-scale commercial logging in primary forests unless management systems which maintain the ecological functions of the natural forest and minimize impacts on biological diversity have been demonstrated in practice. Bank loans should not support mining, oil development, other industrial development, or road construction in primary forests unless effective safeguards to prevent forest destruction are already in place. All loans affecting forest areas should give paramount importance to the needs and rights of indigenous peoples and other long-term forest inhabitants.

- Environmental Assessment -- The Banks should issue EIA guidelines which contain explicit requirements for public access to draft and final EIA documents and public participation in the EIA process, including initial scoping sessions and opportunities for comment on EIA documents, and the establishment of strict EIA requirements for sector and structural adjustment lending.

- Energy -- All energy loans should be based on "least-cost" investment plans that consider a wide range of end-use efficiency and renewable energy options. To the extent possible, "least-cost" planning should include environmental costs of proposed energy developments. Loans for end-use efficiency and non-conventional renewable energy should account for a substantial amount -- on the order of 25% -- of all energy, industry and transportation lending.

We hope our comments and recommendations will be of value to you as you continue your considerations for the replenishment of the African and Asian Development Funds.

760

NEWS FROM CRS

World Headquarters
Catholic Relief Services
209 West Fayette Street
Baltimore, Maryland 21201-3443
Telephone: (301) 625-2220
Fax: (301) 685-1635
Telex: 9100000951 (CRS UQ)

FOR IMMEDIATE RELEASE

CONTACT: Alex Rondos
or Karen Donovan
(301) 625-2220 or
(301) 234-2981

INTERNATIONAL COALITION OF RELIEF ORGANIZATIONS AND CHURCHES CALLS ON UN, DONOR GOVERNMENTS TO RESPOND TO SUDAN FAMINE

BALTIMORE, May 31 -- Deeply concerned that thousands of lives could be lost to hunger this year in the Sudan, a coalition of international relief organizations representing five relief agencies worldwide sent a letter to United Nations Secretary General Javier Perez de Cuellar, calling upon him to intervene with the government of the Sudan and donor governments to ensure that adequate food aid is delivered to the people of Sudan, especially to those in the south.

The coalition, the Licross/Volags Steering Committee for Disasters, sent the letter asking the Secretary General to "urgently intervene with the Government of the Sudan to ensure that the principles of OLS are respected, and to alert all potential donor governments to the immediate need for adequate food aid to the Sudan, particularly the south."

Members of the Steering Committee that signed the letter include Catholic Relief Services, Caritas Internationalis, Lutheran World Federation, Oxfam and World Council of Churches.

A severe drought compounded by years of civil war have created conditions for a famine of enormous proportions in the Sudan. Predictions for numbers of people at risk range from 7 to 11 million people.

Logistical difficulties in the delivery of food aid have compounded severe food shortages in government-controlled northern Sudan. In southern Sudan, which is largely contolled by the rebel army, the Sudan People's Liberation Army (SPLA) and where 3 million are at risk, the United Nations relief program operates under Operation Lifeline Sudan II (OLS II) an agreement that guarantees safety to relief operations and evenhanded deliveries of food aid to both areas controlled by the rebels and by the government.

As of this date, the government of Sudan has been reluctant to facilitate OLS provisions, especially with regard to authorizing adequate delivery of relief supplies to rebel-held areas, in turn making donor governments wary of pledging relief commodities.

In March 1991, the United Nations appealed for 1.2 million metric tons of food aid. Only 50% of this requirement has been pledged for the north and less than 20% for the south.

Steering Committee members also plan to send letters to the heads of state/government of their respective countries, asking them to respond to the Secretary General's appeal for international assistance to the Sudan.

CRS' program in Sudan

Catholic Relief Services, the international relief and development agency of the United States Catholic community, works in southernmost Sudan, delivering relief commodities to war-displaced people in the SPLA-held areas of Torit in Eastern Equatoria and Kaya in Western Equatoria, as well as the government-controlled garrison town of Juba. CRS is working with the Torit Diocese and the SPLA's relief arm, the SRRA, to implement an agricultural rehabilitation program serving approximately 32,000 farm families in Eastern Equatoria. Additionally, CRS supports the New Sudan Council of Churches in its effort to strengthen its ability to implement relief, rehabilitation and development programs in southern Sudan.

###

TOMORROW Vol.1 No.1, 1991

By Erika Bjerström

CAMEROON: Fighting Poverty to Save a Forest

Unlike most of its West African neighbors, Cameroon still boasts huge tracts of untouched rainforest. Ironically, the forest's natural wealth could be its undoing, serving as a magnet for poachers, farmers and logging companies. But by making preservation economically attractive, Cameroon's Korup Rainforest Project may show how the destruction can be slowed.

Until just a few years ago, the Ndian River was the only way to reach Korup, a 60 million-year-old rainforest and one of the world's oldest museums of the triumphs and failures of evolution.

Travelers who wanted to uncover the secrets of Korup used to have to to begin their trip at the river's mouth in Victoria Bay. Several days later, the journey would end at the village of Mundemba, where the palm oil plantations give

PHOTO: MATTIAS KLUM

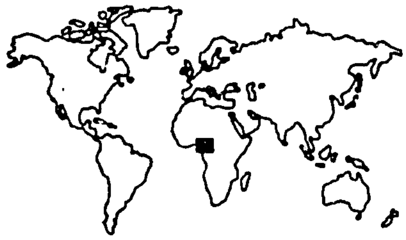
PHOTO: TOMMY SVENSSON

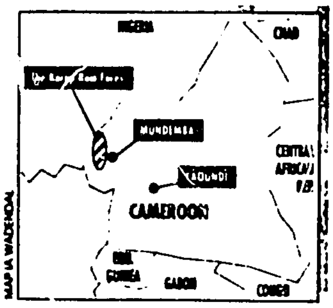
Ruth Mallison, a British agronomist working to establish tree nurseries in the buffe

way to virgin rainforest. Today, the people of Mundemba have another artery connecting them with the outside world: a red dirt road now winds its way through the mountain forest and down to the flatlands.

The new road leads to the city of Douala, Cameroon's trade center and a base for conservationists, whose Range Rovers trail clouds of red dust as they trek back and forth over the mountains. Cameroon is in the midst of a fight to save its its natural heritage, and for once environmentalists may be a step ahead. The country is classed as one of the six most worthy of protection in Africa. It is ecologically rich, with savannahs, mangrove swamps, West Africa's highest mountains and fully a fourth of all mammal species on the continent.

If all goes well, the ancient coastal forests in Cameroon will survive and thrive as they always have, thanks to one of the worlds most successful rainforest project to date. The US$10 million plan, devised by the World Wide Fund for Nature and other organizations, may ensure that Korup is spared the fate of so many other tropical forests in the Congo Basin.





MAP: A WADENIUS

The first and most important step has already been taken. A core area of Korup has been declared a national park, where commercial logging and hunting are forbidden. But since most of the damage to any rainforest is wreaked by poachers and land-hungry farmers, the Korup Project has gone on to tackle the underlying problem of poverty itself.

As the tribes have become integrated into the modern cash economy, the resources of the rainforest become increasingly tempting. It costs money to send children to school or to choose a health clinic over the village medicine man, and for many people the forest is an irresistable source of extra cash.

Unlike other programs that have forcibly moved native populations in order to protect valuable rainforests, this one gives the people of Korup economic incentives to leave their villages in the new park and move into adjoining agricultural "buffer" zones. There, farming can be pursued far more profitably with the assistance of agricultural advisory services. The zones will also offer decent housing, schools and medical clinics.

Roads and bridges are usually seen as the greatest threat to the rainforests. Somewhat surprisingly, they will consume half of the Korup Project's budget. After two years of difficult negotiations, the Baro tribe agreed to move out of the forest if all-weather roads were built so farmers could get their produce to market before it spoils.

"Cameroon's ancient rainforests are part of our global heritage," says University of Wisconsin researcher Dr. Stephen Gartlan, a driving force behind the Korup

e outside Korup.

Project. "If we don't do something soon, the forestry companies will move in." Gartlan, a stubborn English psychiatrist, came to Cameroon nearly 25 years ago to study the behavior of primates. He worked in Korup for several years before meeting Phil Agland, an Englishman who would become another Korup champion. Together they produced the film *Korup - An African Rainforest,* which many regard as one of the best wildlife films ever made.

It dramatically focused world attention on the virgin forest, which Gartlan and Agland proposed converting into a national park as the only immediate way of protecting it. The proposal was adopted by the conservation-minded government of Cameroon in 1986. With funding from the British government and the European Community, WWF came up with a plan for Korup's preservation. The key was the creation of the agricultural buffer.

Based on the WWF proposal and other studies, the Korup Project was inaugurated last year with the blessings of Britain's Prince Charles, whose signature is proudly displayed in the guest book at the project's headquarters. Despite funding difficulties, some major progress was reported in the first few months.

Ruth Mallison, a British agronomist working on the project, is convinced that local villagers above all need economically sound methods of cultivation. "If we can do that," she says, "farmers won't have to go in and burn rain forests in the search for even more land and firewood."

Under her watchful eye, the first tree nurseries have been established in the buffer zone to produce fast-growing timber and fruit trees for everyday local needs. The trees have the added benefit of stabilizing the soil. Crop rotation has been introduced as well, while planting a virus-resistant cassava has increased yields of this dietary staple. Meanwhile, the fruiting cycles of the wild mango tree and other fruit and nut species have been speeded up.

The natural chemistry of Korup has also received its share of attention. Cameroonian and international scientists have now identified nearly 100 natural substances in the rainforest that may be useful in industry or medicine. Their distillation and marketing could raise local living standards while underlining the enormous value of the forest itself. "In this sense the rainforest becomes a genetic nursery," says one of the scientists. "But we have a good deal to learn. Only a fraction of the plants in Korup have been documented."

The *known* facts about Korup are impressive. A quarter of all monkey species in Africa find shelter under its great green canopy, along with 250 species of birds, more than 400 types of trees and many rare fish.

Korup is quite simply a heaven on earth for biologists and ecologists. But getting around in this jungle isn't easy. After leaving Mundemba, we negotiate a shaky footbridge over the Ndian River and follow a narrow path through the dense vegetation. Our guide, Ferdinand Waindah, strides ahead of us in his plastic sandals. Grey parrots mutter and screech overhead and a million crickets add to the cacophony.

It costs money to send children to school or to choose a health clinic over the village medicine man, and for many people the forest is an irresistable source of extra cash.

The forest breathes. The sweet scent of orchids is almost nauseating in the extreme humidity and heat - a heat so obtrusive that the instinctive reaction is to stretch out your hand and try to push it aside like a curtain. This is not a favorable climate for humans, and some local people suffer from repeated attacks of sleeping sickness and malaria.

Waindah, who grew up in Korup, doesn't know the name of every species, but he does know what the various fruits, leaves and roots can be used for. He eagerly asks if we are thirsty, and chops down a withered liana. It's filled with fresh water.

"A herd of forest elephants was here yesterday," says Waindah, pointing to a narrow opening in the forest where the trees have been uprooted and hurled about. The elephants now seem to understand that humans are their enemy. A few months ago, a poacher was skewered on a tusk and then trampled to death.

For us, the greatest danger comes from driver ants, who live in the hollow branches of trees. In this natural symbiosis the ants protect the trees from other insects, but they are bad news indeed for humans. "One bite and you'll get a high fever for three days," says Waindah, striding ahead quickly.

Suddenly we hear something that sounds like a bedsheet fluttering in the wind. A tropical hornbill, with heavy flapping of wings, cruises close to the forest canopy. It flies past a flock of red colobus monkeys hopping between the crowns of the trees. We can tell they are feasting on red nuts by the shells that come cascading through the foliage.

In the great forest, time seems to stand still.

But the Korup Project leaders themselves are in a race against the clock. Even though Korup is a national park, poaching continues unabated. Hunters offer meat to the villagers in return for tips on the whereabouts of elephants, whose ivory tusks are still prized in many parts of the world. Almost every day, armed guards chase away intruders from neighboring Nigeria, where the animal population has been decimated by hunters.

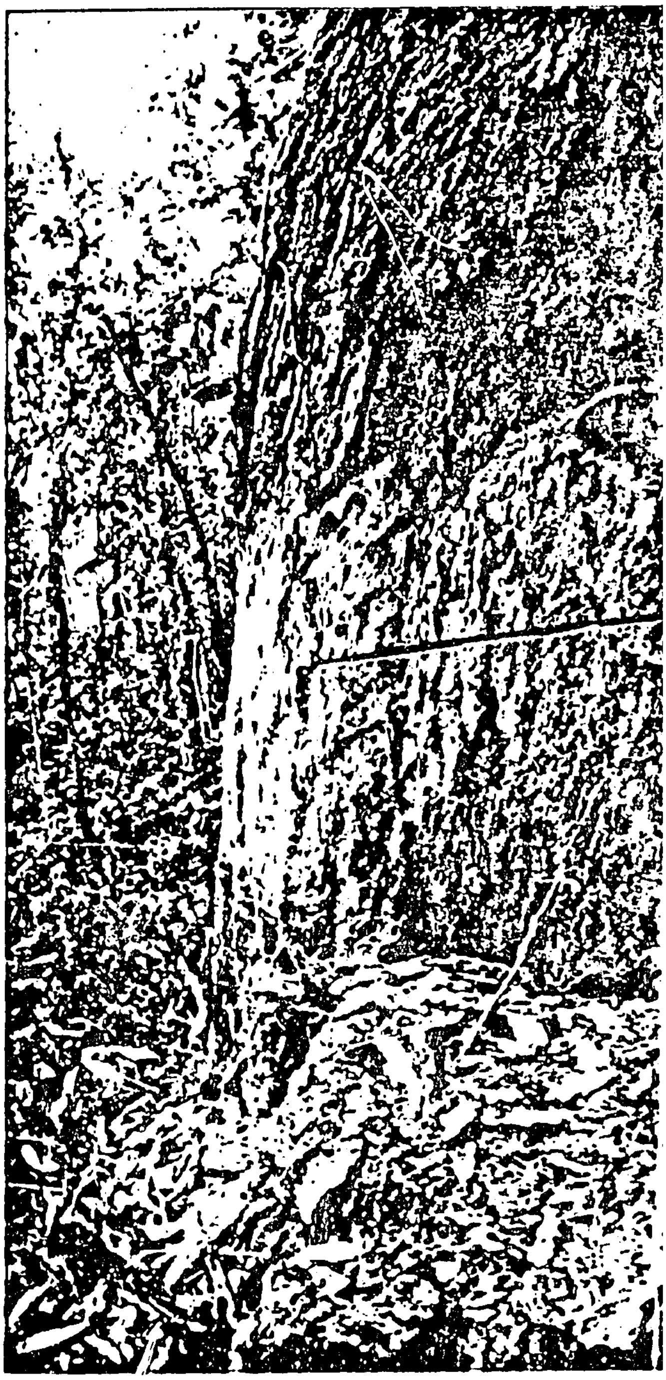
"Cameroon's ancient rainforests are part of our global heritage. If we don't do something soon, the forestry companies will move in."

"But of course you can't throw up a fence around nature and monitor it with guards," says Gartlan, who now manages the WWF office in Cameroon. On his verandra, shielded by huge hibiscus, he elaborates on the thought that the local population must want to preserve their forests. "And that will happen when you take their basic problem into consideration. Their basic problem is poverty."

The Korup Project has been criticized as a form of ecological colonialism, with conservationists in spotless safari suits protecting what *they* think is important. Europeans and Americans have always assumed that their economic power conveys a self-evident right to plan and carry out their projects in Africa.

But Andrew Allo, a Cameroonian civil servant who manages the project, rejects the criticism. "Environmental protection is a post-industrial invention," he says, "and it's not easy to explain to the farmer in the field." Allo points out that the project is a joint venture of the international community and the government of Cameroon, with the stated goal of phasing out Western influence altogether. "Of course, the white man knows what sort of mistakes have been made," he continues. "The white man wants to assist. What's wrong with that?"

Cameroonians for the most part don't know what has happened in other African countries where rainforests are



devastated, where animals are exterminated and water dries up. Allo suggests that the Korup Project "can be a model for our neighbors and all those who want to preserve their rainforests while improving their living standards."

With that pragmatic spirit, WWF in Cameroon has started a unique effort to cooperate with the forestry companies. The strategy is to develop renewable tropical forestry,

Protests back home have forced the Dutch logging company Wijma to adopt new methods, but realities in the forest don't always agree with instructions from the head office.
PHOTO: TOMMY SVENSSON

Any attempt to protect Cameroon's rainforests must first attack the country's main problem: poverty.
PHOTO: TOMMY SVENSSON

rather than prohibiting it.

For 23 years, the Dutch company Wijma has been logging in West Africa. Noisy protests back home, including local communities banning any construction using tropical woods, have forced Wijma to adopt new methods. "We are trying to log ecologically," says Christian Bertein, a spokesman at the company's offices in Yaounde. He shows us brochures describing Wijma's environment program that could have been written by Friends of the Earth. Wijma pays fees to a state-owned Cameroonian company that plants trees in logged areas.

Near the coastal village of Kribi, 300 kilometers from Korup, Wijma workers are loading enormous logs for shipment to Europe and Japan. Ed Tallice, the site foreman, is a scarred, Hemingway-inspired veteran of the Western presence in Africa who says he knows how rainforests should be cut and how blacks should be treated. His philosophy is light-years away from that of his employers in Yaounde.

Tallice wants to demonstrate how fast his men can bring down a tree. He selects a massive azobe, two meters in diameter and 40 meters tall. Chain saws chew their way through in five minutes, and the ground shudders as 50 tons of timber crash down, leaving a stump as big around as a kitchen table. The huge azobe has pulled other trees with it, and there is a gaping hole in what minutes ago was a green ceiling over our heads. If Tallice had followed the procedures in Wijma's brochures, he would have felled the surrounding trees first to minimize damage. But he says the extra work is unnecessary. "The rainforest grows back anyway, it doesn't even need to be re-planted." He says that if large sections of the tropical rainforest belt have been devastated, it's the fault of poor farmers.

Ed Tallice personifies the transition period that Cameroon is now going through. He tells us about himself over lunch in his bungalow.

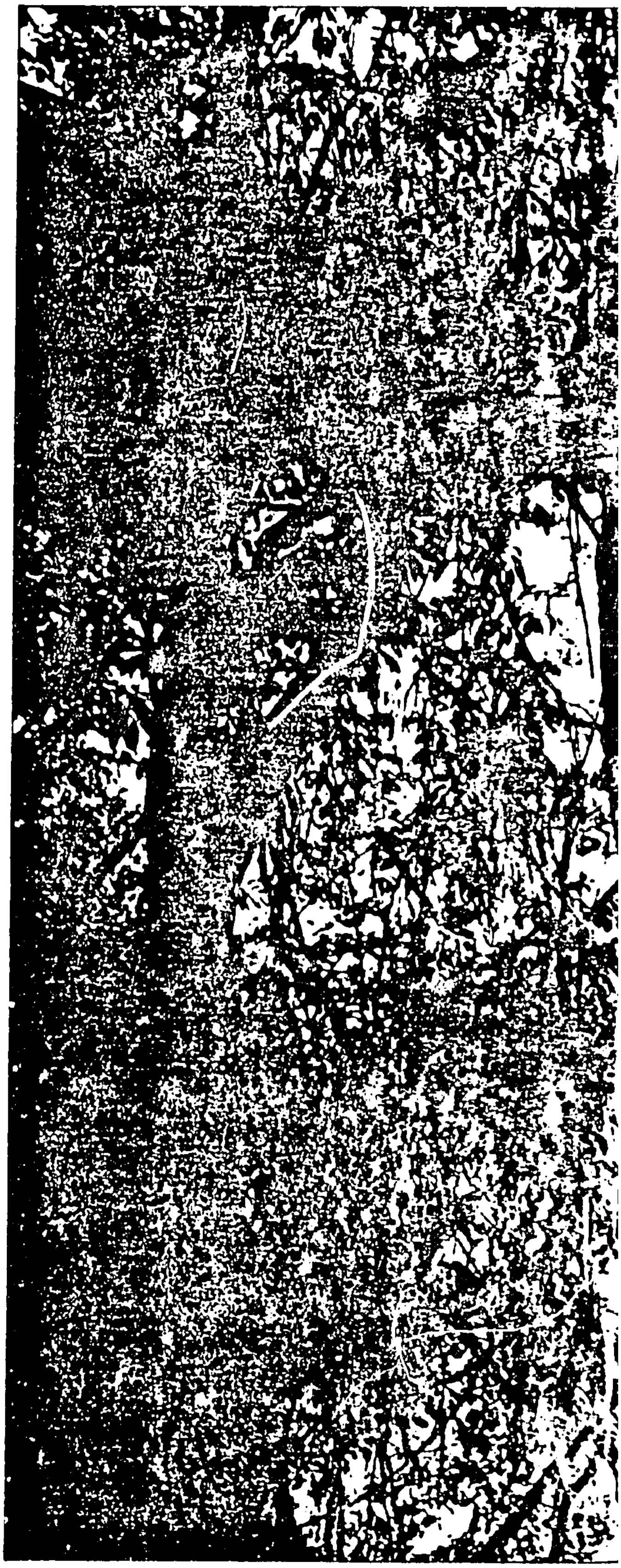
"The white man knows what sort of mistakes have been made, and the white man wants to assist. What's wrong with that?"

He began as a large-scale logger, started his own company in the Congo, and went bankrupt. Now his last job before retirement is with a company that has its own environmental policy. He laughs at the irony and pours an ice-cold beer behind his massive mahagony bar. On a sidetable, a baby elephant cranium serves as a magazine rack for old copies of Paris Match. "I miss the old days," he says. "Back in the fifties, everyone knew their place, both Europeans and Africans. But I know my time here is over."

The old and the new are colliding in other places in Cameroon. Up on Mount Kilum in the north, the high-altitude rainforests are fast disappearing. But every now and then, when the women have burned too much forest in their quest for new farmland, the arboreal god Mabu turns up, a frightening vision in his black ebony elephant mask. On the border between forest and cultivated land he performs the threatening *ju-ju* dance, warning the women away from the dark jungle.

In the rest of Cameroon, where the colonizers' imprint is stronger, the old gods no longer command such respect. Perhaps their role will be taken up by conservationists who also want to protect the rainforest, albeit with modern methods. ●

Erika Bjerström is an environment reporter with Dagens Nyheter, Sweden's largest daily newspaper.



U.S.-AFRICA

Debt Initiative May Be Lasting Summit Legacy

ABIDJAN – The first African-African American Summit was one man's dream, and many people thought, up until the last moment, that he couldn't pull it off. Funding was uncertain, confirmations of participation were slow to come in, and logistical problems threatened to swamp the organizers.

But when the Reverend Leon H. Sullivan stood onstage in the Hotel Ivoire, hands upraised and face streaming with tears, leading a chorus of "The Battle Hymn of the Republic" to the cheers of hundreds of delegates, few doubted that his vision had power. If some of the African participants, raised in more formal cultures than their American cousins, were not wholly at ease with all the fervor, they were ready, nevertheless, to welcome the intent.

"If black Americans can organize around an issue like debt relief," said Tanzania's deputy foreign minister Abdou Kinana, "it could be of immense benefit to Africa."

The occasion was a late-April meeting in Côte d'Ivoire's cosmopolitan capital that drew over 500 Americans as well as five African presidents, one vice-president, and numerous cabinet officials from around the continent. The Summit was conceived by Sullivan, a 68-year-old Baptist minister and businessman who founded a Philadelphia-based job training program in 1964 and recently established a foundation to encourage corporate and institutional involvement in development projects, primarily in Africa. In African circles, he is perhaps best known for his "Sullivan Principles," a 1977 code of conduct for U.S. companies operating in South Africa.

"Africa is the forgotten continent," Sullivan said in an interview. He said a broad, national campaign by African Americans and other friends of Africa offers the only prospect for putting Africa on the U.S. foreign policy agenda.

Terri Hultman/Africa News

Rev. Leon H. Sullivan rouses the Summit delegates with a plea to build a bridge for the future between Africans and African Americans.

C. Payne Lucas, the president of Africare, a Washington, D.C.-based development agency, came to Abidjan because he agrees with that assessment. "Africa's future," he said, "is tied to building a strong African American constituency at home. This conference represents an opportunity to help fashion that new constituency."

Although the focus of the three-day meeting often seemed diffuse, the final sessions offered the prospect that the results could be concrete. A delegation of Congressional representatives, led by House majority whip William H. Gray III (D-PA), pledged to work for an additional $200 million in development assistance for Africa in the 1992 budget. In a speech to the conference, Gray also stressed a theme that had been largely absent from the public discussions – the widespread African movement for greater democracy and human rights. "Human rights must be in the forefront of our relationship," Gray said, "and this principle must apply to all of Africa."

African diplomats at the conference seemed to have a mixture of hope and skepticism about the outcome as they interacted with delegates, many of whom were on their first visit to Africa. Some Africans noted that the attempt to build a voice for Africa in the U.S. is already being pursued by groups like the African American lobby TransAfrica, and that the effort requires a persistent and patient commitment more than an emotional catharsis. But many said any new recruits to the cause of raising Africa's profile are urgently needed, at a time when the continent is feeling increasingly bypassed in world affairs.

"A major goal of this meeting," said Summit planning committee member Sheila Walker, from the University of Texas at Austin, "is to involve African Americans on a much larger and more institutionalized scale than ever before in the economic and social development of Africa."

Sullivan told the conference, in a rousing final speech, that 35 million black Americans pay $70 billion a year in taxes, and that their purchasing power gives them further clout. International companies that don't

Continued on page 18

DEBT INITIATIVE

Continued from page 4

pay fair prices for Africa's commodities, he warned, may find their own products left on the shelves when blacks spend their money.

Promising follow-up through a series of meetings and commissions, including a campaign to be taken to churches across the United States this fall, Sullivan said African Americans possess the power to force the government to help Africa deal with its debt.

Africans attending the meeting seemed in broad agreement that if the push to cancel the debt becomes a reality, the Summit could become the historically important event in African development that Sullivan imagined when he planned it. Even a lively public discussion of the issue in the U.S., said one, could aid Africa's campaign for some form of debt relief that will enable its economies to escape what Sullivan called the "millstone" around African necks.

Although Africa's total debt is smaller than that of Latin America or Asia, and often gets slight attention in international discussions on the third world debt crisis, Africa carries a heavier debt burden in relation to the size of its economies. Latin America's debt, for example, is 60% of its gross domestic product, whereas the percentage for sub-Saharan Africa is over 100%. Only Africa, among all the world's regions, is expected to grow poorer during this decade, a prospect largely attributable to the weight of its debt. African diplomats and economists are united in the view that a lifting of the debt burden could dramatically transform Africa's prospects.

But "unless African Americans are truly organized," says Africare's C. Payne Lucas, "there's little hope that Africa is going to get its share of American foreign policy interest and bilateral aid." On the other hand, he says, African Americans in an alliance with white Americans who care about the continent can create small miracles. The Africare chapter in Chicago alone, he says, has already raised $50,000 for child survival in Burkina Faso. And the NAACP, with 600,000 members, is asking every chapter to plant trees in Africa, where deforestation is among the most pressing environmental problems.

"This is a magic moment for Africa," Lucas says, "and Americans can help insure that the magic materializes." ■

Tami Hultman/Africa News

NAACP President Benjamin Hooks greets the president of Côte d'Ivoire, Félix Houphouët-Boigny.

Tami Hultman/Africa News

An elder stands as an honor guard for delegates arriving at the presidential palace.

Tami Hultman/Africa News

Traditional dancer entertains at the presidential palace in Yamoussoukro.

AFRICA

Amid Continent's Drama, Summit Ponders Future

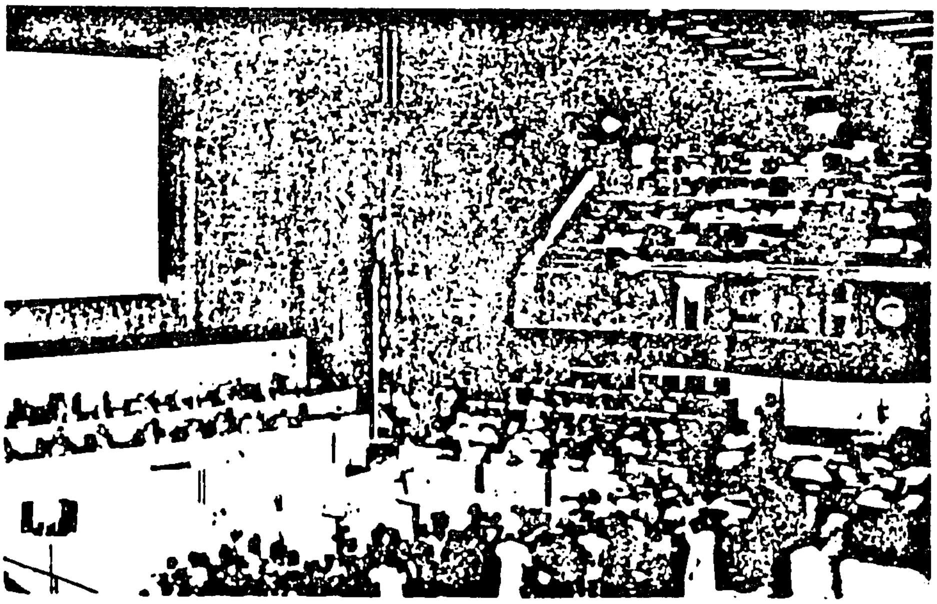
ABUJA, NIGERIA – When Zambian President Kenneth Kaunda was campaigning for his southern African nation's independence from Britain during the early 1960s, Soumana Sacko was the top student at Mopti Elementary School in the west African nation of Mali.

The presence of both men at this month's annual summit of the Organization of African Unity (OAU) was a metaphor for the dramatic changes sweeping the continent. At the age of 66, after 26 years in office, Kaunda is a remnant of the post-colonial generation whose largely autocratic style has dominated African politics until recently. The 40-year-old Sacko, a University of Pittsburgh-trained economist who became Mali's prime minister two months ago, represents the new technocrats whose ascendancy parallels the spread of pro-democracy movements in Africa.

Since the continent's leaders last assembled a year ago, nine of their number have been removed from office by elections or by coups stemming from pro-democracy uprisings. More than a dozen others have been forced to loosen their once-firm grip on power to accommodate demands for pluralism and accountability, and several more stand on the brink of ouster.

The stunning pace of change was evident in last-minute shuffles at the summit. Ethiopia's representatives were hurriedly switched, following the rapid collapse of the Ethiopian government as the four-day conference convened. And Algerian Foreign Minister Sid Ahmed Ghozali was summoned home by President Chadli Bendjedid, to become prime minister and take charge of his government's escalating confrontation with Islamic fundamentalists.

Against that backdrop, this year's OAU summit, meeting in the new Nigerian federal capital of Abuja, drew the largest turnout in a decade. Nigerian President Ibrahim Babangida, the incoming OAU chairman, sat the tone when he called for "a sincere embrace" of democracy in his opening address. He said African leaders should dismantle "all apparatus of unrepresentative power" by the end of the century.



Africa News

OAU leaders gathered at "Africa Hall" in Abuja, Nigeria's new federal capital.

Three dozen heads of state and government attended the Abuja meeting personally, and all but three of the 51 member states sent delegations. The old guard, like Zambia's Kaunda and Mobutu Sese Seko of Zaire, both under fire at home from advocates of greater pluralism, sat alongside Mali's Sacko and the newly-elected Carlos Viega of Cape Verde.

Some leaders attended despite their slipping hold on the reins of power. Cameroon's Paul Biya and Gnassingbé Eyadèma of Togo calmly took their seats, even as protest strikes and demonstrations, demanding their resignations, brought normal life to a halt in both countries.

The same concerns that are fueling the push for more accountable government across the continent also dominated the agenda of the summit – how to attack Africa's crippling economic crisis and end the wars that plague every region.

The main order of business was the approval of a treaty establishing an African Economic Market, similar to the European Community. The treaty calls for the removal of barriers to inter-African trade and travel and the promotion of development through economic integration. The goal is to establish an Africa-wide economic union with a single currency, leading to a Pan-African Parliament with members elected by "continental universal suffrage."

But the creation of a fully-functioning structure is slated to take over three decades. After the treaty-signing ceremony, World Bank President Barber Conable urged Africa's leaders to take the necessary next steps to make the far-reaching design a reality.

Ugandan President Yoweri Museveni, the outgoing OAU chairman who oversaw the drafting process, told his counterparts that integration offers the surest means for reversing what he called "Africa's dismal economic performance in the 1980s." Small markets created by inherited national borders present a major obstacle to growth and development, he said.

For the treaty to take effect, ratification is required by two-thirds of OAU member states, a goal Nigeria's Babangida said he will seek to achieve during his one-year term as organization chair.

But as the leaders moved towards union, they found themselves confronted by countervailing pressures towards greater divisions. Much of an eight-hour closed session on the third day of the summit was taken up with consideration of the regional conflicts that are responsible for so much of Africa's suffering and devastation.

The OAU, from its founding in 1963, has recognized the often irrational colonial boundaries and has upheld the "territorial integrity" of member states so the leaders were quick to condemn the recent secessionist move in northern Somalia. A summit resolution calls upon the Somali National Movement to rescind its secession declaration and work for the unity of the country. The African leaders endorsed efforts by Egypt, Djibouti, Sudan and Uganda to convene a national reconciliation conference of all Somali parties to find a democratic solution to the conflict.

The summit also established a five-nation committee, headed by Babangida, to work for the speedy establishment of a broad-based transitional administration in Ethiopia. A three-person delegation representing the interim Ethiopian government, which took power following seizure of the capital by rebels, assured the OAU that the new coalition is committed to the creation of a democratic Ethiopia.

Fighting in the east African nation of Rwanda sparked some of the sharpest exchanges of the conference, participants reported. Rwandan President Juvénal Habyarimana harshly accused Uganda's Museveni of backing last October's invasion of Rwanda by exiled government opponents, most of them members of the Ugandan National Army who helped bring Museveni to power. But Museveni denied the charge and pledged his cooperation for the five-nation mediation effort led by Zaire's Mobutu, which won summit endorsement as well.

The summit also took decisive action aimed at resolving another conflict, the civil war in Liberia. That action came not in the form of a resolution or debate but from the decision to seat Acting President Amos Sawyer, leader of the interim government in Monrovia. A two-man delegation representing rebel leader Charles Taylor, which arrived in Lagos during the summit, was not allowed to come to Abuja to take part

The African Economic Community – Excerpts From the Treaty

Objectives

1. To promote economic, social and cultural development and the integration of African economies in order to increase economic self-reliance and promote an endogenous and self-sustained development;

2. To establish, on a continental scale, a framework for the development, mobilization and utilization of the human and material resources of Africa in order to achieve a self-reliant development;

3. To promote cooperation in all fields of human endeavor in order to raise the standard of living of African peoples, and maintain and enhance economic stability, foster close and peaceful relations among member states and contribute to the progress, development and economic integration of the continent; and

4. To coodinate and harmonize policies among existing and future economic communities in order to foster the gradual establishment of the Community... .

The Community shall be established gradually in six stages of variable duration over a transitional period not exceeding 34 years.

First Stage (not to exceed five years):

Strengthening of the existing regional structures [such as the Economic Community of West Africa (Ecowas) and the Southern African Development Coordinating Conference (SADCC)] and establishing them in regions where they do not exist.

Second Stage (not more than eight years):

Standardization of tariffs, customs, duties and internal taxes within regional communities; strengthening of regional and continental trade, agriculture, industry, transport and communication; and the harmonization of activities among the regional groupings.

Third Stage (not greater than 10 years):

At the level of the regional communities, establishing a Free Trade Area for intra-regional trade and a customs union for external trade.

Fourth Stage (within two years):

Harmonization of tariffs among the various regional groupings with a view towards adopting a common external tariff.

Fifth Stage (not greater than four years)

Adoption of common policies for agriculture, transport and communications, industry, energy and scientific research; harmonization of monetary, financial and fiscal policies; the application of free movement of persons; and the establishment of budget procedures for the community.

Sixth Stage (within five years):

Consolidation of an African Common Market entailing free movement of people, goods, capital and services; establishment of a single market and a Pan-African Economic and Monetary Union, including a single African currency; creation of a Pan-African Parliament and election of its members by universal suffrage; establishment of African multinational enterprises in all sectors; and the creation of executive organs for the Community.

in the deliberations.

Sawyer was welcomed with full honors, including a 21-gun salute and a police-escorted motorcade, and seated along with other government chiefs at the conference. It was a diplomatic breakthrough for Sawyer's administration, which controls the capital Monrovia while Taylor holds much of the rest of the country. Several other African governments are expected to follow Nigeria's lead and reopen their diplomatic missions in the country.

On the question of South Africa, the leaders chose to reiterate previous declarations linking the removal of sanctions to greater progress towards majority rule. However, in recognition of the erosion in sanctions now taking place and the changes already underway in South Africa, the summit authorized Babangida, as OAU chairman, to initiate a review of this position when conditions warrant "readmitting South Africa into the international community" (see page 13).

The summit also agreed to endorse Babangida's call for a study of reparations to repay Africa for damages incurred from colonialism and slavery. The OAU is to establish a panel of "eminent" persons from Africa and the African diaspora to examine the issue. "We need to carefully collect and record the evidence so that even the most unsympathetic judge will have to rule in favor of Africa," Babangida said.

Looking ahead to the election of a new United Nations secretary general later this fall, the leaders agreed it is time to have one of their own in the post. Addressing the assembly on opening day, Javier Perez de Cuellar, the current UN chief who is leaving the job at the end of the year, said Africa "deserves to be given a chance" when the selection is made.

Looking ahead to the election of a new United Nations secretary general later this fall, the leaders agreed it is time to have one of their own in the post.

The leaders failed to agree on a single candidate, despite speculation that Babangida was seeking to win endorsement for his old commanding officer, former head of state Olusegun Obasanjo. Summit participants said consensus was ruled out in advance by fierce resistance to any Nigeria-led effort from countries like Zimbabwe, who has a candidate of its own (see *Africa News*, May 20, 1991). Instead, the leaders established a five-member committee of African United Nations ambassadors to screen potential candidates and coordinate the election effort.

The leading contenders, in addition to Obasanjo, are Ghana's Kenneth Dadzie, a veteran United Nations official who heads the UN Conference on Trade and Development (UNCTAD), Sierra Leone's James Jonah, the UN undersecretary-general for political affairs, and Zimbabwean Finance Minister Bernard Chidzero. Other well-known figures who have received mention are Olara Otunnu, a former Ugandan foreign minister who heads the International Peace Academy in New York, Senegalese President Abdou Diouf, and former foreign minister of Nigeria Joseph Garba, who was president of the last session of the United Nations General Assembly.

Pledging to wage "a vigorous campaign" for Africa's candidature, Babangida said that by fielding several strong candidates the continent could enhance the chances that one would emerge with sufficient support from the permanent members of the Security Council, particularly the U.S., which dominate the selection process. ■



Africa News photos

Taking their seats but under siege at home (l-r): Presidents Mobutu Sese Seko of Zaire, Paul Biya of Cameroon and Gnassingbé Eyadèma of Togo.

WASHINGTON TIMES
June 18, 1991

CAMERON DUODO

Arms and Africa's military spenders

At this year's summit conference of the Organization of African Unity held at Abuja, Nigeria, African heads of state put their signatures to a document that commits their countries to establish an African Economic Community within the next 30 years.

Their hope is that by turning the continent into a vast single market with trade preferences of the sort enjoyed by members of the European Community, African economies will take off and reduce the misery that is the lot of the majority of the continent's people today.

But instead of setting their sights too far into the next century, the heads of state should have taken a close look at a report just issued by the United Nations Development Program. The "Human Development Report" shows that since the majority of African countries gained their independence in the 1960s, they have been spending enormous sums of money on their armies.

The result has been that their social services — education and health in particular — have deteriorated deplorably and their quality of life has sunk to levels that no one foresaw 30 years ago.

Whereas in Japan average life expectancy at birth is 78.6 years, it is only 42 n Sierra Leone and 43.5 in Guinea — both in West Africa. But whereas Japan spends only 1 percent of its GNP on the military, Sierra Leone's works out at 1.2 percent while Guinea's is 3 percent.

Ironically, the African countries afflicted by the worst cases of drought and famine are also among the highest military spenders. Ethiopia, Mozambique, Sudan and Somalia — countries in which about 20 million people are in serious risk of dying from hunger — are all in the big military spending league.

Because of its long — and eventually futile — attempt to use arms to crush the rebellions in Tigre and Eritrea, Ethiopia has been spending 8.8 percent of its GNP on defense, followed by Mozambique, 7 percent; Sudan, 5.9 percent, and Somalia, 4.4 percent.

Angola is the biggest spender of them all, however, with 12 percent of its GNP devoted to military expenditure.

But fortunately, the situation there is likely to change rapidly for the better, because of the peace agreement currently in force between the government of President Edouardo dos Santos' MPLA (Popular Movement for the Liberation of Angola-Workers Party), and Jonas Savimbi's UNITA movement (National Union for the Total Independence of Angola).

Poor Ethiopia, on the other hand, appears set to continue being saddled with a huge arms bill, with the Ethiopian People's Revolutionary Democratic Front feeling the need to consolidate its tenuous hold on Addis Ababa.

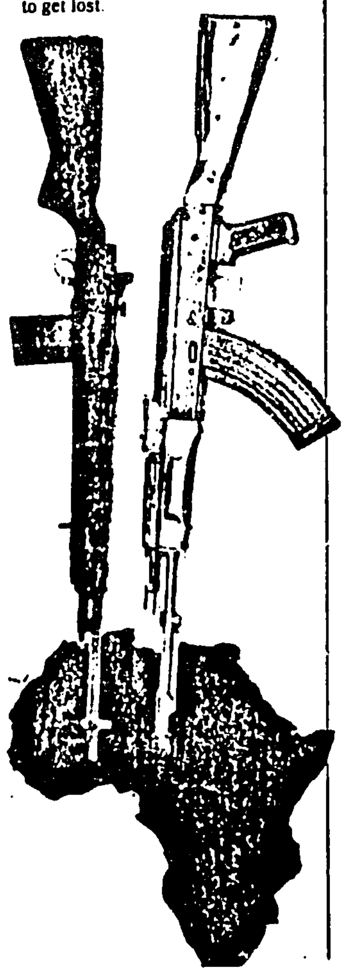
At the same time, Ethiopia will be entering into difficult negotiations with the elements in the country that have a tendency to secede, and each side would like to feel strong at the negotiating table by having a lot of "military muscle" behind it. All of this means that arms merchants rather than food contractors may be the people who will have the politicians' ears.

Unlike other documents that emanate from the stables of international civil servants, the UNDP report does not pull punches in blaming Africa's poor performance on its governments. Instead of merely lumping each country's national income together, dividing it by population and ranking the country according to the result (GNP per capita), the UNDP has introduced a "human development index" that takes "longevity" of life, "knowledge" and "decent living standards" into account in drawing up a table of nations.

Its objective was to attempt to "reflect, if still too dimly, how economic growth translates into human well-being." When such criteria are used, 14 African countries — Angola, Benin, Congo, Cameroon, the Ivory Coast, Djibouti, Gabon, Guinea, Mauritania, Namibia, Senegal, Seychelles, Sierra Leone and Sudan — are demoted no less than 20 places downward.

The report comments: "[These countries] have considerable potential to improve their human development levels — by spending their income better and planning their investment priorities more wisely."

In other words, African countries should learn to tell the arms dealers to get lost.



Cameron Duodo writes for the London Observer. This article was distributed by Scripps Howard News Service.

27

PN-ACF-[illegible]

ASIA
QUARTER 2, 1991

WASHINGTON ECONOMIC WATCH

A Digest of Development Policy Information

A Project of the Overseas Development Council

278

P.S. Please Note:

ASIA

"Foreign Investment in Asia Will Remain Strong," World Bank News, April 4, 1991.

Tsiang, Sho-Chieh. "Why Some Succeed," Economic Insights, March/April, 1991.

Chow Gregory C. "China's Economy: The Case for Strong Growth," Economic Insight, May/June, 1991.

Tolley, George S. Urban Housing Reform in China, An Economy Analysis, World Bank Discussion Papers, No.123, April, 1991.

Lasater, Martin L. A Step Toward Democracy: The December 1989 Elections in Taiwan, Republic of China, American Enterprise Institute for Public Policy Research.

Eagleburger, Lawrence S. Statement before The House Committee on Foreign Affairs, June 21, 1991. (Conclusion)

Cloud, David S. "House Critics of Bush Policy Unite on China Trade Bill," Congressional Quarterly, June 15, 1991.

Lash, William H. "Bangladesh's Really Terrible Unfair Trade Practices," The Christian Science Monitor, May 20, 1991.

Gotur, Padma. "Bangladesh: Economic Reform Measures and the Poor," International Monetary Fund Working Paper, IMF, April 1991. (Abstract and summary)

Doherty, Carroll J. "House Votes to Tie India Aid to Halt in Nuclear Arms," Congressional Quarterly, June 15, 1991.

Winkler, Claudia. "India's Travail Born of Communal Strife," Washington Times, May 23, 1991.

Rosett, Claudia. "Rajiv's Promises, India's Deferred Dreams," The Wall Street Journal, May 23, 1991.

"Indonesia," Pacific Economic Outlook 1991-1992, The Asia Foundation's Center for Asian Pacific Affairs on behalf of the Pacific Economic Cooperation Conference, San Francisco, May, 1991.

Boucher, Richard. Joint US-Laos Statement, US Department of State Dispatch, May 13, 1991.

"The Next Priority," World Link, Volume 4, Number 3, May/June 1991.

Smadia, Claude. "Malaysia: Objective 2020," World Link, Volume 4, Number 3, May/June 1991.

"Mongolia Takes Steps to Join Global Economy," World Bank News, June 20, 1991.

"Philippines," Pacific Economic Outlook 1991-1992, The Asia Foundation's Center for Asian Pacific Affairs on behalf of the Pacific Economic Cooperation Conference, San Francisco, May 1991.

Gulde, Anne-Marie. "Sri Lanka: Price Changes and the Poor," International Monetary Fund Working Paper, IMF, May 1991. (Summary)

"Thailand," Pacific Economic Outlook 1991-1992, The Asia Foundation's Center for Asian Pacific Affairs on behalf of the Pacific Economic Cooperation Conference, San Francisco, May 1991.

Survey Report on Vietnam, Population Today, Population Reference Bureau, April 1991.

Nelson, Kelly S. "Resume Normal Relations With Vietnam," The Christian Science Monitor, May 14, 1991.

O'Brien, Heather M. "Jump-Start for Cambodia," The Christian Science Monitor, May 21, 1991.

William, Larry. Statement before the House Banking Subcommittee on international Development, Finance, Trade and Monetary Policy, May 30, 1991.

"Driftnets Bill Gets Senate Hearing," Weekly Bulletin Environmental and Energy Study Institute, June 17, 1991.

Wong, Chorng-Huey. "Market-Based Systems of Monetary Control in Developing Countries: Operating Procedures and Related Issues," International Monetary Fund, April 1991.

Foreign Investment in Asia Will Remain Strong

The economies of the Asia-Pacific region will continue to attract foreign investment in the 1990s, a group of experts concluded during a meeting in Honolulu, Hawaii March 26-28.

The meeting was cosponsored by the Foreign Investment Advisory Service (FIAS), the East-West Center, and the United Nations Development Programme. FIAS is managed jointly by the International Finance Corporation and the Multilateral Investment Guarantee Agency.

According to Dale Weigel, manager of FIAS, "South Asia in particular will continue to receive growing foreign direct investment flows because of the open economic policies and favorable attitudes of governments in the region to foreign investment and private sector development."

China will be attractive to foreign investors mostly because of its huge market and tremendous economic potential, the meeting's participants agreed. Meanwhile, economies moving away from central planning--such as Vietnam--are making progress in opening up to foreign investors. According to Boris Volic, FIAS program manager for Asia and the Pacific, these countries still face the challenge of "developing and implementing appropriate economic, regulatory, and institutional policies and strategies to create an environment more conducive to foreign direct investment."

282

DEVELOPING WORLD

Why Some Succeed

Sho-Chieh Tsiang
Success or Failure in Economic Takeoff

CIER, (Chung-Hua Institution for Economic Research), Monograph Series, No. 26, 1989. Taipei, Taiwan, Republic of China.

S.C. Tsiang addresses a fundamental question in economic development: why and how do some poor countries manage to take off into sustained growth while others remain mired in poverty? The evidence of the Far Eastern Tigers provides essential clues. Professor Tsiang builds them into a simple but original development model that he then applies to a wide range of developing countries.

Tsiang makes three important changes to Robert Solow's 1956 economic growth model. (1) He introduces a fixed quantity of natural resources as one element of the production function; (2) He makes population growth (and with it the supply of labor) a function of the real wage rate. At low levels of income, the relationship is positive as the death rate declines with higher income. Beyond a certain point, however, the curve flattens out and may even start to decline. (3) He introduces a marginal propensity to save that rises with income, at least up to a certain income level.

With these assumptions grafted onto a standard production function, takeoff is by no means assured. A poor country can be trapped in a low income equilibrium, with the real wage close to the subsistence level and not enough saving to produce a rising real wage for a growing population.

Such a country has four options to free itself from that trap:

- population control;
- stimulation of savings by propaganda or tax incentives;
- improvement of the production function by new technology or by greater reliance on the international division of labor through the liberalization of foreign trade; and
- on a temporary basis, the attraction of capital from abroad through borrowing or foreign aid.

The condition for self-sustained takeoff without reliance on foreign capital is found to be a savings rate in excess of the capital/output ratio times the rate of population growth. Thus, for example, the economy of Taiwan had remained stagnant at an extremely low income level in the 1950s, with a savings rate of only 5 percent. It took off in the 1960s as the savings rate rose to 20 percent and higher—well in excess of a capital/output ratio of about two times the rate of population growth that fell below 3 percent. Taiwan relaxed controls over bank interest rates, allowing rates to rise above the inflation rate, and liberalized trade policies, leading to the development of export industries. Data presented for Korea, Hong Kong and Singapore show a broadly similar story.

By contrast, India and Thailand are shown to hover around the takeoff point without ever reaching spectacular growth. In Thailand, saving did not rise steeply enough, and India suffered from a capital/output ratio of four or more due to an excessive emphasis on capital-intensive investment and insufficient reliance on the benefits of foreign trade. (China's failure to take off, at least until well into the 1980s, is attributed mainly to a capital/output ratio even worse than that of India.) For similar reasons, a number of Latin American countries, as well as the Philippines (all had reached takeoff speeds in the 1960s and 1970s) suffered reversals in the 1980s. The poor performance of Morocco and Tanzania is attributed mainly to inadequate savings ratios, kept low by the imposition of artificially low interest rates.

S.C. Tsiang is president of CIER (Chung-Hua Institution for Economic Research), Taipei, Taiwan and a former professor of economics at Cornell University.

282

REPORT ON CHINA

CHINA'S ECONOMY: THE CASE FOR STRONG GROWTH

by Gregory C. Chow

In late June 1989, soon after the tragic event in Tiananmen Square, I predicted that China would enjoy an annual growth of real output of about 7.5% over the next decade. It is therefore reassuring to read in *China: Between Plan and Market* (World Bank Country Study, 1990) that "... the latent dynamism of [China's] productive sectors will enable the economy to continue growing during the 1990s at rates (once the contractionary policy is eased) that would be considered very respectable in most countries."

This well-written and informative report was prepared by a mission headed by Shahid Yusuf that visited China in 1989. It discusses economic trends since June 1989, the government's policy intentions, medium term economic prospects, and the country's creditworthiness. It analyzes government proposals for further economic reforms and advances its own suggestions. A statistical annex provides 71 pages of tables on many important aspects of the Chinese economy to 1989.

In reviewing the onset and government response to the inflation crisis that preceded the Tiananmen Square events, the report recalls that in June 1988, the government announced plans for a major price reform to be implemented in 1989. Subsequently, inflation worsened as consumers switched in some panic from financial into real assets, and prices that had been rising at annualized rates of 10–15% in early 1988 soared to rates approaching 80% by August (for a short period). The government postponed further price liberalization and adopted a series of stabilization measures, including administrative guidelines to reduce state investment, a contractionary monetary policy based mainly on the administrative allocation of credit, and direct controls on prices and marketing.

These steps sharply cut the rate of inflation, and, together with curbs on imports of consumer goods, reversed a trade imbalance of about $6.7 billion in the third quarter of 1989 to a surplus of $4.54 billion in the first half of 1990. Industrial growth fell throughout 1989, becoming negative in the last quarter, but then recovered, rising 2% in the first half of 1990. Urban unemployment worsened, reaching 2.7% by the end of 1989, and over 5.5% in the first half of 1990.

The report sums up the short-term implication of the events of June 1989 as: a somewhat lower growth rate; smaller trade and current deficits; greater unemployment; the possibility that certain reforms will be postponed for a longer time than was expected in May 1989; partial withdrawal of investors from OECD countries; a fall in tourist traffic from Western countries which has also forced a rescheduling of various hotel loans; and greatly reduced access to the international capital market, which is now compelling China to seek trade and current account surpluses to manage its external transactions.

Nevertheless, the World Bank team concludes that the country's growth as well as export potential are substantial and savings behavior is likely to remain stable. Furthermore, its study finds that projections based on reasonable assumptions regarding macroeconomic policies and the continuation of reform show creditworthiness remaining secure over the 1990-1995 period.

Political development is important in its own right, but it is unlikely to have much effect on the rate of economic growth.

The number of applications for foreign direct investment proposals fell after the events in June and, unless the earlier momentum is regained, this could affect capital inflows for a few years. Foreign investors have made a major contribution to the development of services, oil exploration, and export-oriented manufacturing industries, and the report underscores the importance to China's economic modernization of the maintenance of these capital flows.

To revive interest among overseas investors, the authorities have begun leasing land for development purposes for up to 70 years in the "open cities" and Special Economic Zones. The government has also enhanced incentives for Sino-foreign equity joint ventures. However, the World Bank study points up such continuing difficulties as the time-consuming negotiations that precede any agreement; the high charges for land use, energy and infrastructure; and difficulties with the enforcement of contracts under China's legal system.

By and large, I agree with the descriptions and assessments of the World Bank study. What accounts, then, for "the latent dynamism" of China's productive sectors?

First, almost 60% of China's national product is from market-oriented producers seeking profits, including almost all of agricultural products (32.1% of national income in 1989; see 1990 *Statistical Yearbook of China*, p. 37), about 35% of industrial output (47.5% of national income) that is produced by private, rural collective and some urban collective and local government enterprises, about half of construction output (5.9% of national income) perhaps one tenth of transportation (3.9%) and six tenths of commerce (10.6%). Second, China is an open economy benefitting from foreign trade, with the total value of its exports and imports accounting for 28% of its GDP in 1989. Third, foreign investment is an important driving force.

Concerning foreign investment, I wrote in *Princeton Alumni Weekly* (Sept. 1989, p. 17), that, "New foreign investment has slackened not because of morality, but because investors are recalculating their risks. As long as investors believe that investment in China will be profitable and not unduly risky, they will continue to invest." This applies especially to the people in Hong Kong and Taiwan, even though they had a much stronger emotional reaction to Tiananmen Square than others. Economic dependence on China is stronger in these two lands than elsewhere. Using low-cost labor in China, manufacturers in Hong Kong and Taiwan can compete effectively in the world market, so their entrepreneurs have powerful incentives to maintain their manufacturing facilities in China and to establish new ones. Investment and trade from other Asian nations, including

235

Japan, South Korea, and Singapore, have been affected only slightly by the unrest.

The possible influence of Hong Kong investments on China's economic growth is summed up by a leading entrepreneur, Gordon Wu, who remarked in *Hong Kong Business* (January 1990, p. 4), "We can turn much of south and central China into a suburb of Hong Kong."

My view of the economic prospects of China has remained unchanged since late June 1989, and my expectation is for an average annual growth rate of about 7.5%, a percentage point higher than the government's new five-year plan goals.

Worries are expressed about possible renewal of high inflation over the next several years, but I believe this is most unlikely. Inflation, together with corruption, contributed greatly to the political unrest in 1989, and the government will therefore make the utmost effort to prevent its renewal.

Direct controls, which China has used effectively to control inflation and would again if necessary, also have been used to help correct the trade imbalance. This has drawn criticism from trading partners, particularly the United States, where they have added fuel to the effort to remove most favored nation status. Such retaliation, I believe, could do little more than moderate the growth of Chinese exports over the coming years, since so many of them enter world markets through third countries.

Many people continue to be concerned over political development in China. Political development is important in its own right, but it is unlikely to have much effect on the rate of economic growth in the 1990's. The rate of growth depends mainly on the nature of the existing economic institutions, which allow for substantial market oriented (including foreign) profit seeking activities to take place. These resilient economic institutions, solidified by the vested interests of the rural, urban and especially coastal residents and bureaucrats who benefit from them, are unlikely to be seriously affected by foreseeable political changes. Attempts by central political authorities to achieve further economic reforms, or even to move the economic system backwards, are unlikely to change significantly these economic institutions in the 1990's.

Dr. Chow is Class of 1913 Professor of Political Economy and Director of the Econometric Research Program at Princeton University. He is a past advisor to China's Premier Zhao Ziyang and former advisor to the chairman of the Economic Planning Council in Taiwan.

286

American Enterprise Institute for Public Policy Research

AEI

Book Summary

A Step toward Democracy: The December 1989 Elections in Taiwan, Republic of China

By Martin L. Lasater

This volume describes the 1989 election results in Taiwan and assesses internal conflicts over independence and a continuing threat from the mainland. A summary of the book follows.

On December 2, 1989, the Republic of China (ROC) on Taiwan held elections at the national, provincial, and local levels. Seven hundred twenty-two candidates competed for 293 legislative seats in what many considered an important test for democracy on Taiwan. For the first time since withdrawing to Taiwan following its 1949 defeat by the mainland Communists, the ruling Kuomintang party (KMT) competed for the right to govern with other major political parties.

The elections were also the first since martial law was lifted in June 1987, the first since the legalization of new parties in February 1989, and the first in which a majority of the candidates were selected through party primaries. The number of seats contested was the largest since the 1947 mainland elections, giving voters an opportunity to demonstrate their preferences under conditions most observers thought were fairer than previous elections on Taiwan.

Voter turnout was over 75 percent of registered voters. The KMT won about 70 percent of the seats and about 60 percent of the vote; the Democratic Progressive party (DPP) won about 22 percent of the seats and 31 percent of the votes, with other parties splitting the remainder.

But there were more fundamental issues involved. Over the past decade, Taiwan's political environment has changed dramatically. The KMT has gradually withdrawn as overseer of the island's political, economic, and social institutions, and its unifying role has been lessened. As a result, people on Taiwan are becoming increasingly self-reliant and independent. Special interest groups—labor, students, farmers, business, even the homeless—are organizing to demand their rights. These groups have tried various tactics, including a limited use of violence, to articulate their views and win services.

To some extent the DPP has played a negative role in this process because of its highly visible confrontations with the KMT. It also scored its greatest success in local elections, however, and now governs roughly half of the territory of Taiwan and 35 percent of its population.

Taiwan in Transition

Taiwan is a classic example of a country making the difficult transition from an authoritarian regime to a democracy. All

1150 Seventeenth Street, N.W., Washington, D.C. 20036, 202/862 5800

the elements of hope and danger that such a transition entails can be found there, along with numerous conditions that are uniquely Chinese.

One of the principal problems confronting Taiwan is that democratization occurred without there first being adequate legal and procedural mechanisms in place. Within a remarkably short period of time, President Chiang Ching-kuo lifted martial law, permitted the formation of opposition political parties, removed restrictions on some forms of contact with mainland China, and instituted reforms within the KMT and ROC government. But Taiwan needs a more robust legal and political framework if democracy is to work efficiently, as many bureaucrats still have not caught up with these reforms and subsequent events.

Without question, the "wild cards" in Taiwan's politics are the DPP and other opposition parties. If on the one hand these opposition groups decide to pursue their interests through legitimate channels, then democracy will flourish on Taiwan. On the other hand, if the DPP or other parties try to undermine Taiwan's political system as a shortcut to power, then a return to martial law or military intervention by the People's Republic of China (PRC) cannot be ruled out.

The Debate over Independence

Until 1987, it was illegal to promote Taiwan's independence. In that year the DPP held a number of demonstrations in support of Taiwan's "self-determination," a code word for independence. The subsequent public debate, largely critical of the demonstrations, suggested that independence was still considered a dangerous idea by the majority of Taiwanese. And yet the idea may be more dormant than dead, despite the fact that differences between the mainlanders and the Taiwanese are fast disappearing because of intermarriage, a common educational system, equal opportunities in public service, and over four decades of a common culture.

By introducing democracy on Taiwan, the KMT has taken a great risk. Thoughtful party leaders must ask themselves whether it is possible for any ruling party, after forty years of unchallenged power, to democratize and still preserve its leading role through free elections. Many still believe the Republic of China must remain under a form of political tutelage, with the ruling party directing the evolution of democracy from the top down. For now, the ruling party has strong institutional advantages that most members do not want to give up. Yet there is recognition that the KMT must reform if it is to appeal to voters. The election results may be a sign that the ruling party is not reforming fast enough.

For its part, the DPP wants democracy to evolve from the bottom up, not the top down. But if the DPP is serious about ruling Taiwan through democratic elections, it must act responsibly and appeal to mainstream voters. Since the KMT remains the ruling party, the DPP must cooperate with the KMT to solve the many immediate problems now facing the nation.

Some party members view this as a practical step to ensure the party's future. Others prefer to disrupt the functions of the existing government to promote policies that would result in an immediate change in the country's direction. If problems persist in Taiwan's transition to democracy, they will be largely attributable to the difficulty of finding a workable compromise on the issue of reunification or independence.

The Mainland Threat

A critical variable in Taiwan's future is the People's Republic of China. A democratic Taiwan presents major problems for the PRC, particularly if the issue of

Taiwan's independence looms in importance to voters. The Communist government in Beijing has said repeatedly that it will use force against Taiwan if the island declares independence, although Chinese analysts say that Beijing lacks a political reason to attack Taiwan under current conditions. Still, as part of its deterrent strategy, the ROC government sends very clear signals to the PRC that it will not allow Taiwan to become independent.

To the KMT, reunification of Taiwan with the mainland is a national goal. Party leaders often point out that Taiwanese are ethnically Chinese and cannot leave the mainland as a separate country. As a practical matter, Taiwan is too close to the mainland to be independent. As many as 90 percent of the Taiwanese people, the ruling party claims, want eventual reunification under the "Taiwan Experience." Less than 5 percent of the population are in favor of an independent Republic of Taiwan, although, the ruling party admits, few people actually support immediate or even near-term reunification.

DPP spokesmen, in contrast, argue that Taiwan's independence has become an issue because the people of Taiwan do not want to be part of the PRC. They point out that both the KMT and the Chinese Communist party are controlled by mainlanders who pursue policies that promote mainland interests first. At a minimum, the DPP wants a public discussion of this issue and then the opportunity for the Taiwanese to decide the future of Taiwan and its relationship with the mainland.

Despite the fact that some KMT and DPP candidates were elected on platforms including a commitment to reunification or independence, both parties generally agree that Taiwan's future cannot be solved now. They also generally agree that the main efforts of the government should focus on improving the quality of life on Taiwan and guaranteeing the security of territories currently under the control of the ROC government.

What Role for the United States?

The future of Taiwan thus is as yet uncertain. But what can be said with some degree of confidence is that the DPP's success in the elections and the emergence of Taiwan's independence as a public policy issue are potentially disruptive factors both in ROC-PRC relations and in U.S. relations with the two Chinese governments.

Although the probability of U.S. support for Taiwan's independence is small, given the likely adverse effect this would have on U.S.-PRC relations, that support should not be dismissed entirely, given the historical vacillation of U.S. policy toward China.

It is precisely because of the sensitivity of the Taiwan issue that the United States has found its interests best served by a continuation of the status quo in the Taiwan Strait. Officially, the United States supports a peaceful resolution of the Taiwan issue without prejudice as to whether Taiwan will be independent or reunited with mainland China. What matters to Washington is that the process of resolution be peaceful and supported by both Chinese governments. As the 1989 elections demonstrated, however, the role of the Taiwanese people in this process is a consideration that will probably grow in the future as Taiwan becomes more democratic.

The Democratic Future of Taiwan

Given the entrenched strength of the KMT, the probability of the DPP or another opposition party gaining control of Taiwan appears small for the remainder of this century. Nonetheless, the emergence of the DPP and its promotion of self-determination have introduced a degree of uncertainty in Taiwan's politics that makes the future difficult to predict.

As in the case of Taiwan's economic "miracle," the fundamental political changes under way on Taiwan generally serve U.S. political interests. Taiwan is rapidly becoming a democratic state; its observance of human rights is improving steadily. If the people of Taiwan can successfully adopt the rules of democratic behavior, the country may well become a political as well as an economic model for mainland China and other developing countries. This would benefit the people of Taiwan, help moderate policies on mainland China, and also advance U.S. interests in the Pacific over the next decade.

It should be recognized, however, that a quiet political revolution is occurring on Taiwan. No longer willing to accept tutelage from the KMT, the Taiwanese are assuming control over their own destiny.

This evolution in political consciousness carries vast implications for the KMT, Taiwan, China, and the United States. At minimum, the people on Taiwan will demand and receive greater opportunity to debate the issues confronting them. This will include open discussion of the pros and cons of Taiwan's independence, reunification, or maintenance of the status quo in the Taiwan Strait.

The PRC seems determined not to allow Taiwan to become independent, but the December 1989 elections suggest that the potential for the Taiwanese people to move in that direction is possible. Thus, the elections will likely be seen in Beijing as an indication that it will have to monitor events on Taiwan much more closely in the future.

In terms of the Chinese goal of national reunification, the Tiananmen incident and the subsequent political crackdown in Beijing could not have come at a worse time. The people of Taiwan are unlikely to support Taiwan's reunification, even under peaceful conditions, with a government on the mainland pursuing policies so at odds with their own standards of legitimate political behavior.

Indeed, from a historical perspective, the most significant casualty of Tiananmen Square may have been the possibility of Taiwan's reunification with the mainland at an early date. Peaceful reunification is still possible, but it will probably require at least four conditions: an agreement by the KMT and Chinese Communist party on the timing and specifics of reunification; a consensus among Taiwanese that their interests are best served by an association with mainland China; a return to economic, social, and political liberalization on the part of the PRC; and a credible U.S. commitment to a peaceful resolution of the Taiwan issue. Only the last of these existed as of the early 1990s.

Martin L. Lasater is president of the Pacific Council.

Statement
Lawrence S. Eagleburger
Deputy Secretary of State
House Committee on Foreign Affairs
June 21, 1991

V. CONCLUSION

This is the second year in a row I have testified before the Congress in support of the President's decision to renew MFN status for China. I know that this is an issue of enormous interest and controversy, and I anticipate probing questions from those who do not agree with our position. But this debate is a healthy one, because it shows the Chinese both how our democracy works and how concerned we all are with the human rights situation in that country.

Our concern with human rights in China and whether MFN should be conditional on progress in that or other areas has been a persistent issue for years. In 1979, the Congress posed that very same issue to then Deputy Secretary of State Warren Christopher, when he testified on behalf of the Carter Administration in support of the trade agreement with China that led to the granting of MFN. In response to that issue, Deputy Secretary Christopher made the following statements:

> "[T]his trade agreement does not imply an endorsement of their [human rights] practices or endorsement of their [human rights] policies .... It was not conditioned on anything. There was no linkage, to use that favorite word, in 1979.... [W]e think that the trade agreement stands on its own feet. It benefits both countries. It was not part of a bargain but it was certainly part of the normalizing process which is going on." 1/

1/ "United States-China Trade Agreement," hearings before the Subcommittee on Trade of the House Committee on Ways and Means, 96th Cong., 1st Sess., at 110, 115 (1979).

These words ring as true today as they did 12 years ago. MFN is not something to be turned on and off as reward or punishment for particular behavior. It is an underlying structural component of the relationship -- as much in our interest as that of the Chinese. It makes sense on its own terms, especially when we are dealing with a country as significant as China -- the home of over one-fifth of the world's population and a fellow permanent member of the United Nations Security Council.

That does not mean that we can guarantee a fixed amount of progress on human rights or other issues within a fixed time frame. But we are confident that, over time, the forces of an open economy and a free market will prove to be irresistible. Our goal is to remain engaged over the long-term with China in order to foster its return to the path of freedom.

As we assess our China policy, we need to keep a better balance between our fascination with the China of the 1970s and today's mood of disappointment and hostility. Scholars of U.S.-China relations have long noted the pendulum swings in public attitudes toward China: the "good China" wartime ally; the "bad China" of the Red guards and revolutionary repression. In the real world, we need to steady ourselves and set a policy that will be durable over time.

Tiananmen was a political explosion ignited by a decade of economic progress. The Government in Beijing contained that explosion -- temporarily, we believe -- but it cannot shut off the fuel which ignited it. How ironic it would be if we ourselves tried to do just that by forsaking our best tool for promoting China's economic opening to, and engagement with, the outside world. Denying MFN would work against the forces of economic change which themselves contain the seeds of eventual political reform, and it would play into the hands of hardliners who fear precisely such an outcome.

You might ask then why the Chinese hardliners do not seek to end an economic opening which carries such political risks and implications. Some of them would like to do that, of course. But others gamble that China can participate in the world economy, yet maintain indefinitely its antiquated and repressive political system. We believe they are wrong. We believe they will lose that gamble. But let us not make it easy for them by removing the element of choice. Let us not, by default, allow the hardliners to lead China back into an historically familiar isolation from which no good will come.

Gao Xin, one of the last four hunger strikers in Tiananmen Square, who spent six months in a Chinese prison, put it well when he wrote recently in The Washington Post: "Cancelling MFN would help the hardliners in what they have been unable to achieve on their own -- reassertion of control over the non-state and more progressive sectors of China's society and economy."2/ Put another way, withdrawal of MFN -- or even temporary extension under conditions that might not be met -- would risk the gains we have made now and can make in the future, and would punish the wrong people, both here and in China. In the end, we ought to decide not on what will express our outrage about human rights or other problems in China today, but on what will continue to permit us to encourage the process of reform in China tomorrow.

2/ The Washington Post, at A23 (June 4, 1991).

TRADE

House Critics of Bush Policy Unite on China Trade Bill

President Bush's prospects for preserving normal trade relations with China slipped further as key House Democrats agreed on legislation that would impose high tariffs on Chinese imports beginning in 1992 unless Beijing accounts for and releases prisoners arrested in Tiananmen Square protests.

The Democrats — Nancy Pelosi of California, Stephen J. Solarz of New York and Don J. Pease of Ohio — oppose the Bush administration's request for unconditional renewal of China's most-favored-nation (MFN) status, which provides for low, nondiscriminatory tariffs on Chinese imports. But the lawmakers disagreed about how tough a stance to take toward Beijing. *(Background, Weekly Report, pp. 1512, 1433)*

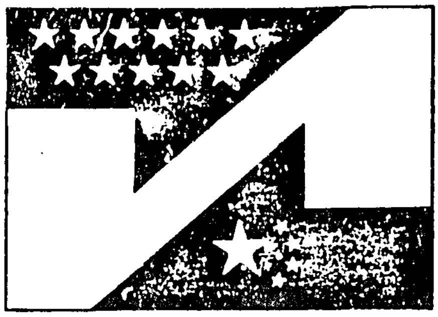
After negotiations the week of June 10, the three Democrats agreed to push legislation that would withdraw China's MFN status a year from now unless Beijing discloses the fate of protesters unaccounted for since the 1989 crackdown in the capital's Tiananmen Square and releases some of those arrested.

Further, the bill would require "overall progress" toward such goals as ending human rights violations, religious persecution, restrictions on press freedom, and harassment of Chinese students in the United States before China could receive MFN status in 1992.

Facing one of the toughest fights of his presidency, Bush has made a concerted appeal for a one-year, unconditional extension of China's MFN status. By joining together, Pelosi, Solarz and Pease hope to bolster their chances of winning a veto-proof margin when the House votes on their legislation, probably in July.

The compromise required Pelosi to accept a slight weakening of her bill. Solarz and, to a lesser extent, Pease, were uncomfortable with stringent conditions requiring Bush to certify that China had made specific improvements before he could renew its trading status. But they accepted her requirement concerning the Tiananmen Square protesters.

By David S. Cloud



"It allows us to present a united front," said Pelosi.

Majorities against Bush's position appear to be accumulating in both the House and Senate. Many lawmakers feel that Beijing has never been adequately punished for the 1989 crackdown and that renewing MFN for another year would send the wrong signal.

If they can put together the votes to override a veto some members believe they can force Bush to accept conditions. If Bush can block the two-thirds majority of the House and Senate needed to override, he can refuse to compromise.

"Any conditions that are meaningful ... will lead to a cutoff of a relationship that we think is important," Deputy Secretary of State Lawrence S. Eagleburger told the House Ways and Means Committee in a hearing on June 12.

Ways and Means must act by the end of the month on a resolution sponsored by Gerald B. H. Solomon, R-N.Y., withdrawing China's MFN status. The panel is considered likely to take up the revised Pelosi bill at that time.

Stakes Highest in Senate

To the administration, the revised Pelosi bill may look positively tame compared with the conditions that are being proposed in the Senate. Majority Leader George J. Mitchell, D-Maine, has introduced legislation that, in effect, would revoke MFN after six months.

In general, where Pelosi's bill requires "overall progress," Mitchell's measure lays out specific requirements that Beijing would have to meet to retain MFN status. They include releasing all political prisoners, ending religious persecution and restrictions on emigration, reducing China's trade surplus, and participating in international efforts to control arms proliferation.

Mitchell's bill has 28 cosponsors in the Senate, including two Republicans, Malcolm Wallop of Wyoming and Alfonse M. D'Amato of New York. Mitchell has said that a majority of the Senate supports his bill, although he does not claim a veto-proof margin.

If Bush prevails, he probably will do so in the Senate — either by seeing his veto upheld or by working out acceptable compromise conditions. Montana Democrat Max Baucus is pressing the administration to take punitive action of its own against China in order to mitigate the feeling among lawmakers that they must act.

"If Congress is to extend China's MFN, we must see tangible evidence that the administration is taking action," said Baucus in a letter to Bush being circulated among other senators for signatures.

Baucus calls for the administration to block loans to China by multilateral institutions, retaliate against China for its barriers to U.S. imports and use of prison labor, negotiate to prevent export of China's ballistic missiles, and drop U.S. opposition to Taiwan becoming a signatory to the General Agreement on Tariffs and Trade (GATT).

Baucus, chairman of the Finance Subcommittee on International Trade, shares the administration view that MFN is the wrong tool to force changes in China's human rights policies. But the administration seems unlikely to adopt all his suggestions, particularly since it has taken some retaliatory steps against China in recent weeks.

For example, the move that would most please conservatives in Congress — dropping U.S. opposition to Taiwan joining the GATT — is unlikely, since, as Eagleburger put it, "there is no question that China would go ballistic."

A crucial element will be the position taken by the chairmen of the two committees with jurisdiction over trade — Dan Rostenkowski, D-Ill., of House Ways and Means, and Lloyd Bentsen, D-Texas, of Senate Finance. It was Rostenkowski who urged Pelosi, Solarz and Pease to reach a compromise, and his blessing could speed the bill through the House. Bentsen met recently with Mitchell, and according to aides, promised that he would not bottle up Mitchell's bill in committee.

But neither Rostenkowski nor Bentsen has taken a position on renewing China's MFN status. ■

295

OPINION

Bangladesh's Really Terrible Unfair Trade Practices

By William H. Lash III

BANGLADESH, with a per capita income of $150, is one of the world's poorest countries. The people of Bangladesh are annually visited by floods, cyclones, and typhoons of truly epic proportions – most recently a storm claiming 125,000 lives. Still, Bangladesh bravely fights on. Indeed, despite its financial woes, Bangladesh contributed to Operation Desert Storm by sending a small detachment of troops to the Persian Gulf.

As Bangladesh struggles to survive, how do Americans thank them for their support and reward their steadfastness? Do we forgive their debts? Do we establish new businesses there? No. Corporate America and the protectionists have chosen to repay Bangladesh by attacking its fledgling economy with allegations of unfair trade practices, and threatening trade sanctions that would close US markets to certain exports.

At this point, even the most protectionist corporate, political, or economic observer must pause and wonder what export from Bangladesh could threaten or injure a US industry. Surely the US semiconductor, steel, and automobile industries can withstand competition from Bangladesh. No, the Bangladeshi are selling cheap rags in the US, and the vital area of our economy under siege from these "unfair practices" is the crucial "shop towel industry."

The US textile industry asserts that Bangladeshi manufacturers of "industrial wiping cloths," more commonly referred to as "shop towels," dump these products in the US markets. This petition to the US International Trade Commission was filed by Milliken & Co. Family-controlled, privately-held Milliken hired the large Washington, DC-based law firm of Wilmer, Cutler & Pickering to assert that the Bangladesh shop towel industry receives export subsidies from the Bangladesh government which materially injure the US market. Fortunately for Bangladesh, the US Department of Commerce has dismissed this claim, determining that the .02 percent export subsidy paid by Bangladesh to shop towel exporters is *de minimus*.

Unfortunately, the US International Trade Commission continues to investigate whether Bangladesh shop towels are dumped in the US. The allegedly dumped goods from Bangladesh in 1990 represent a mere $2.46 million. Milliken is estimated to have sales of over $2.5 billion annually.

Should Milliken and the multi-billion-dollar textile industry be threatened by Bangladesh's $2 million in shop towel sales? Milliken, the self-appointed team-leader in protecting the textile industry, earlier fought the same battle over shop towels – triumphantly repulsing the onslaught by the industrial giant, Pakistan.

The textile industry already has the protection of the Multi-Fiber agreement, which limits textile imports into the US. These textiles are produced in poor countries many of whom are faced with economic disaster. Textile sales often represent one-quarter of the manufacturing exports of less-developed countries. To ameliorate the economic harm caused by these quotas, the US provides foreign aid to replace the revenue these nations lose. In essence, the US is giving less developed countries international welfare to keep them from working. So much for the free market. It is time for the protectionists to stop using the trade laws to bludgeon manufacturers in less developed states. Milliken should quietly throw in the towel.

■ *William H. Lash III teaches international business, trade, and corporate finance at St. Louis University School of Law. He previously served as counsel to the chairman of the US International Trade Commission.*

2916

INTERNATIONAL MONETARY FUND

Asian Department

Bangladesh: Economic Reform Measures and the Poor

Prepared by Padma Gotur 1/

Authorized for Distribution by Christopher Browne

April 1991

Abstract

This paper assesses the impact on the poor of the economic reforms undertaken in Bangladesh under Fund-supported structural adjustment programs. It finds that program-induced changes in production, employment, and incomes have benefitted the poor, while the adverse impact of program-induced price changes has been modest. However, as adjustment efforts are intensified under the current structural adjustment program, more pronounced short-term adverse effects might arise, requiring compensatory measures. The paper reviews special assistance programs for the poor, including those designed to mitigate the potential adverse effects of adjustment, noting that improved targeting would yield sizable fiscal savings that could be used for strengthening social programs.

Summary

The Government of Bangladesh has addressed the difficult challenge of poverty reduction mainly by promoting economic growth through the policies undertaken in its adjustment programs. Since the trickle-down impact may not reach the poor in the short run and may altogether bypass the most vulnerable groups, the Government has also put in place targeted programs to assist such groups. The massive numbers of poor people and the shortage of budgetary resources have, however, constrained the scope of these efforts.

This paper assesses the impact on the poor of the economic reforms implemented under Fund-supported structural adjustment programs. It finds that structural measures have had a beneficial impact on the production, employment, and incomes of the poor, while the adverse impact of program-induced price changes has been modest. Nevertheless, as adjustment efforts are intensified under the ongoing program supported by the Fund's enhanced structural adjustment facility (ESAF), more pronounced short-term adverse effects might arise, requiring compensatory measures.

The paper also reviews special assistance programs for the poor, noting that improved targeting would yield sizable fiscal savings that could be used to augment these and other social programs.

The analysis concludes that the basic thrust of the Government's strategy of poverty reduction is appropriate. Given the past emphasis on ensuring national food security, the Government is now correctly turning its attention to improving the income-earning capacity of the poor by focusing on human resource development. Measures are likely to be needed, however, to compensate for the potential adverse effects of certain relative price changes under the ESAF program. It will also be important to continue to strive for improved efficiency of targeted programs, with a greater role provided to nongovernmental organizations.

291

FOREIGN AID

House Votes To Tie India Aid To Halt in Nuclear Arms

House and Senate authorization bills face veto over family planning proposals

Barred by law from receiving U.S. assistance, the government of Pakistan won a significant symbolic victory June 13, when the House voted to slap stringent economic sanctions on India, its chief rival in South Asia.

By a surprising 242-141 vote, the House approved an amendment from an unlikely alliance of lawmakers to prohibit U.S. aid for India if it attempts to increase its nuclear arsenal. By an equally lopsided vote of 151-252 on June 12, lawmakers rejected efforts to lift similar conditions that already have led to a cutoff of aid to Pakistan. *(Vote 155, p. 1616; vote 151, p. 1614)*

The votes came during House consideration of a foreign aid measure (HR 2508) that would authorize $12.4 billion for fiscal 1992 and $13 billion for fiscal 1993. After working on the legislation for much of three days, lawmakers have only completed about half the bill and will take it up again during the week of June 17.

Foreign aid also moved forward in the Senate during the week of June 10, as the Senate Foreign Relations Committee cleared an authorization measure on June 11 by a 17-2 vote. Both chambers' bills could be doomed: President Bush has pledged to veto them because they include provisions that would repeal U.S. policy on international family planning.

The bills would overturn the so-called Mexico City policy, which bars funding for any international family planning groups that "perform or actively promote abortion."

Bush has sent a letter to Congress reiterating his threat to veto bills that alter abortion policy. *(Letter, p. 1588)*

Even though the measures face serious obstacles — no foreign aid authorization bill has been enacted since 1985 — they are closely watched worldwide as indicators of U.S. policy. In effect, lawmakers told India and Pakistan: Terminate your nuclear programs or risk losing U.S. assistance.

By Carroll J. Doherty

PATTI CHISHOLM

BOXSCORE

Bill: Fiscal 1992-93 foreign aid authorization.

Latest action: House began debate on HR 2508 (H Rept 102-96) on June 11. Senate Foreign Relations Committee approved its version, 17-2, June 11.

Next likely action: House passage.

Background: Both bills would fund international family planning without abortion restrictions; House bill would extend sanctions on Pakistan's nuclear program to India.

Reference: Weekly Report, pp. 1523, 1390, 1304.

The aid program for Pakistan was suspended last year when President Bush failed to certify that its government did not have a nuclear weapon, as required under a 1985 amendment sponsored by Sen. Larry Pressler, R-S.D. The administration had requested $259.5 million for Pakistan in fiscal 1992. In talks with administration officials and members of Congress during the week of June 10, Pakistani officials expressed a willingness to work with other nations to stem regional nuclear proliferation.

For India, which detonated its first nuclear device in 1974, the cost of continuing a nuclear program would be less steep even if the congressional restriction is enacted. The administration requested $22 million in development aid for India in 1992; an additional $77.6 million in food aid would not be affected.

Many House members voted for both measures out of "a sense of fairness," said Robert J. Lagomarsino, R-Calif. He cosponsored the amendment to make aid to India conditional with Charles Wilson, D-Texas, Pakistan's most tireless congressional supporter. Liberal Democrat Peter H. Kostmayer of Pennsylvania added language to slightly ease the conditions.

But lawmakers had other motivations as well. Supporters of Pakistan, stung by the resounding defeat of an amendment offered by Henry J. Hyde, R-Ill., which would have lifted restrictions on aid to Islamabad, redoubled their lobbying efforts on the India amendment. The Lagomarsino-Wilson measure offered members the chance to hurt Pakistan's major adversary while offering support for regional non-proliferation.

Moreover, many members believed that the bill either will not become law or the provision on India will be stripped during a House-Senate conference on foreign aid. The Foreign Relations Committee retained the Pressler amendment restricting aid to Pakistan while taking no action on India.

But Stephen J. Solarz, D-N.Y., a strong supporter of India, warned that the amendment could have an impact even if does not become law. The measure is likely to be "seen in India as a [U.S.] tilt toward China," Solarz said. Chinese troops attacked India in 1962.

Solarz suffered a rare foreign policy defeat when the India amendment was approved. Solarz "doesn't usually lose these kinds of things," Lagomarsino said.

Abortion Debate

The debate over India and Pakistan, while lively at times, had only a fraction of the intensity of the wrangling over abortion and family planning. Lawmakers in both chambers spent more time on the issue than any other single subject, reflecting the domestic political ramifications of an issue that also has dominated the House committee markup of a foreign aid appropriations measure. *(Abortion, p. 1586; appropriation, p. 1599)*

Christopher H. Smith, R-N.J., led anti-abortion forces in the House, targeting two provisions that had been approved by the Foreign Affairs Committee. He proposed stripping $20 million from the bill for the United Nations Population Fund because it has been condemned for operating in China, which has had a record of forced abortions.

And he attempted to restore the Mexico City policy, arguing that it had not interfered with U.S. support for family planning. "The United States remains the leading donor of population aid in the world," he said.

Opponents of the Mexico City policy attacked what they termed "an international gag rule" on abortion. Rep. John Porter, R-Ill., charged that the policy prevents organizations from using their own funds "to even tell a woman she has the option of choosing an abortion."

The rhetoric on both sides was emotional. Smith and Hyde described abortion procedures in graphic detail. Kostmayer, shouting at times during his floor speech, said, "Let the president veto this bill. I hope he does. Let this be the election of 1992."

Kostmayer blocked Smith's effort to restore money for the U.N. fund by offering a substitute amendment, which carried, 234-188. Then, a substitute by Howard L. Berman, D-Calif., overturning Smith's amendment to revive the Mexico City policy, was approved, 222-200. *(Votes 148, 149, p. 1614)*

Abortion rights activists were encouraged by the vote margins, noting that in 1990, Smith had won approval for an amendment to the foreign aid appropriations bill striking aid to the U.N. fund. *(1990 Weekly Report, p. 2077)*

But Smith said in an interview, "What we have proven in the end game here is that we can sustain a veto."

In the Senate Foreign Relations Committee, the debate was only a prelude to what is likely to be a drawn-out floor battle over abortion. The draft authorization bill approved by the International Economic Policy Subcommittee included a repeal of the Mexico City policy.

At the full committee markup on June 12, an amendment striking the provision, offered by ranking minority member Jesse Helms, R-N.C., was defeated, 6-13.

"There will be more fights over abortion than in the last three Congresses combined."

—Rep. Vin Weber, R-Minn.

As in the House, the issue is likely to dominate full Senate consideration of the measures authorizing and appropriating foreign aid. Rep. Vin Weber, R-Minn., said, "There will be more fights over abortion than in the last three Congresses combined."

Common Elements

On most issues, the authorization bills moving through Congress are similar: the House and Senate legislation would cut the administration's request for military assistance generally and for Turkey in particular.

In addition, the two measures include proposals to control the spread of weapons in the Middle East.

The House bill, which may still be amended, calls for a moratorium on U.S. arms sales until another supplier nation provides arms to a country in the region. The Senate bill includes a ban on new U.S. arms transfers for 60 days after the bill's enactment, unless the administration takes steps toward negotiating multilateral proliferation controls.

The full House and the Senate panel have approved a provision — which also has triggered a veto threat — to require that countries spend a percentage of their aid, equal to the amount of assistance they receive in cash transfers, to buy U.S. goods and services.

For most countries to be exempt from the provision, half of the U.S. grain they receive would have to be shipped on "privately owned United States-flag commercial vessels."

The so-called cargo-preference provision has strong backing from U.S. maritime interests and their supporters in Congress. Most Midwestern lawmakers, who fear that the provision could cut foreign grain shipments, oppose it. *(Background, 1990 Weekly Report, p. 2394)*

The House defeated, 175-246, an amendment from Doug Bereuter, R-Neb., to strip the provision from the authorization measure. In the Senate panel, Chairman Claiborne Pell, D-R.I., put the cargo-preference provision in the bill with an amendment that was approved, 12-7. *(House vote 150, p. 1614)*

Enactment Chances

The administration, which already has objected to the large number of earmarks and mandates in the House bill, is likely to find the measure even less to its liking after the House completes its work.

Republicans have indicated that they will offer amendments cutting off U.S. aid for Jordan and placing tough conditions on any direct aid to the Soviet Union.

Managers of the House bill and members of the Foreign Relations Committee concede that if either of the current versions are cleared for the president, they will be vetoed. But the lawmakers are hopeful that passage of even an administration-opposed bill will give the process momentum. Then a bill more acceptable to the president could be crafted by a House-Senate conference committee.

To get to conference, however, the Senate will have to approve a bill. And that possibility appeared to grow less likely when members of the Foreign Relations Committee did not link the foreign aid authorization bill with a bill authorizing State Department operations for fiscal 1992-93. The State Department bill has, in the past, usually received more administration backing. *(State Department, p. 1597)*

Pell had initially predicted that the panel would connect the bills, but his belated attempt to do so as the markup of the State authorization measure was winding down was unsuccessful.

An upbeat Sen. Mitch McConnell, R-Ky., who has taken a leading role in crafting the foreign aid measure as a result of the panel's strengthened subcommittee system, said in an interview that it "bodes well for the process" that the committee "handled the bill with dispatch and with a minimum of the usual partisan bickering." ■

25

WASHINGTON TIMES May 23, 1991

CLAUDIA WINKLER

India's travail born of communal strife

The sense of foreboding that hung over India's election campaign found terrible realization in the death of Rajiv Gandhi.

Before a bomb explosion killed him Tuesday at a political rally in the southern state of Tamil Nadu, Mr. Gandhi had seemed likely to become the next prime minister. Yesterday, the stunned Congress leadership elected Mr. Gandhi's 43-year-old widow, Sonia, as the new party president.

Tamil militants are suspected in the blast, though none have claimed responsibility at this writing. While prime minister from 1985 to 1989, Mr. Gandhi sent troops to nearby Sri Lanka to help quell Tamil minority unrest.

So this third assassination of a top national leader in India's postwar history is probably another fruit of "communal" strife. In 1948, a Hindu fanatic shot the great champion of independence and non-violence, Mohandas Gandhi. In 1984, Prime Minister Indira Gandhi, Rajiv's mother, was killed by members of the separatist Sikh sect.

Tragically, all three represented modern India's constitutional commitment to tolerance. Indira's father was Jawaharlal Nehru, who set the nation on its secular, socialist, democratic course.

Today, religious, ethnic and inter-caste hatred fuels chronic violence that dwarfs the American race riots of the 1960s. Hundreds and hundreds of Indians are killed in unrest every year. About 200 died in the current campaign and first days of voting; the remaining days of voting have been postponed.

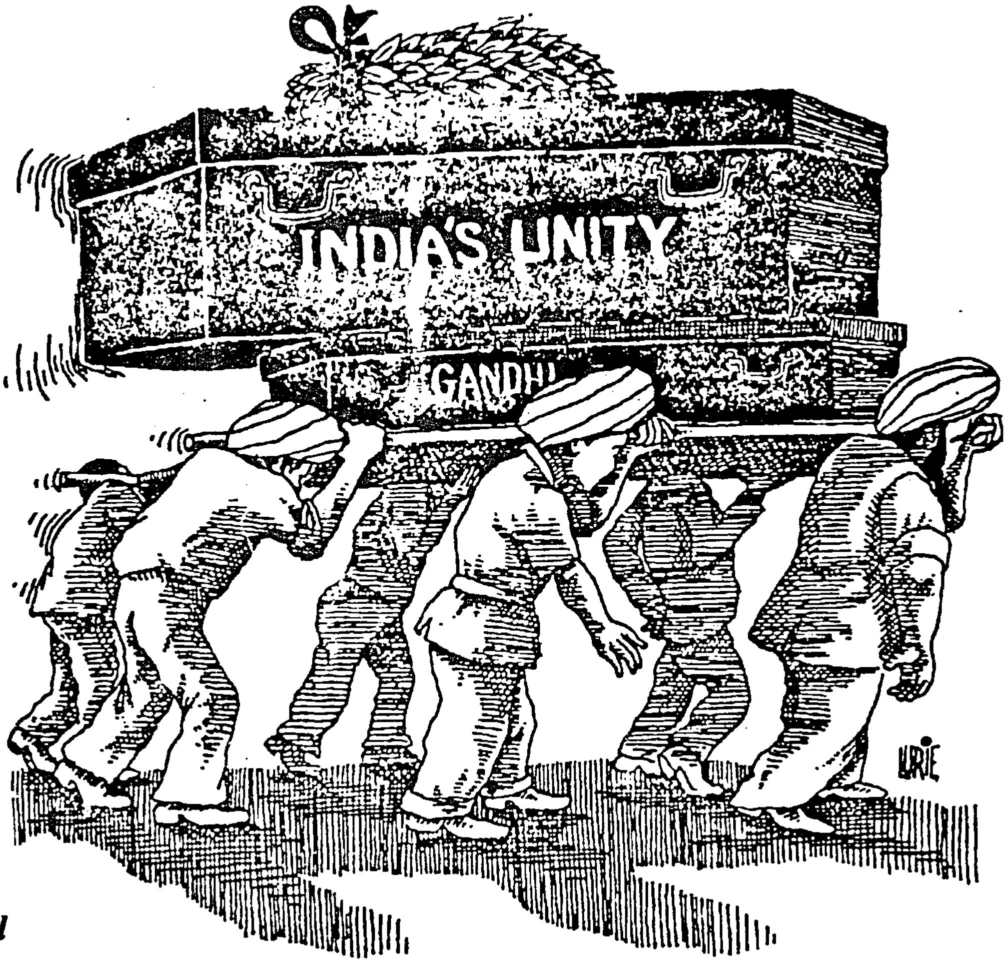
Such disorder corrodes confidence in government. So do the economic ills that inflame divisions in society. Potentially prosperous, India is prisoner of an anti-Western ideology that drives it to shut out foreign investment and trade. Central planning and fiendishly elaborate regulation stifle enterprise. As a result, India's growth has been paltry by the standard of Asian neighbors like South Korea, Thailand and even Pakistan.

As in the Soviet Union, bureaucratic control of economic life breeds corruption as well as inefficiency. And, by keeping the country poor, it forestalls adequate investment in education and health.

Like the Soviet Union, India needs economic restructuring on free-market lines. But its once proud political system — the world's largest democracy — shows no sign of producing leaders who will tackle the fundamental problems. Rajiv Gandhi's murder comes after a succession of weak prime ministers.

From this low point, then, matters may only get worse.

India needs economic restructuring on free-market lines. But its once proud political system shows no sign of producing leaders who will tackle the fundamental problems.



Claudia Winkler is chief editorial writer for Scripps Howard Newspapers.

760

Rajiv's Promises, India's Deferred Dreams

By CLAUDIA ROSETT

NEW DELHI—With the Indian flag for a shroud, the body of Rajiv Gandhi lies in state in the mansion that was once home to his grandfather, the hero of Indian independence, Jawaharlal Nehru. Men and women file by the open front door in long and separate lines. Some clutch garlands of marigolds, brought to show respect. One woman in a purple sari holds the hand of her small son. They are all hurried along by armed guards, who earlier in the day used tear gas and bamboo riot sticks to fight off thousands of angry mourners who came shouting to be allowed inside the high metal gate.

Across the Indian capital, the streets are almost empty. The shops are shuttered. On the Times of India building an illuminated sign flashes the news, "Army deployed in many Delhi areas." People gather by the curbs in small groups, talking and reading copies of a Hindi newspaper that on page one displays a photograph of Rajiv Gandhi's mutilated body. It is a picture taken just after the bomb blast that killed the former prime minister and 15 bystanders at an election campaign rally Tuesday night near the southern port city of Madras. "Do you know who did it?" one young woman asks a reporter. "We want to know who did it, so we can hurt the other party."

Who Will Lead?

This was the scene in the capital yesterday as India went into shock. The world's most populous and fractious democracy has been hit mid-election by the murder of the leading candidate, Mr. Gandhi, president of the Congress (I) Party that has ruled India for all but four of the 44 years since independence. The immediate fear is that there might be a repeat of riots in which thousands died following the 1984 assassination of Rajiv's mother, Indira Gandhi, by two of her Sikh bodyguards.

Rajiv Gandhi

The wider concern is that with Mr. Gandhi's death, the moderate-liberal center has been ripped from Indian politics. "The country was already going through a bout of instability," said R.R. Malhotra, a 37-year-old businessman. He came late Tuesday to the Delhi airport in hope of seeing Mr. Gandhi's body brought back from Madras. "We expected him to come back and lead the nation," said Mr. Malhotra.

Instead, Indian voters must now make up their minds whether they want to be led by Rajiv's widow, Italian-born Sonia Gandhi. The Congress Party's national committee called an emergency meeting yesterday in Mr. Gandhi's old office at the campaign headquarters in Delhi, and sitting around the long teak table voted in Mrs. Gandhi as their new party president.

That quick move may help quell the uncertainty that right now scares India. But even if the polically untried Mrs. Gandhi proves up to the job, the country faces an edgy transition. The parliamentary elections that were taking place this week have been postponed, with the remaining 60% of the 514 million-member electorate rescheduled to vote June 12 and 15. That will give them more time to ponder their bleak choices.

For all the current fear of riots over the murder of Mr. Gandhi, it is a great achievement that India seems likely to carry on with democratic succession.

Since 1989, in desperation and disgust with their political leaders, Indians have voted out almost everyone who comes along. Rajiv Gandhi enjoyed two good years at the start. When he took office in 1984, he was raring to liberalize the absurdly constricted economy. When he swerved from that track, India's 835 million people noticed. Mr. Gandhi lost the 1989 election to a coalition led by a former finance minister, V.P. Singh. Mr. Singh forsook his earlier free-market ways to play up to minority interests, notably with a sort of affirmative-action program offering more state jobs to so-called backward castes. His government lasted only 11 months before it was replaced by the four-month run of a nondescript socialist, the current caretaker prime minister, Chandra Shekhar.

This round of elections had featured as star contenders all three recent prime ministers, plus the increasingly popular head of the radical Hindu party, L.K. Advani. Of the four, Messrs. Singh and Shekhar had by dint of lousy policies reduced their own prospects to vying for swing votes in a ruling coalition. The main contest was between Mr. Gandhi, who campaigned on a promise of stability, and Mr. Advani, who under the saffron flag of purist Hindu philosophy has been whipping up sometimes violent crowds into a frenzy of nationalist unity. The biggest plank in Mr. Advani's campaign has been the goal of replacing an old mosque in the northern town of Ayudhya with a Hindu temple. This crusade cost several hundred lives during riots last fall.

To understand what Indian voters actually need, it helps to consider, say, the central northern state of Bihar, one of the poorest in a country where incomes average just over $300 per year. Typical of the national cynicism about politicians was the comment of a young herbal-medicine scholar leaning on his bicycle in a city market. He would vote for the Hindu Bharatiya Janata Party, "because the others have had their chance and failed."

In the Bihar countryside, the human costs of the political failure is pathetically on show. Many villages have no plumbing and no electricity. People live in mud huts and work at such jobs as carrying bricks on their heads in the 100-degree summer heat. This is the direct result of socialist policy that has for decades restricted India's trade with the world, constricted any entrepreneurial spirit and swamped progress in a tide of paperwork.

A big concern of voters in Bihar was summed up by 65-year-old Botal Singh, a rice farmer waiting to cast his vote in a packed tent in a village where election violence last year left more than 20 people dead. "We are hoping the new government will do something to bring down prices," said Mr. Singh. He can't read, but he does know the nasty effect of inflation that under a profligate government has risen to an annual rate of about 15%.

That people like Mr. Singh turn out for the polls in a bloody election campaign that before Mr. Gandhi's assassination had already taken some 200 lives, is a tribute to the endurance of Indian democracy. For all the current fear of riots over the murder of Mr. Gandhi, it is a great achievement that India seems likely to carry on with democratic succession.

Threatening that democracy, however, is the seeming inability of India's politicians to deliver the freer economy the country needs. Further liberalization would go far to reduce the violence that becomes tempting when poor people are frustrated by a bureaucracy that survives by requiring most of life to be thrice certified, approved and officially stamped.

This is where Mr. Gandhi might have had much yet to offer. Chastened by 16 months out of power, he had returned to the campaign trail newly attentive to the voters he was wooing. "Rajiv would have improved. He would have learned something from the months out of power," said 24-year-old engineer S. Bharaj, who came to grieve in front of Mr. Gandhi's house in Delhi yesterday.

Some are now saying it was Mr. Gandhi's turn toward the people that got him killed. He had been taking big risks for weeks, wading through crowds in which security was impossible. When I saw Mr. Gandhi give a speech in Agra, home of the Taj Mahal, at midnight last Thursday, the only bar to standing next to him was that members of the audience were brawling around him on the makeshift stage for a chance to do the same. There is no doubt that the man-of-the-people image came through. Wearing a sweat-soaked shirt, grimy from the day's campaigning, Mr. Gandhi stood brushing swarms of mosquitoes from his damp hair. In reasonable, tired tones, he spoke for about 25 minutes to a crowd of some 7,000 people who had waited for hours to hear him.

For all that, the crowd during most of the speech was strikingly unexcited. It is worth remembering that voters were by no means committed to handing Mr. Gandhi a mandate. Many here have been waffling right up to the polling booth, and most public opinion polls showed Mr. Gandhi's Congress Party winning a plurality but not a majority in the next parliament. There was at best moderate reaction to most of what Mr. Gandhi had to say. What did wake up a crowd in which most people wore ragged clothes and stood in their rubber flip-flop sandals in a field of grit was when Mr. Gandhi talked about creating jobs and bringing down prices. That got loud cheers.

Out of the Dirt

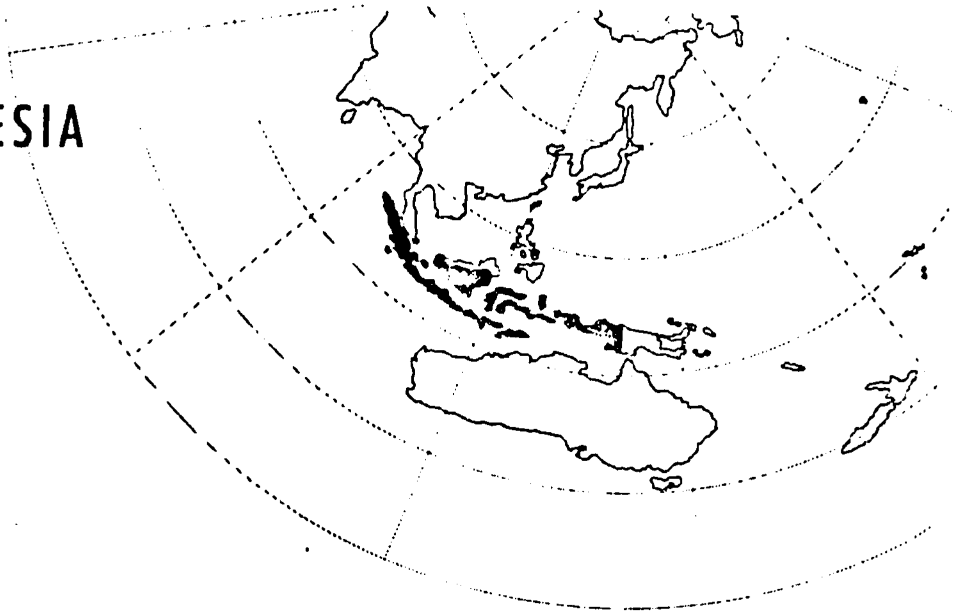
What Mr. Gandhi then asked for was "One more chance for Congress, and I will change everything." The great pity, both for Mr. Gandhi and for India, is that he found it necessary to risk his life rebuilding the image of a politician who would deliver on his promises of a better life. Had he stuck by the substance of his earlier drive for free-market reform, his track record would have been worth a thousand midnight campaign pleas. Instead, he died trying to win the trust of voters grown weary of rhetoric that has yet to lift them out of the dirt.

For Sonia Gandhi to make good on her husband's renewed promises will be a tall order. India must now brace for Mr. Gandhi's funeral tomorrow and for another three weeks of suspense before the voting in this election is finally done. But the question that hangs thick over this tense country is less whether there will be riots in the coming weeks, than whether a politician will finally emerge who can carry through on Mr. Gandhi's promise to create an India in which there is no more reason for such horrors.

Miss Rosett is editorial page editor of The Asian Wall Street Journal.

30

INDONESIA



Real GDP/GNP

RECENT DEVELOPMENTS

The last two years have been good ones for the Indonesian economy. The growth rate of the gross domestic product (GDP) was 7.4 percent in 1989, and for 1990 the estimated growth rate is a robust 7.1 percent. However, by mid-1990 the economy had begun to show some strain. Important goods such as cement for building construction, commercial motor vehicles, and electric power supply could not meet the rapidly rising demand, and prices began to accelerate, fuelled by rapidly expanding volumes of bank credits. The government, fearing the re-emergence of double-digit inflation, applied the brake to monetary expansion starting in June 1990. The tight money policy, which affected both investment and consumption spending, continued during the first quarter of 1991. The consequent weakening of domestic demand, coupled with reduced exports due to the Gulf War, is expected to reduce the growth rate of the economy. Nevertheless, our forecast indicates continued satisfactory growth of the economy in 1991 and 1992.

Apparently, the strong and wide-ranging deregulation measures undertaken by the government since 1983 have exerted considerable impact on the economy. In particular, the deregulation of the banking sector and of the capital market during the last two years has resulted in a substantial increase of economic activity. However, the very rapid expansion of the financial sector was bound to hit some snags because of cut-throat competition on the one hand, and lack of effective supervision by the monetary authorities on the other. It is therefore expected that some rationalization will take place in that sector, by either the closing down of some uncompetitive banks, a merger among them, or their acquisition by stronger and larger companies.

Investment spending has been particularly strong, increasing in real terms by 13.4 percent and 16.2 percent during 1989 and 1990 respectively. As a share of GDP, gross capital formation, which was 23.1 percent in 1985, increased steadily and reached 26.6 percent in 1989 and 28.9 percent in 1990, and is forecast to increase further in the next two years. Government investment, in particular, was one of the largest contributors to growth of GDP in 1989. Private investment also expanded, as a result of an improved investment climate and the relocation of industries from Japan and the Asian newly industrialized economies (NIEs) as their currencies appreciated.

Private consumption expenditures were a leader in the economy since 1989. In 1990, private consumption contributed 4.1 percent to the growth of total GDP, followed by private investment, which contributed 3.6 percent and exports, 2.4 percent. Clearly, consumer spending has been booming in the last few years, perhaps due in part to the recent worldwide boom in consumption. In Indonesia, private consumption has accelerated since 1986 and will subside only after 1990 because of the tightening of monetary policy and the slowing of the economy.

Production in agriculture continued to perform well in 1989, expanding 4.3 percent. In 1990, however, this sector is estimated to have grown only 2.5 percent due to unfavorable weather conditions and a deterioration of its terms of trade.

Manufacturing, especially the non-oil sector, continued to be the best-performing sector after deregulation. Most private (including foreign) investment has been made in manufacturing, including export-oriented manufactures. The sector's average annual growth rate for 1986-89 was 11 percent, and is estimated to have expanded 11.8 percent in 1990.

CPI

Construction has expanded along with the rapid growth of production in the goods sector. Its growth rate has accelerated from 9.5 percent in 1988 to 11.8 percent in 1989 and 12.1 percent in 1990. The demand for construction materials such as steel and cement has surged significantly, leading the government to conclude that the economy had become overheated and to allow imports of cement duty-free. Importation of assembled trucks, which formerly could be imported only in a knocked-down condition, was also permitted in order to meet the surge in demand for transportation, especially of construction materials.

One of the important debates going on in Indonesia at the moment concerns the best way to curb inflation, particularly in view of the adverse effects of high interest rates and the government's tight monetary policy on investment. Besides, the government is also concerned about the effect of inflation on the real exchange rate, and hence on non-oil exports, the balance of payment position, and external debt payments. In addition, the government wants to prevent a deterioration of the purchasing power of fixed-income groups in the society.

The inflation rate in 1988 and 1989 of 6.5 percent per year was relatively low for Indonesia. However, starting in the last quarter of 1989, the rise in prices began to accelerate, and prices rose even faster during the first half of 1990, resulting in a rate approaching over 10 percent for the year as a whole. The Bank of Indonesia, recognizing that the money supply had been growing too fast, and that the sharp increase of fuel prices in mid-1990 had had a spiraling effect on it, was forced to introduce contractionary monetary policies. Because of the swift action taken by the monetary authorities, inflation subsided during the second half of 1990, and the increase in the consumer price index (CPI) was kept to 9.4 percent for the year. This level of inflation is still considered too high, and the government has stated that it intends to aim at a 6 percent average annual rate for the next few years.

The average growth rate of exports for 1986-89, aside from oil and natural gas, was more than 27 percent annually (in current U.S. dollars). But in the first half of 1990 it has grown by less than 7 percent, and is estimated at 8.3 percent for the whole year. The unfavorable trend of primary commodity prices in the world market has reduced primary exports from 20.4 percent annual growth during 1986-89 to negative growth (-1.8 percent) in 1990. But even the growth of manufactured exports is estimated to have slowed from 38.2 percent to

14.6 percent during the same period. Due to the lower growth of exports, coupled with continued increases in imports of capital goods and in debt-service payments, the deficit in the current account balance of payments is estimated to have widened from US$1.45 billion (current dollars) in 1989 to about US$3.19 billion in 1990, or around 3.24 percent of nominal GDP.

THE OUTLOOK FOR 1991 AND 1992

The Gulf War has added uncertainty to our forecast, especially through its impact on the price of oil. We assume a price of US$19.50 per barrel for 1991 and between US$19.50 and US$21 in 1992 (slightly higher that the US$19 price stated in the 1991-92 state budget). The impact of the war could be serious for the economy in 1991, but it is expected to recuperate in 1992, when the price of oil advances and world economic growth accelerates.

Interest rates are likely to stay high but to decrease slightly in 1991 and further in 1992. The government's monetary policy will result in a very slow rate of increase of credit in 1991, followed by a much greater increase in 1992.

In the face of continued uncertainties, the government is likely to maintain steady growth of public investment at about 20 percent per year in nominal terms, especially for infrastructure development. Prices of primary export commodities are expected to remain weak in 1991, with only some mining products able to maintain their 1990 levels; however, some rise is expected in 1992. Concerning the exchange rate, it is assumed that the government will allow the rupiah to depreciate up to 10 percent in 1991 and 8 percent in 1992 in order to maintain competitiveness of Indonesian non-oil exports.

Based on these assumptions, we forecast that the Indonesian economy will continue its trend of robust growth through 1992 in spite of possible slack in 1991 due to the Gulf War. The rate of growth of GDP, which for 1990 is estimated at 7.1 percent, is forecast at 5.5 percent for 1991 and 6.6 percent for 1992. However, the high growth rate of non-oil exports achieved during the second half of the 1980s may be difficult to repeat. Imports will continue their strong growth, and external debt-service payments will continue to rise, which will result in larger deficits in the current account for 1991 (US$6.25 billion) and 1992 (US$4.30 billion), or 5.9 percent and 3.9 percent of GDP respectively. The flow of foreign investment that has increased rapidly during the last few years is expected to slow in 1991 before strengthening again in 1992.

As was the case in 1989 and 1990, private consumption will be the largest source of the growth of GDP in 1991, contributing 2.6 percent, followed by private investment, contributing 2.4 percent, and government investment, adding 2.3 percent. For 1992, our forecast indicates that private investment and consumption will be the main sources of economic growth, contributing 3.4 and 2.6 percent respectively, while exports will add 2.3 percent to the GDP growth rate.

The lingering fear of inflation will be reflected in a continuation of a tight money policy, although less contractionary than in 1990. It is therefore expected that the easing of interest rates will not be as substantial as many private investors expect. Nevertheless, double-digit growth of private investment is still predicted. Consumer prices, which increased 9.4 percent in 1990, are forecast to increase 6.7 percent in 1991 and 6.5 percent in 1992.

304

Joint US-Laos Statement

Statement by Deputy Spokesman Richard Boucher, May 8, 1991.

Delegations from the Lao People's Democratic Republic and the United States of America met in Vientiane on May 4, 1991, to discuss common humanitarian issues. This meeting was a follow-on to the high-level bilateral discussions held on April 17, 1991, between Vice Minister of Foreign Affairs Soubanh Srithirath and Principal Deputy Assistant Secretary of Defense Carl Ford.

Mrs. Kanika Phomm[illegible]hanh, Director of Department Two of th[illegible] Ministry of Foreign Affairs, led the Lao side, which included representatives from the Ministries of Defense and Foreign Affairs. Charge d'Affaires Charles B. Salmon, Jr., led the US delegation, which included representatives from the Defense Department's Office of POW/MIA Affairs, technical experts on the POW/MIA issue from the Joint Casualty Resolution Center and the US Army Central Identification Laboratory, both located in Hawaii. Both delegations lauded the improvement in bilateral relations in the past few years and expressed hope that this improvement would continue.

A comprehensive US proposal for POW/MIA activities was discussed, and the Lao delegation agreed to conduct jointly the proposed investigations of discrepancy cases, grave site surveys/recoveries, and to expand the surveys and excavations of aircraft crash sites. The United States expressed its deep appreciation for Laos' cooperation in this humanitarian area and the hope that the expanded program of POW/MIA activities would be successfully accomplished.

The Lao delegation expressed its sincere appreciation for prior US humanitarian assistance and for additional such assistance during the remainder of 1991, including Title 10 school construction projects, medical equipment and supplies, and medical civic action programs. The United States reaffirmed its commitment to assist in addressing Lao humanitarian concerns.

The talks were constructive and productive and held in a spirit of mutual understanding and cooperation and in an atmosphere of improving bilateral relations. On May 3, 1991, the US delegation paid a courtesy call on Vice Minister of Foreign Affairs Soubanh Srithirath.

205

The necessary evolution from ownership to entrepreneurship

May/June Vol.4 #3

The Next Priority

WORLD LINK

Relying primarily on foreign capital and technology to sustain economic growth in the coming years will certainly remain Malaysia's only option. But many would agree that in the long term what will determine Malaysia's prosperity is the entrepreneurial drive and capabilities of the local population. This will depend, of course, on the attitude of the Malays, who comprise the majority of the population and who have been the beneficiaries of the "positive discrimination" initiated in the last 20 years by the New Economic Policy (NEP).

But the attitude of the 45% of the population who are not Malays will also be crucial. The government is seemingly fully aware that the way the post-NEP caters to the needs of social equality for the Malays – while at the same time hindering the progress of the other ethnic groups or the prospects of high growth rate – will be the make-or-break factor.

> "Equity in itself means nothing; what counts is how you put it to use."

At the same time, there is the clear perception among large segments of the population that many techniques used to promote the economic status of the Malays have now outlived their usefulness. "I would like to see an even greater emphasis on economic growth, rather than looking specifically at the Bumiputra and ethnic issues," says **Tunku Imran Ibni Tuanku Jaafar, the group chief executive of Antah Holdings**. "I would like to see a loosening of these bureaucratic shackles which have been put on businessmen by the rules on the Bumiputra equity share. Without them, Malaysia's growth would even accelerate. Somehow, the government would have to build in some protection and encouragement for Bumiputras – to go into business and do it better. But I doubt that the current insistence on a percentage of equity going to Bumiputras will be necessary in the future."

Like many of his colleagues, Tunku Imran feels that "the Bumiputra trust status has become a double-edged sword" because it is a stumbling block when it comes to divesting: One has to find another Bumiputra who can come up with the investment. "The government may have failed to grasp that control is better than ownership."

"Essentially," says **Dr. Munir Majid, managing director of International Commerce Merchant Bankers**, "the New Economic Policy emphasized a restructuring of equity, employment creation and poverty eradication. This is like motherhood: Everybody is in favor of it. However, it requires that you share a portion of your wealth. But at the same time, since 1987 a foreigner coming in who exports more than 50% of his products could hold 100% of equity. So there are complaints that foreign investors are getting better treatment than Malaysians. The answer has been: You are Malaysian, you have to bear certain responsibility. However, what one wants to see in the successor policy to the NEP is the realization that equity in itself means nothing. What counts is how you put equity to use. So we need to be more flexible about this equity ratio for the Bumiputras. Why 30%? Why not 50% or 25%? For me, the crucial point is that people get involved in the modern sector. What the new policy should emphasize is employment opportunities, management involvement in companies – and not solely ownership of equity. I would like to see that kind of revitalization of the Bumiputra involvement in the economy in the new policy."

A REVITALIZATION

Some observers of the economic scene would now tend to see the first signs of such a revitalization. In the last 20 years, the ultimate goal for young Malays was to join the government. This tendency, plus the previous emphasis on government's role, led to a bloated civil service, which today comprises about 14% of the working population when taking into account people employed in state-owned companies, but excluding the police and the army. But, notes **Ahmad Jaafar, the executive director of Bank Bumiputra Malaysia**, "I have seen a lot of changes in attitude in the last few years. Young people now prefer to go into ventures, for instance putting together software operations and trying to market them.

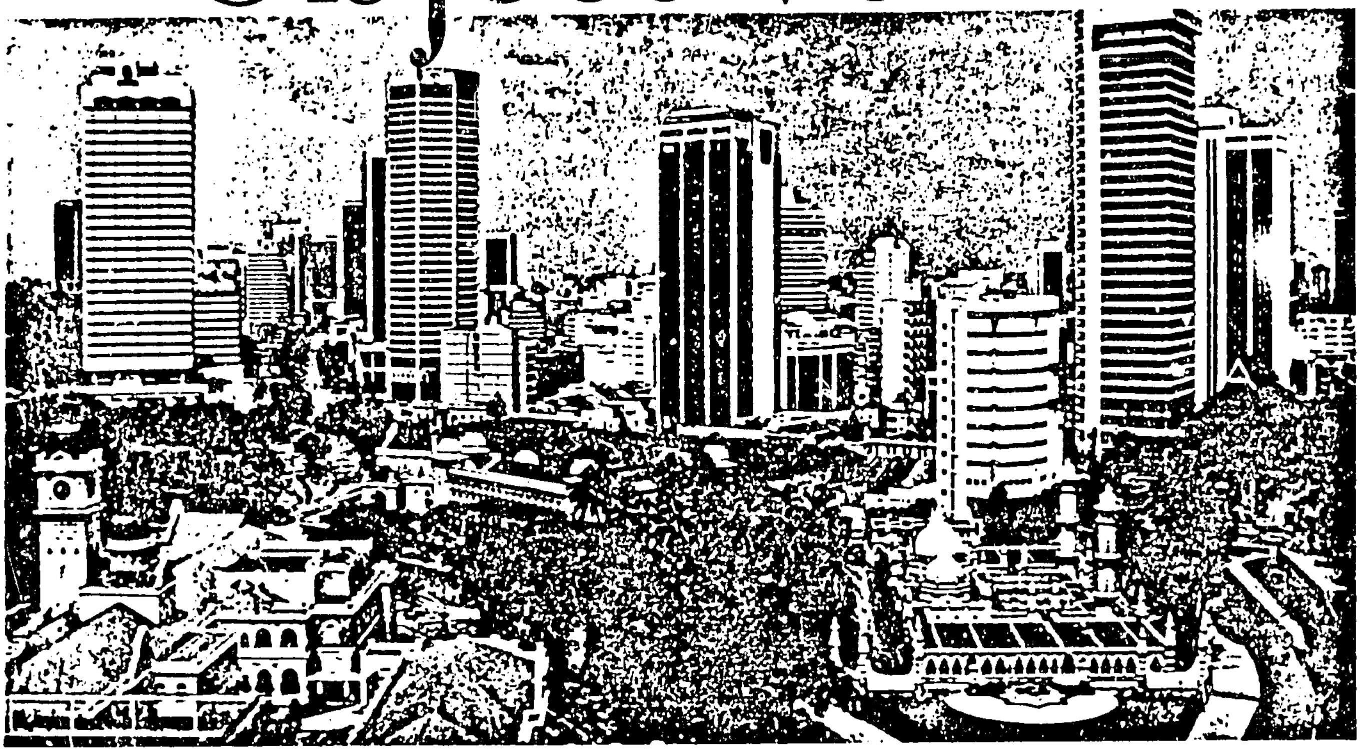
"Entrepreneurial spirit cannot be taught. You must create the proper environment for it," says Jaafar. "Many members of the Malay community have shifted from the property and real-estate market to exportable activities because in the previous period the high exchange rate of the Malaysian currency was a bonus for real-estate speculation. Now the reverse is happening."

The development of the Malaysian financial system and the new flexibility in terms of lending created by the use of benchmark rates will contribute to the emergence of this entrepreneurial spirit. "The interest rate structure in the country," says Jaafar, "is today more reflective of market forces than ever, which means that the allocation of resources is more efficient.

"Already, Malaysia's equity market is one of the most developed in the region, behind only that of Hong Kong and Singapore, with a capitalization which is three times Malaysia's GNP. This will help local capital play a more active role, alongside foreign investment." ■

May/June 1991

Objective 2020



BY CLAUDE SMADJA
WORLD LINK

A recession can indeed be a blessing in disguise. Many Malaysian and foreign investors would now concur that the one which affected Malaysia in 1984-85 might have provided the shock needed to set the conditions for sustained growth. Among other things it forced the government toward a much more flexible interpretation of the New Economic Policy (NEP), in place since 1971. This policy had been an obstacle to foreign investment expansion and had served as a political rationale for expanding the role of the government in the economy. The NEP, aimed at poverty eradication and rebalancing the distribution of wealth between the Malays (50% of the population) and the Chinese (about 35%), has been based on "positive discrimination" toward the Malays, with the symbolic goal of getting them a 30% share of total equity by the end of 1990. As of now, they have achieved, in fact, 20% of equity share.

Severely hit by the free-fall in commodity prices and faced with a decline of GNP and rising unemployment, the government had to scramble to revive economic activity; its only viable option was to put the NEP on the back burner and to embark on a policy geared toward actively courting foreign investment and technology.

The Mahathir government must be given credit for the way it absorbed the lessons of 1984-85 and the swift change of attitude which ensued. On this crucial occasion it demonstrated the kind of pragmatism and flexibility that was needed, but was not necessarily granted on a matter so sensitive politically and so loaded emotionally. By the end of 1986, foreign investment restrictions were not only substantially lifted, but incentives were created to attract foreign investors; and the private sector, both foreign and local, was given the leading role in the economic drive.

The prime minister's leadership proved crucial in pushing the government and the bureaucracy to become more supportive of the private sector, promoting the theme of "Malaysia Inc." to illustrate how closely the government and the private sector should collaborate. Whereas 10 years ago government officials would not have much liked to be seen in public with business leaders, because of fears of wrong interpretations, today it is virtually the other way around: Ministers are criticized by the PM if they don't have close contacts with the business community. "I have rarely come across an environment as open and supportive of the private sector as we have here today in Malaysia," remarks **Ernest Zulliger, president of the International Chamber of Commerce and Industry in Kuala Lumpur**. He points out that "the efficient communication from the private sector right to the top echelon of the government, the government's determination to take action, its pragmatic attitude, and the ability to correct what may hinder investment and growth are without any doubt the cornerstone of Malaysia's success story."

The results of this policy are clear for everybody to read in the GNP growth: 5.2% in 1987, 9.5%

261

in 1988, 9% in 1989, 9.5% in 1990. The forecast for 1991 is 8.5%, making Malaysia the strongest economic performer – with Thailand – in Southeast Asia, according to the latest Asian Development Bank Report. In 1990, foreign investment culminated at US$ 3.1 billion, with the lion's share for Japanese and Taiwanese investments (see Rafidah Aziz interview).

But Malaysia now has to decide on the follow-up of the New Economic Policy (NEP) which was supposed to end last December. The nature of the message which will be given on that matter to investors, foreign and private, will be crucial in consolidating – or eroding – the climate for further growth. As a recent report of the Malaysian Institute of Economic research puts it, "Sustainability of the economic growth will depend very much on the policy options and strategies adopted by the government for the 1990s and beyond." It is especially so as Prime Minister Mahathir has set the objective loud and clear in his speech to the Business Council last March: By the year 2020, Malaysia is to become a fully developed country, which means that the Malaysian economy will have to grow over the next 30 years by an average of 7% annually – in real terms.

MAINTAINING THE MOMENTUM

Indeed, Prime Minister Mahathir has repeatedly shown that one key prerequisite for the new NEP will be to keep the momentum of economic growth. "There will still be a program to achieve the objectives of the NEP," guesses **Tunku Tan Sri Ahmad Yahaya**, the group chief executive of Sime Darby. "But there will be nothing which would be negative to foreign investment. I would not foresee any change of attitude. Some requirements that will remain will not be more difficult to swallow for the foreign investors than what exists now." As Tan Sri Ahmad sees it, "in order to reach the 2020 target, Malaysia will need even more foreign investment than today, because one problem with the local investment is the lack of technology. But it cannot be a matter of just "buying" the technology, and this is where Japan can play a key role: If it wants to be seen and accepted as the leader in the region, it has to be much more forthcoming in terms of technology. They do not need to give it away of course, but be more favorable to technology transfer once they get assurances of adequate protection in that domain."

But, warns Tan Sri Ahmad, "all the efforts to create a developed Malaysia by the year 2020 will come to nothing if we don't take into account the international situation. If we are going to have trading blocs and Asia does nothing about it, Malaysia will be in a difficult situation. Our only choice is to proceed at full speed down the road of the East Asia Economic Grouping. In fact, integration is developing, when one sees the picture of foreign investment in a country like Malaysia."

But even assuming a perfect fit between the domestic goal of 2020 and international and regional developments, it remains to be seen whether the Malaysian economy can sustain the needed growth rate of 7% per annum over a long period without overheating. In this respect, there are already some warning signals with bottlenecks beginning to appear. "This is a key question, admits **Tun Ismail bin Mohamed Ali, chairman of Golden Hope Plantations Ltd.** "We need to make sure that the infrastructure can sustain that kind of growth over the next 30 years. We need to make sure that we have adequate manpower planning and that our telecommunications will be sufficient, as well as our water supply. People are talking about water shortages now in Malacca – in a tropical country! We need to keep ahead with our infrastructure, our roads, our ports.....If we take a country like Indonesia, a pound of rubber coming out of the factory costs half of what it does here in Malaysia. But from the factory door to the port is where we recuperate the advantage. So if we let our infrastructure lag behind, we will be in trouble."

The government has been prompt to react and seems intent on tackling the problem at a very early stage, to avoid what is being labeled as the "Thailand syndrome" in reference to the problems created there by too rapid growth. Indeed, the sixth Economic Development Plan will put a lot of emphasis on infrastructure development and provide acceleration to the privatization process – which has been lagging behind with much discussion but little action. At the same time, this would also help achieve the 30% equity share target set for the Bumiputras (the Malaysians of Malay origin).

> "I have rarely come across an environment as open and supportive of the private sector as we have here."

THE PRESSURES OF DEMOGRAPHICS

Of course, these are a few of the many challenges involved in the objective of "Malaysia 2020." And there is no sign that "Malaysia Inc." is getting complacent about the success of the last four years. The structure of the Malaysian population (6.7 million working people out of a total population of about 18 million), with a demographic growth rate of 2.5% a year, will continue exerting enormous pressure for job creation. The local business community must play a greater role in the future even if foreign investment and technology remain crucial. But for **Tan Sri Zainal Abidin Sulong, chairman of the Malaysian Industrial Development Authority,** "The most important challenge will clearly remain the political one: How to build this country in a harmonious and united way, how to ensure stability. The success we may achieve in the coming years will depend a lot on that first challenge and our ability to meet it. Malaysia is strategically well placed in this part of the world. It has always been at the crossroads of trading routes and civilizations. So if we can succeed at building a united country from out of our multiracial and multireligious society and incorporate that success within the strategic position we have, this would create a combination difficult to beat." ■

Mongolia Takes Steps to Join Global Economy

Early in 1990, Mongolia initiated a sweeping economic reform program that is as bold as any seen in Eastern Europe and the Soviet Union. But, while international attention has been focused on the drama taking place half way around the world, little is known about the rapid strides this vast, underpopulated Asian nation has made toward establishing a market economy.

Half the size of India, Mongolia has only 2 million people, almost half of whom are nomadic herdsmen. For nearly 60 years the country has remained isolated from its Asian neighbors and the world economy and totally dependent on the Soviet Union for all of its trade.

Communications are difficult, says David Pearce who heads the World Bank division in charge of lending to Mongolia. There is no resident foreign journalist in Ulaanbaatar (Ulan Bator), the capital city, no fax machine, and only one airline flight a week from Beijing or Moscow.

Since 1990, the country has been undergoing the same "shock therapy" as many other command economies. "There is no doubt that Mongolians are committed to establishing a market economy," Mr. Pearce says.

The economic reform began slowly in 1985 when Mongolia adopted its own version of "perestroika" by restricting the role of state planning and allowing state enterprises to operate more freely. But the government was forced to quicken the pace of change in 1990 following student demonstrations and the demise of the Council for Mutual Economic Assistance (CMEA) trade pact.

Since then, multiparty elections for a new government have been held, restrictions on private ownership of livestock eliminated, farm and retail prices increased, private enterprises and cooperatives promoted, and a foreign investment law promulgated.

Mongolia further strengthened its links with the international community by becoming a member of the International Monetary Fund (IMF) and the World Bank group in February 1991.

But the collapse of the CMEA trade and payments system and the loss of Soviet financial assistance sent the economy into a downward spiral faster than had been expected. "Mongolia was hit hard by the abruptness of the changes in the Soviet Union, and it faces a balance of payments crisis and major budgetary pressures," Mr. Pearce says.

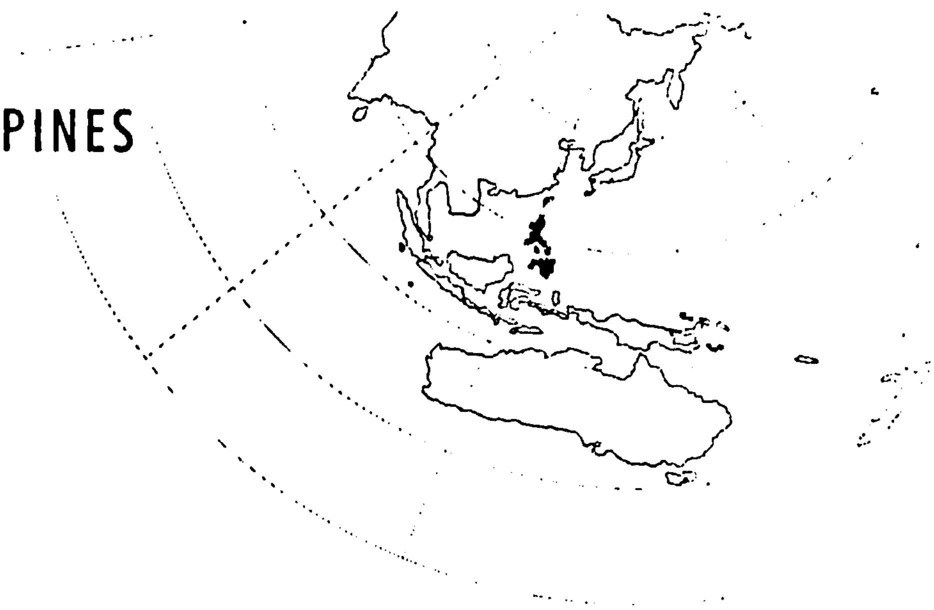
Shortages of petroleum--which accounts for 40 percent of the country's imports from the Soviet Union--and food are critical, he adds. Mongolia has requested emergency food aid from Germany, Japan, the Republic of Korea, the United Kingdom, the United States and the European Economic Community. In addition, Mongolia is seeking quick access to IMF and World Bank resources.

"Mongolia is seeking improved ties with China to gain access to seaports and is looking to Japan and the other rapidly industrializing countries of Asia as sources of financial and technical advice for its modernization program," Mr. Pearce says.

A World Bank team will visit Mongolia soon to review the economic situation, Mr. Pearce says, noting that the Bank is considering a "quick-disbursing" lending operation within a year. Such an operation would be likely to help finance critical imports to restructure industries, and pay for spare parts for machinery and essential commodities such as petroleum and fertilizers, he says.

Despite its problems, Mongolia's longer term outlook is good, Mr. Pearce says. The country currently exports meat and meat byproducts, leather goods, wool and copper concentrates. And with the country's large reserves of coal, minerals, precious metals and as yet unexplored petroleum reserves, there are ample opportunities to diversity the economy.■

PHILIPPINES



ECONOMIC PERFORMANCE IN 1990

Real GDP/GNP

A combination of natural factors and policy mistakes has made recent economic performance depart from government targets. From growth rates of real gross national product (GNP) of 5.8 percent, 6.8 percent, and 5.7 percent for 1987, 1988, and 1989 respectively, 1990 had a growth rate of 3.1 percent.

Drought, the July earthquake that leveled and isolated major production areas in the north of the country, a devastating typhoon hitting Visayas and Mindanao, and the Gulf crisis top the list of natural and external events that hit the Philippines in 1990. Power shortages, lack of infrastructure facilities, and distorted prices top the list of policy inadequacies that took an equal toll on economic performance in 1990.

There was a sharp decline in construction activities, both government and private, government consumption, and exports. Though agriculture recovered in the third quarter, its overall growth of 2.2 percent was lower than 1990's 4.3 percent. But industry suffered most, as manufacturing grew by a mere 1.4 percent from last year's 6.4 percent, and construction decelerated to 4.2 percent from 1990's 13.9 percent. Finally, the December price adjustments of oil products, which rose steeply in an effort to remove subsidies and deregulate the industry, imply the continuation of double-digit inflation.

OUTLOOK FOR 1991

Official projections indicate that the economy's GNP is expected to grow in real terms by 1.9 percent in 1991. Consumption will decelerate to 2.5 percent, government consumption and investments will grow to 5.3 and 6.5 percent respectively to take up the slack, and exports will expand by 6.1 percent.

Agriculture will experience a slight recovery of 2.8 percent from the 1990 rate of 2.2 percent; manufacturing is expected to grow by 2.4 percent, and services by 2.1 percent.

The forecast of monetary variables may not be fully consistent with this growth outlook. Interest rates on T-bills will continue to be above 25 percent. Liquidity growth is expected to be 6.6 percent, lower than the 12 percent in 1990, and the 25.9 percent in 1989. Indeed, in the International Monetary Fund (IMF) stabilization program liquidity growth is proposed to be about 7 percent. Other variables include the uncertainty of oil prices, the extent of recession in the developed countries, and the movement of import and export prices in general.

May, 1991

The outlook of 1.9 percent GNP growth in 1991 is therefore quite optimistic. It is highly possible that the year's gr··vth will be less than that — or even zero — depending on the character of monetary and fiscal policies under an IMF program. Given the similarity between the current state of the economy and the 1984-85 experience, a narrow stabilization program will mean a recession. The Philippine government has yet to conclude a formal agreement with the IMF.

PERSPECTIVE FOR 1992

The political arena in the Philippines will heat up in 1992 (and even as early as mid-1991), and this will have short-run stimulating effects on the economy. Since this will also be the tail end of the IMF program, there may be some freeing of the restrictions on monetary and fiscal variables, thus possibly contributing to a slight recovery. Growth will be about 4 percent, led by government construction (in keeping with the political efforts to win votes by way of public works). Exports will also pick up by more than the recovery of imports.

The agriculture sector is projected to grow by 4.5 percent, manufacturing by 4.2 percent, construction by 8.2 percent and services by 3.1 percent. This is higher than the 1991 growth rates of 2.8 percent, 2.4 percent, -11.1 percent and 2.1 percent respectively.

Inflation is projected to remain high at a rate of 8.3 percent, though this would be a decline from the 14.3 percent rate in 1991. Interest on T-bills will remain high at 20 percent, while liquidity will grow by 11.2 percent.

Some improvement in the trade balance is expected, with a deficit declining from US$3.4 billion in 1991 to US$3.3 billion in 1992, which, in turn, improves the current account from a US$2.0 billion deficit to a US$1.9 billion deficit. Some significant increase in exports is expected to help this come about. The current account deficit relative to GNP will also decline, but more slowly. In all, the prospects for 1992 appear positive only in the context of an election-related public expenditure binge, some improvement of trade performance, and recovery in vital sectors of agriculture and manufacturing.

CPI

CONCLUSION

The outlook for the Philippines for 1991 and 1992 illustrates the short-term, stop-go nature of its growth. It depicts the country's inability to embark on a long-term sustainable growth path. The unusual series of natural calamities that hit the country certainly curtailed its growth for 1990. But it is doubtful that they explain in any large part the structural weakness of the economy. Resiliency is a product of appropriate adjustments to shocks.

The major challenges for the economy include the real institution of dramatic economic reforms that are comprehensive, internally consistent, and contributive to long-term sustainable growth. These include trade policies, fiscal matters, privatization, and other policies which have already been identified and spelled out.

Given the history and experience of policy changes in the Philippines, the likelihood that anything of the magnitude and substance that a package of structural reforms requires will be undertaken for the remainder of the present administration's term is nil. The rest of 1991 and 1992 will be occupied with putting out fires, rather than carrying out a package of reforms. If the economy further deteriorates or unemployment worsens, it will be twice as difficult politically to pursue reforms in 1991 or in the election period of 1992.

WP/91/46

INTERNATIONAL MONETARY FUND

Asian Department

Sri Lanka: Price Changes and the Poor

Prepared by Anne-Marie Gulde 1/ ∅

Authorized for distribution by Kadhim A. Al-Eyd

May 1991

Abstract

This paper examines the short-run impact of Sri Lanka's recent structural adjustment program on the poorest segments of society. While the ultimate goal of all macroeconomic adjustment programs is to overcome structural rigidities and put the economy on a sustainable growth path, some of the measures implemented, such as the liberalization of food and energy prices, cuts in subsidies and other budgetary spending, and exchange rate changes, may cause significant increases in relative prices faced by the poor. On the other hand, there are offsetting income effects even in the short run, such as adjustments in wages and output prices and retargeting of subsidies.

Summary

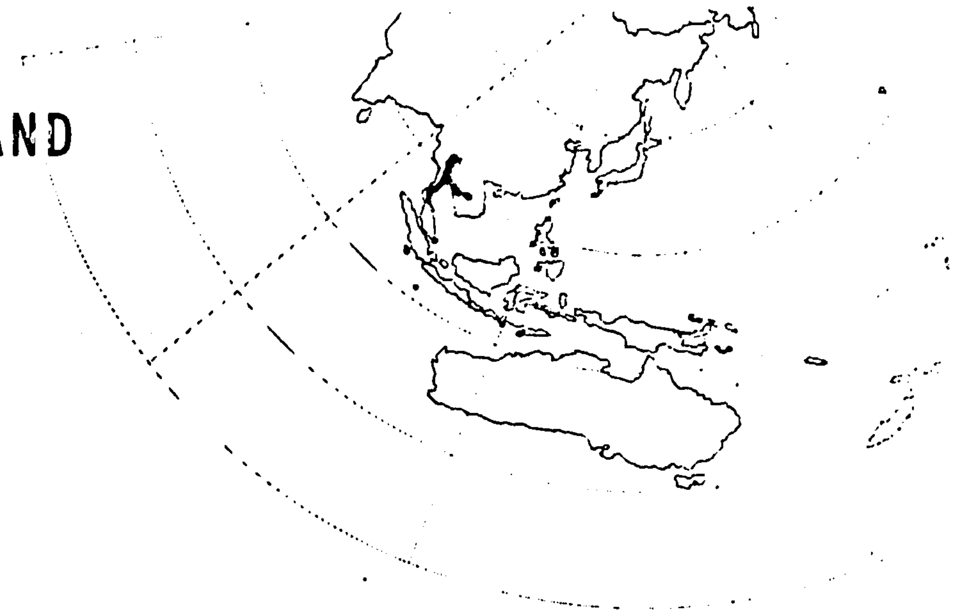
This paper examines how Sri Lanka's recent structural adjustment program affects the poorest segments of society. While the ultimate goal of all macroeconomic adjustment programs is to overcome structural rigidities and put the economy on a sustainable growth path, some of the measures implemented in Sri Lanka, such as the liberalization of food and energy prices, cuts in subsidies and other budgetary spending, and exchange rate adjustment may increase prices paid by the poor. On the other hand, even in the short run, adjustments in wages and output prices and retargeting of subsidies will have offsetting income effects.

The first section presents a "poverty profile," describing the size, background, and expenditure pattern of the poor. Based on this information, the second section estimates the effects of program-related measures on real incomes of the poor. As food expenditures account for more than 80 percent of all spending by the poor, it is suggested that the income effect can be approximated by the increase in food prices adjusted for any increases in earnings. The weighted average increase in food prices related to the program is estimated to be 30 percent. Different poor groups are shown to be affected to varying degrees, as wage increases in the urban and rural informal sectors and the effects of the devaluation on output prices lead to different changes in the incomes of rural and urban workers and of smallholders.

The last part of the paper describes measures to protect the poor during adjustment. It focuses on the policy mix and compensatory measures associated with the program. While the economic situation prevailing at the outset of the program required strong adjustment efforts, some price increases were phased in gradually to allow the poor to adjust their consumption basket. Furthermore, given Sri Lanka's traditional emphasis on social welfare expenditures, more efficient targeting of these expenditures could substantially shelter the truly needy during the adjustment process.

3/12

THAILAND



THE ECONOMY IN 1990

Despite the slowing of the world economy, and the Persian Gulf crisis, the Thai economy grew at a very high rate of 10 percent in 1990. Of greatest importance was the growth of domestic purchasing power. Moreover, investment of both the public and the private sector was healthy, particularly in export-oriented industries.

The Gulf crisis will affect the Thai economy less than the two previous oil crises did because the present Thai economy is fundamentally much stronger now than in the past. Moreover, the country's dependence on foreign energy sources has been reduced from 90 percent during the second oil crisis to only 60 percent now. And the rise in oil prices was no more than US$18 per barrel at constant 1980 prices.

The agricultural sector in 1990 declined by 2 percent, due to unfavorable climatic conditions, the drought, widespread crop diseases, and large floods. A shortfall of water for agricultural purposes aggravated conditions.

Manufacturing production grew at an impressive rate of 14 percent as a result of strong export performance and rising domestic demand. The most notable products involved were vehicles, construction materials, electrical appliances, computers and computer components, textiles, and integrated circuits.

The construction sector expanded by 23 percent, led by government infrastructure investment projects and by state enterprises. On the private side, projects were undertaken for the construction of condominiums, housing estates, and golf courses.

Thailand's trade and current account deficit widened markedly. The trade deficit soared to 240 billion baht, or 11.7 percent of gross domestic product (GDP), as against 140.8 billion baht recorded in the previous year. The current account deficit amounted to 156 billion baht, 7.5 percent of GDP, as compared to a deficit of 63.7 billion baht recorded in 1989.

Export growth slowed because of the reduction of agricultural exports. The value of exports rose only 16 percent from 1989. Imports, however, rose 27 percent. The increasing price of oil forced the government to spend additional foreign exchange of about 15 billion baht. The number of foreign tourists dropped sharply, while the remittances from Thai labor in foreign countries also abated very markedly.

The consumer price index (CPI) rose by 6 percent in 1990; however, the December 1989 to December 1990 rise was 8 percent. Inflation was generated by excess demand at the beginning of the year, and wage increases during the year increased both costs of production and domestic purchasing power. Furthermore, the reduction of major crops, and the drop in fruit and vegetable production due to the flood, added to price pressures. Finally, the increase of domestic oil prices in September caused the CPI to increase in October by 2 percent. However, as a result of government measures to curb inflationary pressures, the CPI increased marginally by 0.4 percent in November and declined by 2 percent in December.

GOVERNMENT ECONOMIC POLICIES IN 1990

Last year the government designed and implemented numerous measures enabling Thailand to adjust swiftly to the new economic environment. Though they caused a rather severe short-term impact on the economy, the economy will benefit in the long term from a stronger base.

CPI

Among the measures implemented was a liberalization of foreign exchange controls. In addition, interest rates on loans by commercial banks were raised from 15 percent to 16.5 percent, and the interest-rate ceiling on deposits was abolished. A formula for the automatic adjustment of domestic retail oil prices was introduced. Regulations on importing soybean, animal feed, and fertilizer were eased. Measures aimed at moderating the "brain drain" from the bureaucracy were also launched. The government continued investment in infrastructure, and new projects were added.

At the time of the Persian Gulf crisis, the ceiling on interest rates on loans was raised from 16.5 percent to 19.5 percent. Also, the tax rate on the import of machinery and equipment was reduced to 5 percent in order to cut production costs and promote production efficiency.

In addition to the important adjustment of retail oil prices to reflect world markets, both short- and long-term energy policies were reviewed so as to reduce Thailand's dependence on energy sources from the Middle East. Plans to diversify energy needs both by source and by type were accelerated, including the development of energy resources in neighboring countries. The legal limit on oil reserves was raised.

Assistance to disadvantaged groups in the society was started after the oil price was increased: The tax on rubber exports was abolished; a tax and duty exemption was created for the import of pesticide and fertilizers; and other measures of this type were also taken to help agricultural producers.

THE OUTLOOK FOR 1991

We assume that with the end of the Gulf War, the world economy will recover, and the average price of oil (crude and products) will be US$23.60 per barrel. A number of good effects should follow for Thailand. Exports should rise 3 percent more than they would have otherwise. The number of tourists in 1991 is estimated to be 5.3 million persons, an increase of 2 percent. The improvement of the investment climate should increase private investment by approximately 1.5 percent in real terms. Additional employment of about 10,000–15,000 Thai workers in the Middle East will add to remittances from them.

Given these assumptions, the Thai economy is expected to grow between 8.5 and 9.0 percent this year. The manufacturing and service sectors will benefit more with an increase of 1.5 to 2.0 percent marginally. Agricultural output is expected to grow at a moderate rate of approximately 2 percent because of the expected drought and limited water, especially for irrigated rice areas.

Exports of manufactures should do well, and apparel, electrical appliances, and electronics production will increase. Major services, such as, hotel, restaurant, trade, and tourism, will also recover as a result of peace in the Gulf.

Inflation should ease as the pressure on domestic oil prices declines. Together with a declining trend of domestic interest rates, the inflation measured by the CPI is forecast to be 6 percent.

The trade and current account deficit will still be a major concern this year, as a trade deficit of about 11.0 percent of GDP is expected. Meanwhile, a slowdown in the growth of tourist revenues will cause the current account deficit be about 7.4 percent of GDP, which means no improvement over 1990.

SURVEY REPORT

Population Reference Bureau

Vietnam

The Socialist Republic of Vietnam conducted its first nationwide survey on fertility and family planning in 1988. The survey, funded by the United Nation's Population Fund (UNFPA) and carried out by the National Committee for Population and Family Planning, was based on the 1985 version of the Demographic and Health Survey (DHS) "Model A" questionnaire, but was adapted and shortened to fit local information needs. In particular, many health questions were dropped. The survey asked 72 questions, rather than the model's full quotient (190 questions).

Vietnamese women: They now marry later and want fewer children.

With more than 4,000 respondents, the survey indicates that a slow fertility decline, which began two decades ago, has continued in recent years. The total fertility rate–4.0 children per woman–is significantly lower than the 6.1 children ever born for currently married women at the end of their reproductive years. The survey also hints that the downward fertility trend is likely to continue: the average desired family size is 2.6 children.

Age at first marriage has also risen over the last two decades. The median age of marriage for 25-29 year olds is 21.3 years and for 45-49 year olds, 19.9 years.

Contraceptive awareness is high in Vietnam. About 94 percent of women could identify methods of family planning–primarily the IUD, the main method currently available in Vietnam. Contraceptive use is not as high: 63 percent of ever-married women had used contraception at some time, and 53 percent reported current use. The majority of current users (62 percent) use the IUD, followed by the traditional methods of withdrawal and rhythm (28 percent).

Differences in contraceptive use emerge between urban and rural women, women residing in the north and south, and women of different educational levels. Women in the northern part of the country are more likely to be practicing family planning (58 percent for the north and 47 percent for the south). Patterns of use are also different: women in the south using a method are more than twice as likely to be using a traditional one. Significant educational differences also appear: only about 29 percent of illiterate women report current use of any method, compared to 55 percent of women with a primary education.

Breastfeeding is very common and lasts on average 14.5 months, with only small differences by residence or socioeconomic level. Infant mortality in the five years before the survey was calculated to be 34 deaths per 1,000 live births, down from 40 per 1,000 during the 10 to 14 years before the survey. These are low estimates compared to other sources and may reflect underreporting.

-*N.Y.*

Resume Normal Relations With Vietnam

It's in the US diplomatic and trade interest to help Hanoi back into the global economy and thereby reward reforms

By Kelly S. Nelson

VIETNAM is once again making headlines in the United States. For 16 years, since the Vietnam war ended, the US has refused to deal with Vietnam on either a diplomatic or economic level. The only contact between the countries since that time has been with regard to humanitarian concerns, as the two attempted to reconcile painful issues left unresolved from the war.

Over the past nine months, however, this contact has been expanded to include high-level discussions between officials from both countries. In recent weeks, the administration released a new proposal on US-Vietnamese normalization, which has led to a flurry of discussion on Vietnam in the media, in Congress, and among the public.

Normalization of relations with Vietnam has been postponed by successive administrations since 1975 for various reasons. The Bush administration has made it quite clear that normalization will only be considered in conjunction with a comprehensive political settlement in Cambodia, as well as continued cooperation on the POW/MIA issue. Vietnam has resisted the US call for a resolution of the Cambodia conflict by opposing the UN-sponsored peace plan, claiming it will allow the Chinese-backed Khmer Rouge to return to power. The timetable for normalization released last month does not deviate from previous policy. By offering Vietnam detailed incentives to comply with the peace settlement, however, the proposal signals a new attempt by the administration to end the stalemate over Cambodia.

Both countries have been adversely affected by the lack of relations. Vietnam, though rich in natural resources, is one of the poorest and most undeveloped countries in the world. The trade embargo imposed by the US on Vietnam in 1975 has succeeded in limiting development aid, multilateral loans, investment, and other sources of income needed for Vietnam's economic development.

The US has also been damaged by the fact that many countries do not recognize the US-imposed trade embargo. US companies are finding themselves at a disadvantage as many foreign concerns begin to invest and profit in Vietnam. Japan, Singapore, Australia, the United Kingdom, France, Italy, and the Netherlands have initiated trading and investment discussions with Vietnam. Indeed, Japan is now Vietnam's second largest trading partner after the Soviet Union.

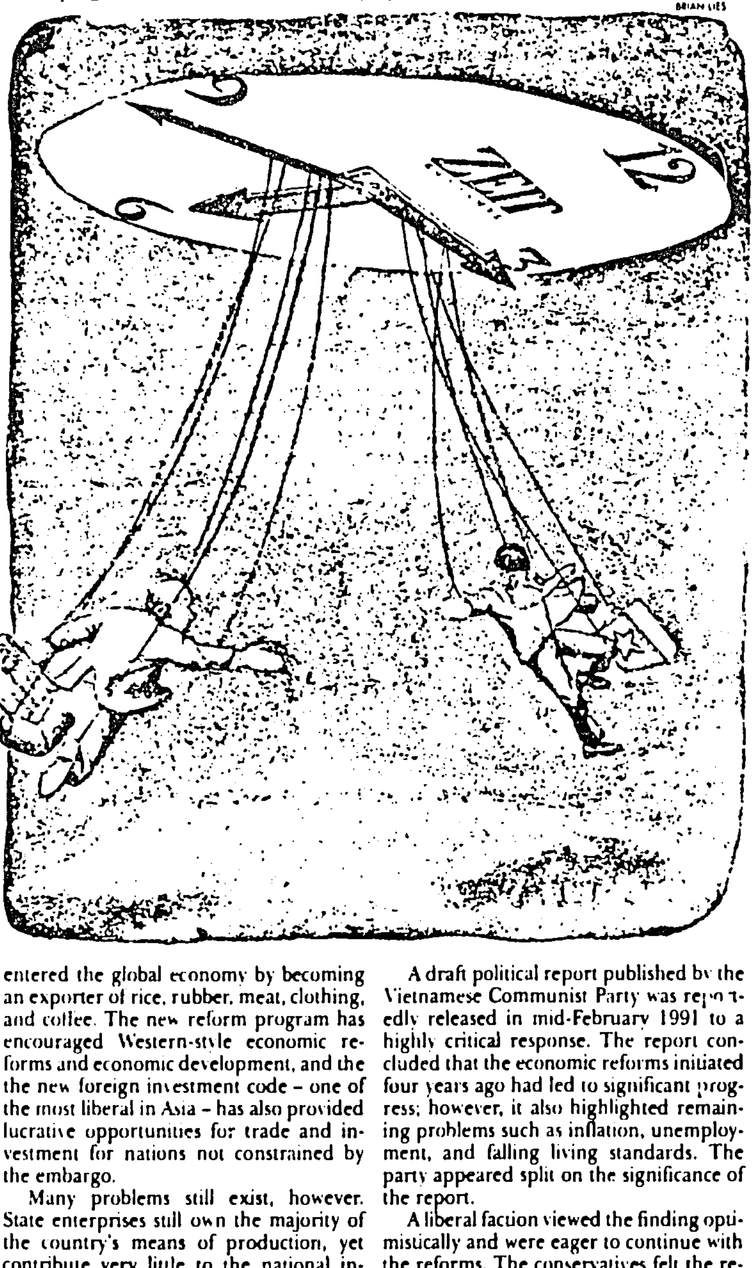
Observers of Vietnam see the 1990s as a turning point for the country as it continues its reform program, faces the collapse of communism around the world, and considers the declining influence of it patron, the Soviet Union. If normalization of relations were to occur, it could result in a resumption of mutually beneficial economic activity and could offer the US the opportunity to participate in a new balance of power in the region.

Under the leadership of Foreign Minister Nguyen Co Thach and General Secretary Nguyen Van Linh, Vietnam has been following a new foreign and economic policy since 1986. These leaders have undertaken Gorbachev-style reforms, called *doi moi* (renovation), that attempt to move the economy more in line with market forces and away from central planning, and that place an emphasis on attracting foreign investment.

Since the initiation of the economic-reform program, Vietnam has successfully entered the global economy by becoming an exporter of rice, rubber, meat, clothing, and coffee. The new reform program has encouraged Western-style economic reforms and economic development, and the the new foreign investment code – one of the most liberal in Asia – has also provided lucrative opportunities for trade and investment for nations not constrained by the embargo.

Many problems still exist, however. State enterprises still own the majority of the country's means of production, yet contribute very little to the national income. Many of the goods produced are not globally competitive because of poor quality. In addition, the investment climate still leaves much to be desired. Vietnam's infrastructure is weak, with such deficiencies as unreliable power supplies, and years under a socialist system have contributed to a poor work ethic.

The new world order is apt to have strategic and ideological implications for Vietnam's future. The Communist Party of Vietnam has attempted to retain its power over the country while the socialist bloc has crumbled internationally. Pressure has been building for the government to broaden its economic reforms to include political reform. Although Vietnam appears to be politically stable, there are signs that it could turn out to be fraught with the same political upheavals and reversals of policy China has experienced.



A draft political report published by the Vietnamese Communist Party was reportedly released in mid-February 1991 to a highly critical response. The report concluded that the economic reforms initiated four years ago had led to significant progress; however, it also highlighted remaining problems such as inflation, unemployment, and falling living standards. The party appeared split on the significance of the report.

A liberal faction viewed the finding optimistically and were eager to continue with the reforms. The conservatives felt the report implicitly criticized the Communist Party for Vietnam's economic problems and expressed concern that the reforms are moving the country toward capitalism. In March, further pressure was added when a prominent Vietnamese intellectual called for the Communist Party to step down and "return all authority to popularly elected organs and the state."

Vietnamese trade with its largest trading partner, the Soviet Union, has been declining in recent years. Before 1991, Vietnam conducted approximately two-thirds of its trade with the Soviet Union. However, a new economic agreement between Vietnam and the USSR signed Jan. 31 will seriously cut trade and development aid. The new pact will also place strain on the Vietnamese economy by pricing exchanged goods at international market prices and demanding hard currency for all transactions. The new economic burden will undoubtedly speed Vietnamese efforts to attract other investors and trading partners, thereby strengthening its entry into the international economy.

As the Soviet Union has decreased support to Vietnam, the country has become increasingly in need of outside assistance. China has made repeated overtures to fill the gap left by the Soviet's departure. In January, Vietnam responded by sending a delegation of high-level officials to visit China. The delegation was apparently invited to examine China's economic reform program; however, discussion on reconciliation is believed also to have occurred.

These recent events show that the 1990s could indeed be a turning point for Vietnam, and for the US should relations be normalized. Normalization could prove beneficial to both countries for both geopolitical and economic reasons. As the global geopolitical balance of power shifts, normalization would find the US better positioned to help Vietnam become politically stable and free from the influence of the Soviet Union or China.

Normalization of relations would also ease the handicap that US business interests have been subjected to by the 16-year-old trade embargo with Vietnam. As the reform program progresses, Vietnam appears likely to become a new market for investment. Indeed, many observers believe it may become the next "Asian miracle economy." Normalization would allow US businesses freely to compete for ventures in the country with the Japanese, European, and Asian states that have already been investing in and profiting from the newly opened market.

Vietnam has proven willing to meet some of the US conditions for normalization. By withdrawing from Cambodia, pledging further support on the POW/MIA problem, and allowing discussion on the emigration of Amerasian children, Vietnam has shown a desire to cooperate with the US and the international community.

In addition, its economic reforms have indicated its intention to integrate into the global economic community. Normalization of relations would recognize Vietnam's efforts to cooperate and would encourage its transition to an economically healthy and politically stable force within the region.

■ *Kelly S. Nelson conducts research on Asian trade issues for the Washington law firm Arnold and Porter. She is also a university fellow and doctoral candidate at The George Washington University.*

OPINION

The US could accelerate progress toward peace by lifting its embargo on humanitarian and developmental aid

Jump-Start for Cambodia

By Heather M. O' Brien

ALL four factions at the core of the Cambodian conflict have joined hands in a shaky cease-fire until the Supreme National Council meeting scheduled for this month. The basic problem is a political deadlock between Cambodia's two most powerful factions – the State of Cambodia's de facto government, communist but reformist, and the radically Maoist Khmer Rouge guerrillas – over details of the United Nations peace plan.

Meanwhile, in the field the number of refugees on the Thai-Cambodian border has climbed to more than 380,000, and more than 180,000 civilians within Cambodia have been displaced. The current political "red-lock" threatens the momentum of the Cambodian peace process.

The flurry of diplomatic activity following the optimistic internationalization of the Cambodian peace process in August 1989 produced the UN Security Council's framework for a political settlement in Resolution 688. This "Perm-5" plan will create a UN peacekeeping operation, the UN Transitional Authority in Cambodia (UNTAC), which will neutralize the volatile military environment, supervise five key government ministries, and prepare Cambodians for the first free elections in Khmer history. During this transition period, the Supreme National Council will enshrine the national sovereignty of Cambodia and hold Cambodia's seat at the UN. Factional disputes within the council have caused the present impasse.

The Cambodian peace process needs a jump-start. This could be done simultaneously from two angles: external and internal.

First, the internal problem. Military machinery within Cambodia must be effectively neutralized and international guarantees of peace must be strengthened. The UN's Perm-5 framework unwittingly favors the Khmer Rouge over the State of Cambodia (SOC) forces. Although soldiers from all four Khmer factions will be held in cantonment under UN guard, the very nature of the guerrilla group gives it the unfair advantage of invisibility.

While SOC troops are under keen international eye, Khmer Rouge rank and file will melt unseen by the UN into the Cambodian populace and further entrench a culture of fear and coercion. While the SOC military would be meticulously dismantled, the Khmer Rouge would be "neutralized" by UN blue helmets checking surrendered weapons against lists provided by the Khmer Rouge themselves. Such a system, dependent on Khmer Rouge honesty, invites deception.

Authentic international guarantees by UN Security Council members are essential. Khmer civilians must be assured that the Khmer Rouge will not return to undermine a newly elected government. Current draft guarantees are vague and noncommittal.

CHANGES in the external environment are equally important. Here the US can make a vital contribution by lifting the embargo against humanitarian aid to Cambodia. This would demonstrate a commitment to helping the Cambodian people and to the P-5 process.

Allowing humanitarian and developmental aid to enter the country so that Prime Minister Hun Sen can better care for the Cambodian people may appear to benefit the de facto regime in the short run. But if the lifting of the embargo is coupled with assurances that Hun Sen will agree to the P-5 plan, UNTAC will ultimately ensure that the Cambodian people benefit from this aid. Once elections have been held, the US will be freed of a residual cold-war conflict and can concentrate on fostering ties with Cambodia's politically more important neighbor, Vietnam.

While complete normalization of diplomatic relations may yet be politically premature, opening channels of communication between Indochina and the US is crucial. Sen Robert Kerrey's proposals to establish a liaison office in Phnom Penh to supervise the distribution of humanitarian aid and encourage informal exchange between Washington and Phnom Penh would be one such positive channel.

Fostering economic ties by lifting the trade embargo would open many windows of opportunity – political, economic, and humanitarian – to US relations with Indochina. It would also help to relieve domestic pressure from the US business community, led by Sens. Richard Lugar and Frank Murkowski, to address US business interests by discarding the "trading with the enemy" act.

The political implications of lifting the trade embargo would be great. It could entice Hanoi and Phnom Penh into agreeing to the Perm-5 framework for peace, providing the needed lever to secure US interests with both warring Asian communists and their respective Security Council comrades. From the Soviet camp, the US and its allies in the region would finally get verification of the complete withdrawal of Vietnamese military forces from Cambodia. UNTAC-supervised elections would provide a face-saving way for Beijing to drop its Maoist proxies, thereby pre-empting any Khmer Rouge plans to return to power for a second round of the killing fields.

To achieve these ends, the US should remove its political barricade to aid and allow financial institutions such as the IMF, World Bank, and Asian Development Bank to decide whether the SOC's recent economic reforms merit eligibility for development loans. Cold-war politics froze the aid vaults shut. Cambodia is the only country ever to be denied developmental aid from all the usual loan sources.

Current US foreign policy significantly contributes to the human-rights nightmare in progress in Cambodia. Fostering political stability and economic development will open new windows of opportunity to promote US interests and to cultivate mutually productive long-term relations with Southeast Asian nations.

■ *Heather M. O'Brien, a former researcher with the Far Eastern Economic Review, helped draft sections of the UN peace plan for Cambodia.*

STATEMENT OF LARRY WILLIAMS
WASHINGTON DIRECTOR, INTERNATIONAL PROGRAMS
SIERRA CLUB

BEFORE THE

HOUSE BANKING SUBCOMMITTEE ON
INTERNATIONAL DEVELOPMENT, FINANCE,
TRADE AND MONETARY POLICY

REGARDING THE SIXTH REPLENISHMENT OF THE
AFRICAN DEVELOPMENT FUND AND THE
FIFTH REPLENISHMENT OF THE ASIAN DEVELOPMENT FUND

MAY 30, 1991

Thank you for the opportunity to testify today on behalf of the Sierra Club and the Environmental Defense Fund to provide our assessment of how the African and the Asian Development Banks are doing with regard to protecting the environment. As many of the members of this panel know first hand, the interest and concern expressed by the U.S. Treasury Department and the development banks over the environmental quality of the activities of the MDBs is directly due to the leadership this subcommittee has provided since the early 1980's. As a result, more attention is being paid, by some of the MDBs, to the environmental problems associated with their lending practices.

In 1988, this subcommittee passed an amendment, sponsored by Rep. Nancy Pelosi, to require the banks to provide environmental impact assessments to the Treasury Department and members of the public, 120 days prior to the project coming before the Board of Executive Directors for a vote. As you will recall, the law does not allow Treasury to support the project if an EIA, or a comprehensive summary of the EIA, is not provided in a timely fashion. Wisely, the law gives the banks two years to adjust their policies and procedures. This coming December, the Treasury Department will be obliged to vote against any project which has a significant impact on the environment for which an EIA was not prepared. The 120 day advance rule for the release of an EIA means that any project coming before the Board of Executive Directors after December 19th, 1991 will have to have a completed EIA available to the Treasury Department and the public by the middle of August.

The primary question is this: are the Asian and African Banks going to be able to comply with the EIA requirement? Of the four development banks, the Asian and African Development Banks seem to be having the most difficulty making preparations to meet the requirements of this law.

ASIAN DEVELOPMENT BANK:

The environmental staff of the Asian Bank supported the adoption of the Pelosi amendment because it already had EIA procedures in place. We remain concerned, however, as to whether their procedures have been amended in order to meeting the requirements of the U.S. law. As you will recall, the law requires that the EIA include a review of the proposed action <u>and alternatives to the proposed action</u> and that the EIA, or a comprehensive summary of the EIA, be made available to "the multilateral development bank, affected groups, and local nongovernmental organizations." From our discussions with Bank and Treasury staff it is our assessment that the Asian Bank is not yet ready to fully comply with the EIA law. We understand that the Bank is having trouble adjusting its project development cycle to meet the 120 day submission rule for the EIA. In addition, their old assessment procedures did not require the evaluation of alternatives, the involvement of affected groups or nongovernmental organizations; and it certainly did not include the requirement to release the EIA, or its equivalent, to the public and the U.S. ED 120 days in advance of the vote. These elements of the EIA procedures are the key to the whole process. Without public involvement in the process the EIA looses much of its meaning and becomes a paperwork drill.

The Acting Director of the Environmental Department, Bindu Lohani, was most supportive when the U.S. MDB/EIA law was under consideration by this Subcommittee and assured us that the ADB will meet the law's requirements. Mr. Lohani has always been most assessable to the environmental community, in the donor and borrower countries alike. However, we not so sure that Mr. Lohani openness is representative of the Bank in general. We were disappointed that the Bank's management made no effort to meet, or in other ways interact, with the NGOs who came from all parts of the world to attend the Bank's April annual meeting in Vancouver BC, Canada. Symptomatic of this problem is the slow progress the Bank has made in selecting a director of their environmental department. Until the director is in place, the expansion of the environmental staff must wait. In August, 1990 U.S. Treasury Deputy Assistant Secretary for Developing Nations, George Folsom, wrote to Mr. Kimimasa Tarumizu, the president of the Asian Development Bank, regarding the pending replenishment of the Asian Development Fund.[1] Mr. Folsom noted in his letter that:

> "We are concerned that the Asian Development Bank continues to be seriously under-staffed in the environmental area and that progress on the reforms called for at the economic summit can not be made unless steps are taken to increase the number of environmental experts on the Bank's staff. In its budget proposals for next year, we urge the Bank to make provision for a substantial increase in fully-

[1]. Report to the Congress from the U.S. Treasury Department on the environmental performance of the MDBs, March 1991, pg. 23.

qualified environmental staff. We believe that the number of these experts on the staff should be increased to ten by the end of June, 1991, with the understanding that a further increase to fifteen would take place before the end of the calendar year."

Folsom goes on to urge the Bank to "adopt and implement promptly procedures for assuring that environmental impact assessments (EIAs) are completed for all projects that will have a significant effect on the environment."

Here we are, a month or so away the implementation date of the EIA law and nine months since Mr. Folsom's letter and we still have no assurances that the Bank has responded, or will respond in the near future, to these needs. We remain hopeful, but very concerned with the speed in which the Bank is proceeding.

I would like at this point to submit for the hearing record a copy of a letter from 14 U.S. and Asian nongovernmental organizations, dated April 25, 1991, to the President of the Asian Development Bank. This letter was written at the Bank's annual meeting in Vancouver, B.C. I believe that you will be interested in the reviewing the 14 recommendations these organizations have suggested to the ADB. To note just a few the groups call for greater public participation in ADB activities; the integration of environmental and social factors into the loan policies; increase the number of environmental and social staff; give more attention to the impact of ADB development activities on women and children; and, establish an independent monitoring and evaluation process.

Global environment/oceans

Driftnets bill gets Senate hearing

The Senate Commerce Committee and the National Ocean Policy Study — a panel of senators established by the committee to oversee oceans issues — will hold a hearing Friday on a bill that would require the president to impose economic sanctions against countries that fail to eliminate large-scale driftnet fishing.

Introduced April 23 by Sen. Bob Packwood (R-Ore.), the measure (S 884) is aimed at the nations of Japan, South Korea and Taiwan, which continue to use driftnets in the North Pacific ocean despite international pressure to end the practice. While the three nations use the nets primarily as a means of catching squid, driftnets indiscriminately trap and kill many sea creatures, including seabirds, marine mammals and sea turtles, as well as other non-target species of fish.

Packwood stressed in an April 23 statement before the Senate that among the non-target species trapped by driftnets are U.S.-origin salmon, which spend part of their life cycle in the ocean before returning to fresh water to spawn. U.S. fishing interests charge that driftnets are a threat to North American salmon.

A September 1990 Congressional Research Service report estimates that as much as 30,000 metric tons of North American salmon and steelhead — possibly 21 million fish — are caught each year by Asian driftnet fleets. Driftnets are huge plastic fishing nets that stretch along the ocean surface for up to 40 miles and may reach 30 to 100 feet deep. Known to environmentalists and other critics as "walls of death," the nets are placed into the water and allowed to drift with ocean winds and currents.

Bill: S 884 is designed specifically to implement a 1989 United Nations resolution calling for an end to high seas driftnet fishing by June 30, 1992, unless adequate conservation and management measures are in place. However, while it is the United States' position that no conservation program would be adequate to compensate for the indiscriminate nature of driftnetting, Japan opposes the moratorium, arguing that current international efforts to monitor driftnet fishing are adequate.

A committee aide said the key to the Packwood bill is that it would require the president on Jan. 1, 1992 — six months prior to the U.N. deadline — to certify to the Congress any country that has not announced its intention to adhere to the moratorium. This would give the United States some lead time in trying to implement the U.N. resolution, the staffer said.

Once a country is certified, the president under current U.S. law (22 U.S.C. 1978 et seq.) has the authority to ban imports into the United States of fish products from that country. However, the Packwood bill would go one step beyond current law by *requiring* the president on June 30, 1992, to ban fish products from any country that has not stopped using driftnets.

The bill would authorize additional economic sanctions if:

- the president determines that banning fish products alone is not sufficient to stop a certified country from engaging in large-scale driftnetting;
- a country retaliates against the United States with sanctions of its own; or
- a country is caught violating the U.N. moratorium.

The scope of the additional sanctions would include duties, import bans and other restrictions on the goods and services of the other country.

Witnesses: Witnesses are expected to include representatives of the State Department, the Commerce Department, the Pacific States Marine Fisheries Commission, Greenpeace and the Animal Protection Institute.

When: The hearing is set for Friday, June 21, at 9:30 a.m. in 253 Russell.

Senate Commerce contacts: Penny Dalton, majority, x44912; Earl Comstock, minority, x48170. —*DR*

WP/91/40
April 1991

INTERNATIONAL MONETARY FUND

Asian Department

Market-Based Systems of Monetary Control in Developing Countries: Operating Procedures and Related Issues 1/

Prepared by Chorng-Huey Wong

Summary

This paper reviews issues in the development of a market-based system of monetary control in the context of financial reform in developing countries. It discusses the appropriate sequencing of financial reform measures that would facilitate the transition toward a market-based system. It emphasizes the implementation of the basic reforms of monetary control procedures and prudential regulation prior to the enhancement of banking competition and the removal of direct instruments.

After examining central bank operating procedures that employ market-based instruments, the paper focuses attention on measures required to strengthen the effectiveness of market-based operations. In this connection, it discusses the coordination of monetary policy with fiscal and external sector policies, concern about interest rate stability, and the establishment of secondary and repurchase markets. The paper also assesses the effects of financial reform on the demand for money function and stresses the importance of developing up-to-date economic indicators for policy formulation and implementation when the demand for money is unstable.

Introduction

In recent years, many developing countries have begun to reform their central bank operating procedures in favor of a more active use of indirect or market-based instruments to achieve macroeconomic objectives. The introduction of a market-based system of monetary control, together with financial liberalization, is generally aimed at strengthening savings mobilization and improving the efficiency of resource allocation, which has often been inhibited by direct interest rate and credit controls. This paper reviews issues in the development of a market-based system of monetary control in the context of financial reform in developing countries.

The plan of the paper is as follows. Section I discusses the interaction between monetary policy reform and financial liberalization, the appropriate sequencing of financial reform measures, as well as the role of public policy in developing financial markets. Section II examines the policy framework and central bank operating procedures under a system of indirect monetary control and discusses several related issues that have arisen during various stages of financial reform. Emphasis is placed on policy coordination and measures required to strengthen the effectiveness of open market operations and to prevent a financial crisis while liberalizing the financial system. Section III assesses the effects of financial reform on the demand for money function and the implications for the formulation and implementation of monetary policy. Conclusions are drawn in Section IV.

PN-ABP-030

LATIN AMERICA
QUARTER 2, 1991

WASHINGTON ECONOMIC WATCH

A Digest of Development Policy Information

A Project of the Overseas Development Council

325

P.S. Please Note:

LATIN AMERICAN

Bush, George. The 1st Anniversary of the Enterprise for the Americas Initiative, Statement at a White House News Conference, Office of the Press Secretary, June 27, 1991.

Katz, Julius L. Testimony before the Committee on Finance, U.S. Senate, April 24, 1991.

Mulford, David C. Statement before the Subcommittee on Deficits, Debt Management and International Debt Finance Committee, U.S. Senate, June 12, 1991.

Williamson, John. "The Problem of Latin American Flight Capital," Statement before the Subcommittee on Deficits, Debt Management and International Debt Finance Committee, U.S. Senate, June 12, 1991.

Feinberg, Richard E. and Peter Hakim. "Make the Free-Trade Vision a Reality," The New York Times, June 30, 1991.

Response of the Administration to Issues Raised in Connection with the Negotiations of a North American Free Trade Agreement. Transmitted to the Congress by the President, May 1, 1991.

Bush, George. "North American Free Trade Agreement," U.S. Department of State Dispatch, May 6, 1991.

"First Step, North America," Interview with Carla Hill, Latin Finance, Number 25, 1991.

Bentsen, Lloyd. "Pluses, Minuses of Free Trade with Mexico," The Christian Science Monitor, March 29, 1991.

Zoellick, Robert B. "Trade is Not a 'You Win, I Lose' Proposition," The Washington Post, April 28, 1991.

LaFalce, John. "Mexico" Social Concerns Count," The Journal of Commerce, April 5, 1991.

Faux, Jeff. "No: The Biggest Export Will Be U.S. Jobs," The Washington Post, April 16, 1991.

Kirkland, Lane. "U.S.-Mexico Trade Pact" A Disaster Worthy of Stalin's Worst," The Wall Street Journal, April 18, 1991.

Conyers, John. "The Efficiency and Effectiveness of U.S. Advisory and Assistance Efforts in Panama," Opening Statement before the Legislation and National Security Subcommittee, April 17, 1991.

Horton, Frank. "Status of United States Assistance to Panama," Opening Statement, April 17, 1991.

Fessler, Pamela. "Panel Maintains El Salvador Aid," Congressional Quarterly, June 15, 1991.

Falco, Mathea. "Don't knock Colombia for Dealing with the Devil," The Los Angeles Times, June 27, 1991.

Chamorro, Violeta. "A Future Linked to Support," The Washington Times, April 29, 1991.

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release June 27, 1991

REMARKS BY THE PRESIDENT AT CEREMONY FOR THE 1ST ANNIVERSARY OF THE ENTERPRISE FOR THE AMERICAS INITIATIVE

The Rose Garden

4:05 P.M. EDT

THE PRESIDENT: Please be seated. Welcome, distinguised members of Congress and both Houses. Let me salute our Secretary of the Treasury and another Cabinet member, Ambassador Carla Hills. Minister Foxley of Chile, Minister DeFranco of Nicaragua, Minister Alfaro of Panama. I could not be more pleased to have you all join me up here today. And look at this audience, sweating out there. (Laughter.) Change that -- perspiring out there.

Bob Mosbacher is here, our Secretary of Commerce; and Ed Madigan, General Scowcroft, Bill Reilly, Mike Boskin, Larry Eagleburger -- and I'm going to get in trouble -- Mr. Robson and many, many more. Fred Zeder and John Macomber of the Ex-Im, Ron Roskens of AID. You have our top people here and it's very symbolic and important that they be here. I think that this shows vividly our commitment to building a better and more prosperous hemisphere.

We're also pleased to have with us Mr. Enrique Iglesias of the Inter-American Development Bank. It seems like he just left. He was just here the other day, and we welcome him back. The Ambassadors from Latin America and some of the Caribbean countries, from the OAS, the Secretary General here, we salute you, sir; and many members of the diplomatic corps. To everyone, I would say my warmest greetings to you on this historic day. Feel free to take your coats off. If it weren't for these cameras, I'd take mine off. (Laughter.)

I'm just delighted, again, that you're all here. And we've come here today to celebrate the first anniversary of the Enterprise for the Americas Initiative. As you know, this initiative wasn't a unilateral thing, it grew out of talks between many of us here today.

I heard many of your concerns about building a prosperous hemisphere, of throwing off the deadening weight of debt and economic stagnation, and building strong ties of idealism and self-interest.

With the Enterprise for the Americas Initiative, we vowed to encourage free trade, stimulate investment and reduce the debt burden that overwhelms so many of our neighbors and our colleagues.

329

We've made great progress. In just one year we've signed eight bilateral framework agreements for trade and investment: with Chile, Colombia, Costa Rica, Ecuador, El Salvador, Honduras, Peru and Venezuela. Make that 10 agreements, because today Carla Hills will sign bilateral framework agreements with Minister DeFranco of Nicaragua and Minister Alfaro of Panama. We also are negotiating with Guatemala and the 13-nation, English-speaking Caribbean community.

Last week, right here, Ambassador Hills also joined representatives of Argentina, Brazil, Paraguay and Uruguay in signing what we call The Rose Garden Agreement, the first regional framework accord under the Enterprise for the Americas Initiative. Carla has been very busy, and I'm glad to see her bringing a lot of these things to fruition. I congratulate her and Dave Mulford and so many others who have worked tirelessly on these projects.

Ambassador Hills and her counterparts will pull down tariff and nontariff barriers, protect patents and intellectual property, strengthen investment environments and make it possible for firms to repatriate their profits. In short, we will build a solid foundation for economic cooperation and prosperity.

We've also begun making our hemisphere more hospitable to investment. The Inter-American Development Bank has approved its first investment sector loan. It's $150 million to Chile. Minister Foxley and President Iglesias completed arrangements for this loan today, I am told.

President Iglesias, I want to thank you, sir, and congratulate everyone at the IDB for this important step. And we should congratulate Chile for the impressive free-market reforms that it has undertaken. Through these loans, the IDB will help Latin America and the Caribbean countries compete for capital and embrace reforms that foster economic growth.

For years the world experimented with the fantasy that experts could manage economies. The utter failure of the communism system demonstrated that expert cadres can no more manage growth than they can manage the weather or anything else. Free markets reward people who have ideas, not just those who have connections. They allow poor people to become rich. They make possible unprecedented levels of social mobility. And, of course, they mean jobs. They teach people hard study, hard work and commitment to others -- those commitments produce real wealth.

I'm also pleased to report that our proposal for a $1.5 billion Multilateral Investment Fund has gotten off to a great start. Japan has pledged $100 million for each of the next five years. Canada, France, Portugal and Spain have expressed keen interest in supporting the fund, which will provide targeted support for countries that undertake the difficult reforms necessary to encourage investment and stimulate free enterprise.

Pillar three of our proposal, debt reduction, also has gotten off to a rousing start. Five nations already have negotiated far-reaching reductions in commercial debt through the provisions of the Brady Plan. Other nations will take advantage of the plan as their economic reforms take shape.

Congress has agreed to reward economic reform and trade liberalization by reducing a portion of a nation's debt -- the food assistance loans contracted under PL 480. Congress also supported our recommendation to use interests on remaining debt for grassroots environmental projects. And this ambitious, innovative plan already has produced results.

Today, the U.S. will sign an agreement with Chile, slashing Chile's PL 480 debt 40 percent, to $23 million. This is the first example of bilateral debt reduction under EAI. We look forward to reaching an understanding soon on the environmental component of this agreement.

So now, just briefly, let me talk about what lies ahead. As you know, Congress recently voted not to terminate the fast-track trade procedures that enable us to deal in good faith with you -- and with Congress -- in trade negotiations. Our goal is to create a free trade zone that will cover all of North America. This trade zone -- 360 million consumers and markets that produce more than $6 trillion in annual output -- will set the stage for something even more dramatic -- a whole hemispheric zone of free trade.

I was very proud and pleased the way so many countries south of Mexico and in the Caribbean supported the FTA, the fast-track authority, with Mexico. It's broad vision, because it should sweep through -- this whole concept of free trade must sweep through our whole hemisphere.

The Enterprise for the Americas Initiative can link our nations with their diverse cultures, work forces, and creative forces. I know some have worried that the EAI might indicate a reduction in our commitment to the multilateral trading system. Not so: we remain fully committed and fully determined to make that system work.

Indeed, as part of the Uruguay Round, we have joined our Latin American and our Caribbean allies in trying to pull down protectionist barriers in Europe and in Asia. I want to stress the importance of reaching a successful conclusion to the round. It can establish a basis for worldwide free and fair trade. Without it, we're going to have great difficulty moving forward.

We live in an extraordinary place at an extraordinary time. When Cuba embraces democracy, ours will become the first truly democratic hemisphere in the world. That is a major goal, a major accomplishment by most countries already; Cuba being this holdout.

There's no accident of history here. From the Northern tip of Alaska to the southernmost point of Tierra del Fuego, we share common heritages. Our people can trace their roots to all the nations of the world. We share ties of culture, and of blood, and of common interest. And now, as democracy sweeps the world, we share the challenge of leadership through example.

We can lead the way to a world freed from suspicion and from mercantilist barriers, from socialist inefficiencies. We can show the world how prosperity preserves the social order -- and the land, air, and water as well. We can show the rest of the world that deregulation, respect for private property, low tax rates and low trade barriers can produce vast economic returns. We can show the rest of the world how to build upon each other's strengths, rather than preying upon weaknesses.

Today, I simply want to pledge to you, our friends, my full effort to make the Enterprise for the Americas Initiative a total reality. I urge Congress to pass promptly the legislation necessary to enact EAI. This includes debt reduction authority and authority for the United States to contribute its share to the Multilateral Investment Fund.

In 1876 -- I think I mentioned this the other day when President Collor was here -- the Brazilian Emperor, Dom Pedro II visited the United States, and stopped in St. Louis, among other places. And he noted that local craftsmen were using only the sturdiest materials in building a customs house. The emperor was stunned. "But an iron building would last 400 years," he noted. "You do not mean to tell me that there will be any custom houses in 400 years."

We meet today to honor Dom Pedro's vision of a hemisphere shorn of customs houses and jammed with thriving markets. If we can build a hemisphere devoted to freedom, one that prefers enterprise to envy, we're going to create our own new world order.

We've worked miracles in one year; and so let us shape a revolution in the next. Because I honestly believe that, together, we can make our hemisphere's freedom first and best for all.

Thank you, and God bless you. And thank you all for coming down here on this very hot, but very significant occasion. Thank you. (Applause.)

One half of it done. (Applause.)

Q Mr. President, have you thought about a successor to Thurgood Marshall?

MORE

TESTIMONY OF
AMBASSADOR JULIUS L. KATZ
DEPUTY UNITED STATES TRADE REPRESENTATIVE
BEFORE THE COMMITTEE ON FINANCE
UNITED STATES SENATE

April 24, 1991

Introduction

Mr. Chairman, thank you for the opportunity to discuss the trade aspects of the President's Enterprise for the Americas Initiative in the context of the Committee's consideration of our request for extension of "fast track" procedures for approval of trade agreements.

The Enterprise for the Americas Initiative (EAI), proposed by the President in a major policy address in Washington on June 27, 1990, is the result of a thorough review of U.S. economic policy toward Latin America. It represents a new approach, and a new more equal and reciprocal relationship, with the other nations of the Western Hemisphere. The Initiative would not have been conceivable absent the impressive commitment of individual Latin American nations to economic reform, liberalization and democracy in recent years.

Implementation of the Initiative offers the prospect of significant economic and political benefits to our nation and to our relations within the hemisphere. We will benefit as reform encourages faster growth and progress across a range of social, political and economic issues. Stronger and more prosperous neighbors are better neighbors and better customers for U.S. goods and services.

The Enterprise for the Americas Initiative consists of policy proposals in three areas: trade, investment and debt. In addition, the Administration proposes to channel local currency interest payments on reduced debt reduction operations to fund environmental activities in the region.

The policy initiatives in each area are interrelated and mutually reinforcing. For example, we expect that the prospect of expanded trade opportunities will stimulate new investment; that capital flows responding to improvements in investment climates will help countries deal with their debt obligations; and that reductions in the stock of debt will make it easier to attract capital and finance trade flows.

332

Implementing the Initiative

The President's speech of June 27 laid out an ambitious long-term program for trade liberalization in the hemisphere. Over the months since the speech, we have been consulting with Members of Congress, business, labor and other interested groups in the United States, and with the Latin nations concerned, to begin the process of implementing the Initiative. We have reached some preliminary conclusions as to our basic approach and developed critèria for implementing the policy on a country-specific basis.

As to the general approach, we have five main tenets. First, as I have mentioned, the United States remains committed to the multilateral trading system. In fact, the success of the Uruguay Round is of the utmost importance to our free trade initiatives in the hemisphere. The United States cannot be the only market for Latin America, and outwardly oriented, competitive economic policies are the best guarantee of continuing growth and development.

I know that some have interpreted the Enterprise for the Americas as a U.S. contingency plan for a failure of the Round, or as an indicator of a trading system breaking down into blocs. In truth, the opposite is the case: the EAI and the Uruguay Round are complementary. We expect, for example, that a successful Round will set international baseline standards for services trade, in protection of intellectual property rights, in investment performance requirements, and other equally important areas, that will make the negotiation of free trade agreements in the hemisphere considerably easier.

The Round must also be the venue for dealing with the agricultural Gordian knot, for that certainly cannot be solved in the Western Hemisphere alone. On a more political level, we anticipate that a failure of the Round would lead to an atmosphere far more conducive to protectionist and unilateral solutions and more skeptical of trade liberalization.

Our second tenet is that the proposed negotiations on a free trade agreement with Mexico and Canada will come first. Mexico is by far our largest trading partner in Latin America, and a close neighbor with which we share many economic interests. As the President stated in announcing the participation of Canada in the NAFTA negotiations, such an agreement would be "a dramatic first step toward the realization of a hemispheric free trade zone." Provided "fast track" will be available and we begin the talks this summer as proposed, we think there is much to be learned there that will help us to define and develop the EAI free trade vision. Naturally, we would expect that whatever innovations in form or scope of an FTA that we develop in the NAFTA process would be carried over to the later Enterprise for the Americas agreements as well.

In the meantime, and third of the tenets, we are proceeding to conclude framework agreements on trade and investment with those countries and groups of countries that wish to work toward freer trade in the hemisphere. In fact, we began the trade liberalization process with Mexico in 1987 with the signing of just such a framework agreement.

Framework agreements, in and of themselves, do not bind the signatories to carry out specific trade liberalization commitments. They merely constitute a declaration of trade and investment principles, an agreement to consult on a regular basis, and an initial agenda for consultation. Illustrative of the enthusiasm for the President's initiative, Bolivia, Chile, Colombia, Costa Rica, Ecuador, Honduras and Venezuela have signed framework agreements with us thus far. We are negotiating about a half dozen more.

Completion of a framework agreement with a country or group of countries does not imply that the United States will be proposing free trade negotiations with such countries immediately. But it does establish a channel to explore various trade liberalization options and promote the Enterprise for the Americas vision.

Fourth, and perhaps least appreciated, is the fact that we see the process of creating a free trade area for the hemisphere as taking many years and stretching into next decade. The commitment to open markets completely and on a reciprocal basis is a difficult one for any government to make. We know there will be many complications to negotiating such arrangements between the United States and other countries in the hemisphere, and between the parties and those with which we already have or hope to have free trade arrangements (such as Mexico and Canada).

As we proceed to explore possible opportunities and as we consider approaches to our goal, we believe that it is essential to maintain a close consultative relationship with the Congress and especially with this Committee.

Fifth, and related to these negotiating challenges, we believe that we should be prepared to negotiate with individual countries and in particular with groups of Latin American or Caribbean countries that associated to remove trade barriers among themselves. The President made this point in his June 27, 1990 speech. " ... [T]he U.S. stands ready to enter into free trade agreements with other markets in Latin America and the Caribbean -- particularly with groups of countries that have associated for purposes of trade liberalization."

From the U.S. perspective, negotiating with an integrated, fully open market created by a number of contiguous countries is attractive because it will provide us with access to a larger market and move us towards regional integration. This does not rule out concluding bilateral agreements where these are appropriate (e.g., with Chile). Bilateral agreements can be a model and incentive for other countries to undertake needed reforms. Our overall objective remains to encourage countries in this hemisphere to increase trade among ourselves and reduce barriers to sub-regional trade as part of the overall process of promoting free trade throughout the hemisphere.

Moving Toward Free Trade - Indicators of Readiness

Since the process of creating a hemispheric free trade system is likely to take many years, the timing and pace of free trade agreement negotiations with countries and/or groups of countries will assume considerable importance.

A variety of economic and political factors will affect our recommendations in this regard. Before proposing to initiate FTA negotiations with a country or group of countries, we will consider how such an agreement would be in the economic interest of the United States and contribute to our overall hemispheric policy objectives. Again, I want to emphasize that any decisions to proceed would not be taken without consultations with the Congress and, in particular, with the members of this Committee.

To be a realistic candidate for an FTA, however, a country or countries must have the institutional capacity to fulfill the long-term, serious commitments involved, and the economic policies required for the success of the FTA. In particular, we would expect that a prospective FTA partner be committed to a stable macroeconomic environment and market-oriented policies before negotiations begin.

The international financial institutions, in particular the Inter-American Development Bank and the World Bank, are ready to help the region's nations adopt structural and investment policy reform programs with this goal in mind.

Another aspect of readiness is a country's commitment to the multilateral trading system. As I have stated, we consider the Enterprise for the Americas Initiative to be compatible with, and supportive of, the multilateral trading system. Indeed, we are using the meetings of the EAI-related councils established under our framework agreements to coordinate our positions in the GATT. As to FTAs, we have been clear that we will only negotiate agreements fully consistent with the provisions of GATT Article XXIV.

To ensure this positive linkage between the GATT and the EAI, we will look to see that our prospective FTA partners have demonstrated progress in achieving open trade regimes and are members in good standing of the GATT. Such a policy will also be helpful in assuring our non-regional trading partners that the EAI is in their interest as well.

Elements of EAI-Related FTAs

Since we envision ultimately combining the various bilateral and plurilateral agreements to create a "hemispheric system of free trade," Enterprise for the Americas-related FTAs should be largely consistent in scope and terms with each other and with the evolving form of the NAFTA. In addition, free trade agreements in the hemisphere need to cover a variety of trade-related economic policies in addition to the classic tariff phase-out provisions, so as to minimize distortions and promote our common objectives. The following elements constitute our initial negotiating objectives, recognizing that in some respects agreements will be tailored to individual country circumstances:

- An EAI-related free trade agreement should aim to eliminate all tariffs on the trade between the parties to the agreement in products originating in the customs territories of the parties. Elimination of barriers on "substantially all trade" is a prerequisite for GATT consistency and makes economic sense as well. GATT-consistent tariff reductions should be implemented according to a specified phase-in schedule.

- There should be an analogous phase-out of non-tariff barriers.

- A free trade agreement should cover services, since services are becoming increasingly important in international trade, and are a source of U.S. competitive strength. Our goal would be effective market access on a broad scale.

- Likewise, a free trade agreement should provide standards for the treatment of investment, guaranteeing investors based in the parties to the agreement national treatment in the territory of the other party. Trade-distorting "performance requirements" imposed on investors also have no part in a free trade relationship.

- A free trade agreement should have a mechanism or mechanisms for settling disputes about the application of its terms and the treatment of investors.

- A free trade agreement should guarantee investors and traders that their intellectual property rights will be protected. We cannot foresee a free trade arrangement with a country that denies U.S. pharmaceutical patent holders the right to exploit their inventions, for example.

- Special provisions might be necessary to handle trade in and access to natural resources and natural resource-based products, given the often extensive state involvement and regulation of the natural resource field.

- A variety of other operational, technical or security provisions also will be needed in a free trade agreement. These would include: rules of origin and rules for the application of standards; public health and safety exceptions; essential security interest exclusions; safeguards; "docking" provisions for adding on future FTAs; consultative and dispute settlement procedures.

- Finally, a free trade agreement should discipline specific categories of government actions that could undermine the basis of the agreement. This includes provisions covering subsidies, state trading, trade restraints justified on balance of payments grounds, and the use of foreign exchange restrictions and controls.

As you can see, Mr. Chairman, negotiations of this nature will need to cover many issues, and they will not be lightly entered into by either the United States or its potential free trade partners in the hemisphere.

TEXT AS PREPARED
FOR RELEASE UPON DELIVERY
EXPECTED AT 2 P.M.
JUNE 12, 1991

STATEMENT BY
THE HONORABLE DAVID C. MULFORD
UNDER SECRETARY FOR INTERNATIONAL AFFAIRS
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON
DEFICITS, DEBT MANAGEMENT AND INTERNATIONAL DEBT
FINANCE COMMITTEE
UNITED STATES SENATE

I welcome this opportunity to discuss today two financial issues which are of continuing concern in this Hemisphere: capital flight and debt. The Administration is addressing these problems through both the Strengthened Debt Strategy and the Enterprise for the Americas Initiative (EAI).

The prospects for future economic development in Latin America and the Caribbean will be largely dependent on policies which attract new capital investment. In many instances these policies are now being implemented and represent a significant reversal of past, failed policies of statism and protectionism that have contributed to capital flight and to a dependence on debt financing from abroad. We have been impressed by policies implemented by a number of new Latin leaders, but more must be done. The EAI can make a significant contribution in realizing these objectives.

While Latin America requires capital for growth, competition for international capital has intensified with the opening of Eastern European economies and demands in the Middle East. At the same time, commercial bank lending to developing countries has diminished and budget limitations constrain flows from official bilateral sources. As a result, private capital, including repatriated capital, is increasingly the engine for economic growth for the 1990s.

NB-1324

There are no reliable measurements of capital flight, and economists' estimation procedures produce both variable and dubious results. Some estimates have placed the level of capital flight from Latin America at greater than the level of foreign borrowing, but these estimates probably have minimum credibility. Whatever the magnitude of capital flight in the past, we believe that the pace of outflows may be easing for several countries, and that some are experiencing inflows, but outflows continue to be a major problem for other less developed countries.

CAUSES AND CONSEQUENCES OF CAPITAL FLIGHT

What are the causes of capital outflows? Private capital leaves one country for another to seek a higher return on investment or a safer haven with reduced risks. Important factors therefore include the direction of macro-economic policies and the relative stability of the political climate. High inflation rates erode purchasing power, increase uncertainty and exacerbate risks. Investors anticipating sudden currency devaluations as a result of inflationary policies will move their money abroad to preserve their capital.

Political uncertainty, and the threat of nationalization and populist hostility capital may also discourage both foreign and domestic investors. Drug production, trafficking and money laundering threaten political stability in some countries, and also contribute to instability in domestic financial markets. The Administration is vigorously pursuing policies to combat drug-trafficking in Latin America.

Many countries pursue unfavorable and short-sighted investment policies, which stimulate capital outflow. Investment opportunities can be limited by restrictions or prohibitions on investment in "sensitive" sectors. These often include areas such as telecommunications or transportation, which are reserved for the state or for a state-sanctioned monopoly. Onerous regulatory regimes, together with a reliance on price controls and subsidies, further erode the profitability of investment.

These problems are often compounded by market-distorting credit policies. Interest rate policies, including ceilings on interest paid to depositors, and credit allocation policies, undermine capital markets. Tax avoidance may be another stimulus to capital outflows, reflecting discriminatory tax policies that erode the return to investors. Restrictions on transfering funds out of a country also encourage investors, where possible, to keep and invest their capital abroad.

The negative consequences of massive capital outflows from less developed countries are clear. Capital which is invested abroad is capital that is not available for investment in the developing country. Investment and economic growth will tend to be lower. Moreover, profits on capital held abroad are seldom fully repatriated. Capital outflows also erode the national tax base, due to unreported and unrecorded income which escapes the tax authorities. Foreign exchange receipts may also be under-reported and held abroad.

240

The political leaders in less developed countries must address the need to reform the investment regimes, to make them more hospitable to investment by both nationals and foreigners. In the past few years we have witnessed a growing awareness of the importance of an attractive investment regime that offers competitive returns and a wide range of investment opportunities.

Such reform is at the heart of both the Strengthened Debt Strategy, known as the Brady Plan, and the EAI.

THE STRENGTHENED DEBT STRATEGY

The major objective of the Brady Plan has been to encourage highly indebted countries to successfully implement market-oriented macroeconomic and structural policy reforms in order to achieve sustained growth and ultimately resolve their debt servicing problems. IMF or World Bank supported adjustment programs are prerequisites for debt reduction under the new strategy.

In advancing this strategy, we have encouraged commercial banks to consider debt and debt service reduction as well as to mobilize additional financial resources in support of debtor reforms. We have also redirected IMF and World Bank resources to back debt and debt service reduction for commercial banks while creditor governments continue to provide needed support.

As we begin our third year under the strengthened debt strategy, we can survey some key successes and progress made to date. In assessing progress within the strategy, we should consider first the magnitude of debt covered through debt reduction agreements and the number of countries involved.

Agreements have now been reached with eight countries, including five in Latin America --Chile, Costa Rica, Mexico, Venezuela, and Uruguay. The eight agreements account for some $125 billion in commercial bank debt, or nearly half of the commercial bank debt of all of the major debtor nations.

The benefits to these debtor nations have been substantial: Mexico's stock of medium and long term commercial bank debt was reduced by 34%, Costa Rica's by 62% and Uruguay's by 40%, in addition to significant annual debt service savings and innovative collateralization have reduced the burden of principal payments. The IMF and World Bank have provided some $5 billion in resources to support debt and debt service reduction by commercial banks.

The strong reform efforts by such countries as Mexico, Chile and Venezuela have been rewarded by their successful reentry into the capital markets and increased cash flows into their economies. All have liberalized their trade and investment regimes. Chile has one of the most open investment regimes in Latin America and has moved to privatize key public enterprises. Venezuela is also beginning a privatization program. Mexico has privatized its airline, copper, and trucking industries in the past 18 months, and has

341

announced some $20-25 billion of future privatizations of government-owned enterprises in the banking, steel, telecommunications, fertilizer, and insurance sectors.

Investor confidence is increased when a country maintains sound relations with its international creditors, including commercial banks and the international financial institutions. Both Mexico and Chile experienced inflows of repatriated funds and foreign capital following reduction of their debt with commercial bank creditors under the Brady Plan. We also believe that Venezuela, which reached agreement with commercial bank creditors in March, 1990, has begun to see a reversal of capital outflows.

EAI - CONTINUING SUPPORT FOR REFORM

To enhance growth and prosperity throughout the hemisphere, last June President Bush announced the Enterprise for the Americas Initiative -- an ambitious agenda for strengthening our ties with Latin America and the Caribbean. The Initiative proposes specific action on three economic issues of greatest importance to the region -- trade, investment, and debt. A key focus is to help countries in the region attract the capital essential for growth and development.

Trade

Our long-term goal is to establish a system of hemispheric free trade. As our first step toward our objective, the President has announced our intention to negotiate a North American Free Trade Agreement. We have recently gained from Congress an extension of fast-track negotiating authority, which will allow us to enter into negotiations with Mexico and Canada to eliminate barriers to trade and investment.

The Administration is also proceeding to conclude EAI Trade and Investment framework agreements with eight countries -- Colombia, Ecuador, Chile, Honduras, Costa Rica, Venezuela, El Salvador and Peru. We are also discussing such agreements with Panama, Nicaragua, the CARICOM group of countries, and a group of countries composed of Argentina, Brazil, Uruguay and Paraguay. Framework agreements constitute a declaration of trade and investment principles and set up Councils to consult on these issues and to work towards liberalization.

Investment

To encourage countries to liberalize their investment regimes and help improve their ability to attract capital, the Initiative proposed creation of a new investment sector loan program in the Inter-American Development Bank (IDB), and the creation of a Multilateral Investment Fund. The IDB has sent diagnostic teams to several countries to negotiate investment sector loans. The first loan, for Chile, will be discussed by the IDB Executive Board on June 19th, and we expect programs for Jamaica and Bolivia to follow this summer.

We are also seeking contributions from other governments to a $1.5 billion Multilateral Investment Fund to be administered by the IDB, which would provide additional support for investment reforms. The US has proposed to contribute $100 million a year, for 5 years. The Japanese have already announced their commitment to provide $100 million a year, for five years, in grant resources to the Fund. Last week, several other governments indicated support for the MIF, and we hope to be able to achieve firm commitments in the near future.

We are confident that investment reforms negotiated with the IDB, together with the creation of a new Multilateral Investment Fund, can make an immense difference in the climate for investment in the region, and to its future growth.

Debt

The debt reduction element of the EAI establishes a coherent approach to bilateral debt reduction which reinforces ongoing economic reforms in Latin American and Caribbean countries. It complements the strengthened debt strategy by addressing the debt problems of countries whose debt portfolio is primarily owed to official creditors rather than to commercial banks.

We propose to reduce existing debts to the USG of countries which are undertaking macroeconomic and structural reforms, are liberalizing their investment regimes, and have negotiated agreements with their commercial banks, as appropriate. We have gained authority from Congress to take such action on PL-480 debt.

Several countries -- including Chile, Jamaica, and Bolivia -- are well positioned to qualify for PL-480 debt reduction in the next few months. Other countries could also move to qualify in the near future.

The potential for bilateral official debt reduction has been welcomed throughout the region. To provide the full extent of debt reduction proposed under the Initiative, we must gain additional authority from Congress. In particular, we are seeking authority to reduce AID debt -- which represents $5.2 of $7 billion in concessional debt owed by the regional countries to the US -- and to sell, cancel or reduce a portion of Eximbank loans and Commodity Credit Corporation (CCC) assets acquired through its export credit guarantee program for debt-for-equity, debt-for-nature, and debt-for-development swaps.

By reducing bilateral official debt, we hope not only to ease countries' financial burdens but also to provide significant support for the environment. If the debtor country has entered into an environmental framework agreement, interest payments on reduced concessional debt obligations will be made in local currency into an Environmental Fund in the debtor country.

The burden of external debt has constrained the resources available for growth and tested the resolve of nearly every government in Latin America and the Caribbean. By easing the burden of official debt for countries committed to necessary economic reforms, we can reinforce the rewards of sound economic policies -- helping them to restore confidence in their economy and attract both domestic and foreign investment.

342

COUNTRY CASES

I have explained the policy initiatives undertaken by the Administration to encourage economic reform and to address the debt burden in countries in Latin America and the Caribbean. Let me now turn to developments in several countries.

Mexico

Mexican economic policy reforms since the mid-1980s have substantially increased confidence in the Mexican economy, bringing a dramatic reversal in the direction of private capital flows. Trade and investment liberalization, tax reform, and measures to reduce the burden of the public sector have provided a backdrop for economic recovery and for repatriation of flight capital.

We estimate that capital repatriated into Mexico ranged from $1.5-2.0 billion in 1988 and from $2.0-3.5 billion in 1989. All told, since the announcement of the commercial bank deal in June, 1989, Mexico has received an estimated $5.5-6.0 billion in capital repatriation and an additional $5.0-5.5 billion in foreign direct investment. This represents a dramatic turnaround from the early 1980s, when capital flight averaged an estimated $7 billion per annum.

Increased confidence in the Mexican economy is also reflected in Mexico's return to the international capital markets. Mexican firms raised over $5.5 billion in debt and equity financing during 1990, and nearly $3.5 billion so far in 1991.

Mexico's success is due to several factors, in addition to the reforms already mentioned. Investor confidence has improved significantly since the announcement of the commercial bank debt and debt service reduction agreement. This renewed confidence was reflected in a dramatic decline in Mexican interest rates from nearly 50% per annum before the announcement of the commercial bank agreement, to under 20% today. Lower interest costs have been a key element in the fall in Mexico's fiscal deficit, from 13% of GDP in 1988 to 3.5% in 1990. This improved fiscal position has enabled Mexico to reduce inflation from 160% in 1987 to under 30% in 1990, while at the same time achieving GDP growth of 3.9% last year.

Recent measures have further enhanced Mexico's attractiveness to investors. These include a constitutional amendment in June, 1990, that allows privatization of nationalized commercial banks. The announcement of plans to negotiate a Free Trade Agreement with the US was another positive factor, as was the introduction of a well-designed tax amnesty program for repatriation of flight capital. Under this program, Mexican nationals pay a flat 1% tax on all repatriated funds.

Venezuela

Venezuela appears to have reversed capital flight beginning in 1988, when over $1.5 billion in capital was repatriated. Poor economic performance caused capital outflows to resume briefly in 1989, but at modest levels. Falling real GDP (-8.3%) and rising inflation (81%) were the principal causes that year.

In 1989, Venezuela successfully adopted a series of strong adjustment measures which spurred renewed growth and cut inflation. The Government of Venezuela continues to implement an ambitious program of economic reform in a number of sectors and has undertaken trade and fiscal reforms, financial sector reforms, and privatization. These initiatives have been reinforced by the 1990 debt package with commercial bank creditors under the Brady Plan, and together have contributed to attracting capital back into the country. Investor confidence is growing, a fact reflected in the decision of one-third of commercial bank creditors to participate in the new money option in the 1990 debt package.

Chile

Chile has not had difficulty with capital flight since the severe, world-wide recession of 1982 that produced significant economic uncertainty. Chile's successful debt-conversion program has reduced Chile's stock of debt by about $10 billion since 1985, equivalent to about 70% of medium and long-term debt to commercial banks outstanding at end-1985, and has provided a vehicle for investment including repatriated capital. In 1985 the Government put in place a structural adjustment program which has been very successful in fostering both domestic and foreign confidence in the Chilean economy.

A key result of the program is that Chile has one of the more open investment regimes in Latin America. Increased investor confidence in Chile is apparent from Chile's return to voluntary commercial bank lending in 1990 and from the $320 million international bond issue in early 1991. Private foreign investment inflows of direct investment and loan disbursements have increased dramatically from about $400 million in 1986 to $1.6 billion in 1990. In addition, foreign portfolio investment has increased substantially in the past two years. Chile continues to work to improve its investment climate and is very close to reaching an agreement with the Inter-American Development Bank on an investment sector loan.

Argentina

Capital outflows have long been a problem in Argentina. Recognizing that the only way to bring capital back to Argentina is through sound and sustained economic policy, Argentine policy makers have sought to stabilize the economy and rebuild confidence.

In the past 2-3 years, Argentina has undertaken a number of steps to make the country more attractive for investment and to promote economic growth. The trade and investment regimes have been opened, an ambitious privatization program has begun, and the Administration has persisted in its efforts to rein in public spending and cut inflation. In April of this year, the Government of Argentina established a new exchange rate regime and continued a tight monetary policy in order to control inflation and further stabilize the economy.

In 1990, under its privatization program, the Government sold two parastatals, the telephone company ENTEL and the airline Aerolineas Argentinas. Although these transactions were difficult to arrange, Argentina ultimately attracted both foreign and domestic capital: Morgan Guaranty and Citibank participated as agents; the European firms STET, Radio France and Iberia Air participated as buyers. Today, Argentina is pursuing privatizations, through sale or concession, of other state entities including oil fields, steel, electricity, gas, shipping and railroads.

Besides addressing its structural problems, Argentina is also taking specific tax measures to address the problem of capital flight. Legislation proposed last month would tax capital held abroad this year at 2%, but would tax it at 1% if it is repatriated. Capital returning through the end of this month (June 1991) would be exempt from any legal or administrative penalty and from any past tax obligations. This legislation awaits passage by Argentina's Congress. Argentina is seeking an IMF program as a precursor to discussions with commercial bank creditors.

Despite the many positive developments, investors - both foreign and domestic - continue to be cautious with respect to Argentina. Major reflows of capital will depend on a sustained period of economic performance and completion of additional elements of the structural reform process.

Brazil

Brazil appears to have experienced relatively little capital flight in the 1980s, in part due to prevailing high domestic interest rates. Rough estimates place capital flight at about $15 billion cumulatively from 1980 to 1987.

In testimony to the Brazilian Senate's Commission for Economic Affairs in early June 1991, a Central Bank official estimated that, since 1980, Brazil had incurred a cumulative $35 billion in capital flight, equivalent to 10% of GDP. A large part of the recent capital flight, he claimed, was attributable to the Government's move to block deposits in March, 1990.

Capital flight in Brazil since March, 1990 appears to be driven primarily by economic policy miscalculations and the accompanying plunge in investors' confidence. A key event propelling capital flight has been the failure of the massive freeze on domestic deposits in March 1990 to curb the high inflation rate. This event has not only intensified capital flight, but investors appear to have fled depository accounts in the domestic banking system in fear of another confiscation of their deposits. Numerous investors have thus transferred their funds into other assets such as real estate and the domestic stock markets. In fact, there have recently been strong upturns in Brazil's two major stock markets, attributable to inflows from both domestic and global institutional investors. The inflows from international investors have been spurred by new regulations permitting foreign investors to directly buy and sell shares on Brazil's stock exchange.

Substantial repatriation of capital probably will not occur until Brazil has convinced investors that it can successfully implement adjustment and reform policies needed to stabilize the economy and foster non-inflationary growth.

Colombia

In the past few years, increased drug trafficking and violence has promoted capital flight from Colombia. This has been partially offset by repatriation of some of the drug profits. Colombia has recently implemented a number of market-oriented reforms and has liberalized trade and investment regimes. In February, 1990, Colombia launched its "Apertura" policy of gradual trade liberalization. Colombia has also taken steps to improve the investment climate, including launching a privatization program and announcing a policy of granting equal treatment to foreign and domestic investors.

CONCLUSION

Private investment plays an increasingly important role in growth and development. Repatriated capital and increased flows of foreign investment are critical motors of economic growth. For this reason, it is important for developing nations work to improve their macro-economic and investment climates in order to attract investment. We are supporting these efforts by Latin American countries with initiatives which are aimed at supporting reform: the Brady Plan, and the EAI.

As the examples of Mexico, Chile and Venezuela demonstrate, strong reform efforts generate a pay-off in terms of inflows of foreign investment. These examples have confirmed the potential for economies in the region to make the transition from crisis to performance.

2,41

THE PROBLEM OF LATIN AMERICAN FLIGHT CAPITAL

Statement by

John Williamson
Senior Fellow
Institute for International Economics

before the
Subcommittee on Deficits, Debt Management and International Debt
Finance Committee
United States Senate

June 12, 1991

The only recent estimates of capital flight of which I am aware, compiled by Chartered WestLB Bank and shown in Table 1, indicate that for the past two years there has been a significant net repatriation of flight capital to Latin America. These figures should be treated with considerable caution: as the first four rows of the table demonstrate, there are substantial discrepancies between the recent estimates of Chartered WestLB and estimates presented to the conference on capital flight that the Institute for International Economics organized in 1986.[1] Nonetheless, the major turnaround shown for Mexico, which dominates the aggregate result, is certainly a historical fact rather than a statistical error.

Causes of Capital Flight

The principal cause of capital flight in Latin America was macroeconomic mismanagement. This generated fears of major losses if capital were left at home. Overvalued exchange rates made it obvious that a big devaluation would have to occur before long, which gave an incentive to wealth-owners to place their funds abroad before the devaluation actually happened. Fiscal deficits led to a buildup of foreign debt that created expectations that the government would have to raise taxes to service the debt. Real interest rates were sometimes strongly negative, and at other times they were so high as to nurture fears that the government was heading for insolvency and would be unable to continue respecting its obligations. Inflation provided an arbitrary way of raising revenue when explicit taxes failed. The slowdown in real growth made domestic investment opportunities less attractive. Fears that the economic order was collapsing led to great uncertainty as to whether property rights would be respected.

---

[1] That conference was reported in D.R. Lessard and J. Williamson, eds., Capital Fight and Third World Debt (Institute for International Economics), 1987.

There is also some evidence that conditions in the developed countries acted as a magnet to attract flight capital. In particular, high real interest rates prevailed during the 1980s. In addition, an increasing number of developed countries - starting with the United States in 1984 - exempted interest income earned by non-residents from taxation. Since the Latin American tax authorities had no way of learning of the interest income earned abroad by their residents (and in some cases did not even attempt to subject such income to taxation), Latin wealth-owners were confronted with a very unlevel playing field when it came to deciding where to place their funds. At home they were taxed; abroad they escaped taxation by both their country of residence and the country where the funds were placed.

It is important to recognize the role of foreign debt in stimulating capital flight. A high level of foreign debt surely raises threats of high taxation, high inflation, and conceivably expropriation of domestically-held assets, and thus tends to promote capital flight. But easy access to additional foreign credit has also been blamed for promoting capital flight, since it permitted the maintenance of sloppy macroeconomic policies and provided the foreign exchange that financed capital flight.

Most major episodes of capital flight have taken place from currencies that were not subject to exchange controls. For example, of the five countries shown in Table 1, only Brazil had capital controls when major outflows occurred. The fact that Brazil lost so much capital even though it was illegal shows that there is no easy administrative solution to the problem of capital flight: it cannot simply be banned. At the same time, it is just not true that capital controls are totally ineffective, as is sometimes asserted. At the very least, capital controls can slow down the process of capital flight, and thus give the authorities time to adjust the policies causing the trouble before the country has been bled dry.

Effects of Capital Flight

The principal effect of capital flight is to reduce the funds available for investment at home, thus depressing both the level of income in the short run and its rate of growth in the longer run. This effect may be intensified by the shortage of foreign exchange, which may compel the government to deflate demand and/or to devalue more than is appropriate from a longer-run standpoint (which also tends to be deflationary in the short run). In addition, the fact that interest income avoids taxation increases the budget deficit. Alternative forms of taxation, including the inflation tax, are almost invariably more regressive, so that the poor end up paying the bill for the ability of the rich to place their funds abroad.

Those of us who have never confronted the ugly choice between risking the future wellbeing of our family by keeping money at home and jeopardizing the prosperity of our society by sending it abroad should not be too self-righteous in condemning the decisions that were made by Latin wealth-owners. But that does not mean that the effects of capital flight were anything other than pernicious for the countries involved.

Policy Responses

Just as the principal cause of capital flight was macroeconomic mismanagement, so the indispensable precondition to capital repatriation is the restoration of prudent macroeconomic policies. This has already been accomplished in several Latin countries: both Chile and Mexico, as well as Colombia (the one Latin American country that never rescheduled its debt during the 1980s, as a consequence of the responsible macroeconomic policies that it had followed during the preceding years), have now placed their policies securely on a sound basis. As Table 1 shows, both Chile and Mexico have enjoyed substantial capital repatriation in recent years.

While enlightened macroeconomic policies are an essential precondition, they will not necessarily suffice by themselves to reverse capital flight. Wealth-owners need also to be convinced that the country will be capable of managing its debt burden according to the agreed contractual terms before they will be confident that the threat to their wellbeing posed by holding capital locally has vanished. The Brady Plan restructuring of Mexico's debt was critical in persuading Mexican wealth-owners that it was safe to bring their money home. The reduction in debt-service payments engineered by the debt restructuring itself was modest compared to the spin-off benefits of transforming the attitudes of Mexican citizens regarding the advisability of holding wealth at home: not only did this bring a turnround of approaching $10 billion per year in the flow of resident-owned capital, but it permitted a reduction of something like 20 percentage points in the real peso interest rate, which improved the Mexican fiscal position by around 5 percent of GNP.

While I could have wished that the Brady Plan had been better funded and thus able to offer somewhat more relief on commercial bank debt, it seems to have proved just about adequate to the task of dealing with the commecial bank portion of the debt. What remains to be done is to arrange for comparable relief on public-sector debt (a topic of interest primarily to the smaller countries, notably in Central America). The Enterprise for the Americas Initiative provided a framework for such relief, but apparently on a scale much less generous than that accorded to Poland in its recent restructuring. It is time for the administration to stop playing at King Canute, and admit that the Polish settlement created a precedent.

Not only must macroeconomic policy be placed on a sound footing and debt service obligations be reduced to a level that the country can handle, but wealth-owners must feel confident that this situation will not be jeopardized by political change. The importance of this factor is indicated by the large capital repatriation to Chile in 1990 (Table 1), following inauguration of the first democratic government and its commitment to the maintenance of prudent macroeconomic policies.

While present and future macreconomic policies and their consistency with debt-service obligations are unquestionably the key factors that drive large short-run swings in capital flight, there are also several important background factors that influence how large a part of their portfolio Latin investors want to hold abroad even when circumstances at home are normal. One of these is the level of real interest rates in the rest of the world; this provides yet another reason for hoping that the US budget deficit will be brought down on schedule (or, better still, ahead of schedule) in the coming years. Another is financial sector reform in Latin America; liberalization should provide investors with a more attractive menu of assets at home, as well as raise domestic currency real interest rates by compressing interest spreads.

But the most important such factor relates to taxation. As noted above, present tax arrangements have in many cases resulted in a distinct bias encouraging Latin portfolio investors to place their funds abroad, where they can expect to avoid taxation. Eliminating this distortion is bound to be a long-term process requiring comprehensive international agreement, but the process is one in which the average taxpayer in the United States and other indutrial countries also has a strong interest, since in the absence of adequate international arrangements it seems certain that the rich would increasingly hold their money abroad with the object of evading taxation. An end to tax evasion will require four mutually reinforcing measures:[2]

--internationally consistent tax legislation, in which all countries aim to tax the world-wide income of their residents

--international action to prohibit bearer securities

---

[2] A study under way at the Institute for International Economics will develop proposals along these lines: see G.C. Hufbauer, U.S. Taxation of International Income: Blueprint for Reform (Washington: Institute for International Economics), forthcoming.

--a multilateral tax-information sharing agreement, in which tax authorities will inform each other of the portfolio income of each other's residents

--a common rate of withholding tax imposed by the country in which portfolio income is earned, which is reimbursed on presentation of evidence that the income has been reported to the authorities of the country in which the taxpayer is a resident.

The United States already has an appropriate system of taxation based on the residence principle and encompassing world-wide income. It has also recently ratified the multilateral tax-information sharing agreement negotiated in the OECD in 1988-89; since Finland, Norway, and Sweden have also ratified and the agreement becomes operational after five ratifications, it requires only one further ratification to come into force. The United States has also concluded (rather limited) bilateral tax-information sharing arrangements with several Latin American countries, notably Mexico.

Unfortunately, however, it is only the latter step that is of any direct assistance to Latin countries in eliminating the tax distortion to invest abroad. The OECD agreement is open only to member countries of the OECD and the Council of Europe. A serious attack on the tax distortion in Latin America would require that this agreement be opened to all countries (or at least to those of Latin America), as well as extensive revision of the tax legislation in many Latin countries and an international agreement to outlaw bearer securities. Finally, and perhaps most difficult of all, it would need a reversal of the tendency of the last ten years to abolish withholding requirements against foreigners. Such a reversal is doubtless conceivable only in the context of a parallel move on a multilateral basis, so as to avoid the loss of competitive ability to attract foreign investors that motivated the dismantling of withholding taxes in the mid-1980s.

Concluding Remarks

Three of the seven major countries of Latin America - Chile, Colombia, and Mexico - have at last clearly put the debt crisis behind them. Another one, namely Venezuela, is showing hopeful signs, though doubts remain. The other three, namely Argentina, Brazil and Peru, are still struggling, but at least they are struggling to do the right things.

Reversal of capital flight is a crucial element in recovery from the debt crisis. Achieving the repatriation of resident capital is primarily a matter for the Latin countries themselves, through implementing responsible macroeconomic policies and achieving a social consensus that such policies should be invariant to political change. But the industrial countries have an important supporting role, notably in ensuring that countries that have adopted the necessary policy reforms receive help in cutting back their contractual debt service obligations to a level that the debtor country can afford to pay. Particular policy initiatives that would be helpful include recognition that Poland does indeed constitute a precedent for relief of public-sector debt and, in the longer term, a major overhaul of worldwide arrangements for the taxation of portfolio income earned outside the taxpayer's country of residence.

Table 1

Estimates of Capital Flight (-) and Repatriation (+)
(million dollars)

	Argentina	Brazil	Chile	Mexico	Venezuela	Total
1983	-1,729	-4,302	+237	-1,818	-4,509	-12,121
1983a	-1,955	-617	-344	-4,314	-715	-7,945
1984	+924	-6,366	+1,202	-3,092	-1,626	-8,958
1984a	+1,635	+406	+439	-2,585	-1,210	-1,315
1985	+390	-1,313	+1,004	-4,130	+444	-3,605
1986	+1,639	-413	+583	-2,608	+1,223	+964
1987	-1,766	-1,015	+190	-1,610	+975	-3,226
1988	+833	-1,494	-566	-5,265	+1,791	-4,701
1989	-1,297	-1,704	+28	+5,203	+1,181	+3,411
1990	+333	-1,023	+1,401	+5,507	+747	+6,965
Total	+673	-17,633	+4,079	-7,273	+226	-21,279

Sources: Chartered WestLB Bank, reproduced in Latin Finance, May 1991, p. 7.

Alternative figures (labelled 1983a and 1984a) from J. Cuddington, "Macroeconomic Determinants of Capital Flight: An Econometric Investigation", table 4.1, in D.R. Lessard and John Williamson, eds, Capital Flight and Third World Debt (Washington: Institute for International Economics), 1987.

The New York Times

THE NEW YORK TIMES FORUM SUNDAY, JUNE 30, 1991

Make the Free-Trade Vision a Reality

Dupont Photographers

By RICHARD E. FEINBERG
and PETER HAKIM

WITH the end of the Cold War, trade has displaced security as the centerpiece of relations between the United States and Latin America.. Yet there is not one organization with the mandate and expertise to exercise leadership on inter-American trade issues. This is a vacuum that now should be filled by the governments of the Americas.

President Bush set off a flurry of activity a year ago, when he put forth the vision of a Western Hemisphere free-trade area. Country after country in Latin America declared interest in free trade with the United States — and six have signed bilateral or multilateral "framework agreements" with Washington providing for regular discussion on key issues. The proposal has also reinvigorated existing trade pacts throughout Latin America; prompted Brazil, Argentina, Paraguay and Uruguay to work toward a common market, and spurred other nations to begin free-trade talks. All this activity surely will accelerate now that fast-track authority for United States trade negotiations has been renewed.

This, then, is the time for the United States and other governments to create, with the private sector, an Americas Commission for Trade and Trade-Related Matters. It would help promote unrestricted hemispheric commerce, serving as:

- A clearinghouse, to collect, systematize and disseminate trade statistics and information on national trade policies;
- A think tank, to analyze trade and trade-related issues;
- A trade monitor, to review and evaluate proposed trade arrangements among nations, and
- A source of technical assistance, to provide expertise to countries formulating trade policies and negotiating trade agreements.

Over time, the commission could be entrusted with the more sensitive tasks of defining rules to guide hemispheric trade negotiations, mediating them, investigating alleged violations of trade accords and settling disputes. It could be set up within an established institution like the Inter-American Development Bank or as a free-standing agency.

Trade is now reshaping hemispheric relations. Expanding commerce could help create a Western Hemisphere economic community along European lines. But burgeoning trade could, just as easily, produce new conflicts in the Americas, as it has in relations between Washington and Tokyo. An effective hemispheric trade organization could help prevent this by injecting order and purpose into the current mosaic of trade negotiations. With some imagination and a small investment by hemispheric governments — no more than $10 million a year — the Americas Commission for Trade could be up and running in short order. ■

Richard E. Feinberg is executive vice president of the Overseas Development Council, Washington. Peter Hakim is staff director of the Inter-American Dialogue, Washington.

357

Response of the Administration to Issues Raised in Connection with the Neotiations of a North American Free Trade Agreement, Transmitted to the Congress by the President on May 1, 1991.

EXECUTIVE SUMMARY

RESPONSE TO ISSUES RAISED IN CONNECTION WITH THE NEGOTIATION OF A NORTH AMERICAN FREE TRADE AGREEMENT

In letters to the President from Chairmen Bentsen and Rostenkowski, and from Majority Leader Gephardt, the Administration has been asked to address a variety of economic, labor and environmental concerns that have been raised about the proposed North American Free Trade Agreement (NAFTA). The Administration's response sets forth detailed action plans for addressing these concerns, as well as views on the economic impact of a NAFTA.

THE POSITIVE ECONOMIC IMPACT OF A NAFTA

- o From 1986 to 1990, as Mexico reduced import barriers, our exports more than doubled from $12.4 billion to $28.4 billion, generating 264,000 additional U.S. jobs.
- o Under a NAFTA, we can do even better. Mexico still has higher trade barriers than the U.S. Mexico's average duty is 10% compared to 4% in the U.S. Significant nontariff barriers remain. We therefore have much to gain from the elimination of these barriers.
- o All three major economic analyses done to date corroborate that the U.S. will benefit from a NAFTA in exports, output and employment.
- o We will benefit from Mexican growth: for each dollar Mexico spends on imports, 70 cents is spent on U.S. goods; for each dollar of GNP growth, 15 cents is spent on U.S. goods.
- o Further, the resulting economic integration will strengthen the ability of the U.S. to compete with Japan and the EC.

ADJUSTMENT PROVISIONS WE WILL SEEK IN THE NAFTA

- o Transition Measures: In order to avoid dislocations to industries and workers producing goods that are import-sensitive, tariffs and non-tariff barriers on such products should be eliminated in small increments over a time period sufficient to ensure orderly adjustment.
  - -- In determining import sensitivity, we will rely heavily on advice of the International Trade Commission, the Congress, and the private sector.
  - -- We will be prepared to consider transition periods beyond those in the U.S.-Canada FTA.

2.96

o <u>Effective Safeguard Provisions</u>: Even where reductions in tariffs and other trade barriers are staged over a lengthy period, there may be isolated cases in which injurious increases in imports could occur. To prevent injury from such increases, we will seek to include in the agreement a procedure allowing temporary reimposition of duties and other restrictions.

-- This mechanism should be designed to respond quickly, especially in cases of sudden import increases.

-- Special "snap-back" provisions should be included to address the unique problems faced by producers of perishable products.

o <u>Strict Rules of Origin</u>: We will negotiate rules of origin to ensure that the benefits of a NAFTA do not flow to mere pass-through operations exporting third-country products to the U.S. with only minimal assembly in Mexico.

-- Rules of origin will impose clear, tough, and predictable standards to the benefit of North American products.

-- We will seek to strengthen the required North American content for assembled automotive products.

-- We will consult closely with the private sector and the Congress in designing these rules.

<u>DOMESTIC WORKER ADJUSTMENT PROGRAM</u>

o Since trade barriers on sensitive products should be decreased over a long timeframe, we do not expect immediate or substantial job dislocations.

o Nevertheless, beyond including adjustment provisions in the NAFTA itself, there is a need to assist dislocated workers who may have adjustment difficulties.

o The Administration is committed to working with Congress to ensure a worker adjustment program that is adequately funded and that provides effective services to workers who may lose their jobs as a result of an agreement with Mexico.

o Whether provided through the improvement or expansion of an existing program or through the creation of a new program, worker adjustment measures should be targeted to provide dislocated workers with comprehensive services in a timely fashion.

359

LABOR ISSUES

LABOR MOBILITY

- We have agreed with Mexico that labor mobility and our immigration laws are not on the table in NAFTA talks, with the possible exception of a narrow provision facilitating temporary entry of certain professionals and managers.

WORKER RIGHTS AND LABOR STANDARDS

- Protections afforded by Mexican labor law and practice are stronger than generally known.

- Mexico's laws provide comprehensive rights and standards for workers in all sectors, including the maquiladoras.

  - Mexico has ratified 73 International Labor Organization conventions on worker rights, including those on occupational safety and health.

  - Mexico has a minimum working age of 14 and mandates special protections and shorter working hours for those between the ages of 14 and 16.

- A substantially higher proportion of the Mexican workforce is unionized than is the U.S. workforce.

- While enforcement problems have resulted largely from a lack of resources, a NAFTA would both raise living standards and create resources for enforcing existing laws.

FUTURE U.S.-MEXICO COOPERATION ON LABOR MATTERS

- Memorandum of Understanding: The Secretary of Labor and her counterpart from Mexico are prepared to sign a Memorandum of Understanding providing for cooperation and joint action on a number of labor issues which could be implemented in parallel with our FTA negotiations.

  - These include health and safety measures; work conditions, including labor standards and enforcement; labor conflicts; labor statistics; and other areas of concern to the United States and Mexico.

- Specific Projects: U.S. and Mexican officials have agreed on joint projects to address specific concerns in the labor sector.

  - Initial projects include: occupational health and safety; child labor; and labor statistics.

ENVIRONMENTAL ISSUES

MEXICO'S COMMITMENT TO ENVIRONMENTAL PROTECTION

- o Mexico has no interest in becoming a pollution haven for U.S. companies.

- o Mexico's comprehensive environmental law of 1988, which is based on U.S. law and experience, is a solid foundation for tackling its environmental problems.

- o All new investments are being held to these higher legal standards and an environmental impact assessment is required to show how they will comply.

- o Enforcement has in the past been a key problem, but Mexico's record has been improving dramatically. Since 1989, Mexico has ordered more than 980 temporary and 82 permanent shut-downs of industrial facilities for environmental violations; the budget of SEDUE (Mexico's EPA) has increased almost eight-fold.

ENVIRONMENTAL ISSUES IN THE NAFTA

- o Protection of Health and Safety: We will ensure that our right to safeguard the environment is preserved in the NAFTA.

  -- We will maintain the right to exclude any products that do not meet our health or safety requirements, and we will continue to enforce those requirements.

  -- We will maintain our right to impose stringent pesticide, energy conservation, toxic waste, and health and safety standards.

  -- We will maintain our rights, consistent with other international obligations, to limit trade in products controlled by international treaties (such as treaties on endangered species or protection of the ozone layer).

- o Enhancement and Enforcement of Standards: We will seek a commitment to work together with Mexico to enhance environmental, health, and safety standards regarding products, and to promote their enforcement.

  -- We will provide for full public and scientific scrutiny of any changes to standards before they are implemented.

359

-- We will provide for consultations on enhancing enforcement capability, inspection training, monitoring, and verification.

JOINT ENVIRONMENTAL INITIATIVES

- In parallel to the FTA negotiations, we intend to pursue an ambitious program of cooperation on a wide range of environmental matters.

- We will design and implement an integrated border environmental plan to address air and water pollution, hazardous wastes, chemical spills, pesticides, and enforcement.

- During the design phase of the border plan, there will be an opportunity for public comment and hearings; during implementation, there will be periodic comprehensive reviews.

- We will consult on national environmental standards and regulations, and will provide an opportunity for the public to submit data on alleged non-compliance.

- We will discuss expanded cooperative enforcement activities, such as coordinated targeting of environmental violators.

- We will establish a program of technical cooperation and training, which will include facilitating sharing of technology for pollution abatement.

INFORMED POLICY MAKING AND PUBLIC PARTICIPATION

- We will broaden public participation in the formulation and implementation of trade policy to ensure that efforts to liberalize trade are consistent with sound environmental practices.

- We will appoint individuals to selected trade policy advisory committees who can contribute both an environmental perspective and substantive expertise.

- In consultation with interested members of the public, we will complete a review of U.S.-Mexico environmental issues, with particular emphasis on possible environmental effects of the NAFTA, to enable U.S. officials to consider the results during FTA negotiations and other bilateral efforts.

75

North American Free Trade Agreement

President Bush

Letter to Congress, May 1, 1991

Following is the text of identical letters to the Chairman of the Senate Committee on Finance Lloyd Bentsen, Chairman of the House Ways and Means Committee Dan Rostenkowski, and House Majority Leader Richard Gephardt. A similar letter was sent to every Member of Congress.

Dear Mr. Chairman:

Through the better part of this century, successive Congresses and Administrations—Republican and Democratic—have worked to open markets and expand American exports. This partnership has resulted in unparalleled growth in world trade and huge economic benefits for the United States. Opening foreign markets means economic growth and jobs for all Americans.

Historically, the fast-track procedures established by the Congress have served us well. On March 1, I requested an extension of fast track so that we could continue to realize increased economic growth and the other benefits of expanded trade. The fast track in no way limits the ability of Congress to review any agreement negotiated, including the Uruguay Round or a North American Free Trade Agreement (NAFTA). If Congress is not satisfied, it retains the unqualified right to reject whatever is negotiated. But refusing to extend the fast track would end negotiations before they have even begun and relinquish a critical opportunity for future economic growth.

Initiatives to open markets will enhance the global competitiveness of the United States and create new opportunities for American workers, American exports, and American economic growth. The Uruguay Round offers a vital opportunity to eliminate barriers to our goods, investment, services, and ideas. A NAFTA offers an historic opportunity to bring together the energies and talents of three great nations, already bound by strong ties of family, business, and culture. Prime Minister Mulroney and President Salinas are both leaders of great vision. They believe, as do I, that a NAFTA would enhance the well-being of our peoples. They are ready to move forward with us in this unprecedented enterprise.

In seeking to expand our economic growth, I am committed to achieving a balance that recognizes the need to preserve the environment, protect worker safety, and facilitate adjustment. In your letter of March 7, you conveyed a number of important Congressional concerns about free trade with Mexico. At my direction, Ambassador Hills and my Economic Policy Council have undertaken an intensive review of our NAFTA objectives and strategy to ensure thorough consideration of the economic, labor, and environmental issues raised by you and your colleagues. The Administration's response is presented in the attached report. Let me emphasize the following:

First, you have my personal commitment to close bipartisan cooperation in the negotiations and beyond. And you have my personal assurance that we will take the time necessary to conclude agreements in which both the Congress and the Administration can take pride.

Second, while economic studies show that a free trade agreement would create jobs and promote growth in the United States, I know there is concern about adjustment in some sectors. These concerns will be addressed through provisions in the NAFTA designed to ease the transition for import-sensitive industries. In addition, my Administration is committed to working with the Congress to ensure that there is adequate assistance and effective retraining for dislocated workers.

Third, based on my discussions with President Salinas, I am convinced that he is firmly committed to strengthened environmental protection, and that there is strong support for this objective among the Mexican people. Because economic growth can and should be supported by enhanced environmental protection, we will develop and implement an expanded program of environmental cooperation in parallel with the free trade talks.

Fourth, President Salinas has also made it clear to me that his objective in pursuing free trade is to better the lives of Mexican working people. Mexico has strong laws regulating labor standards and worker rights. Beyond what Mexico is already doing, we work through new initiatives to expand US-Mexico labor cooperation.

Thus, our efforts toward economic integration will be complemented by expanded programs of cooperation on labor and the environment. The catalyst for these efforts is the promise of economic growth that a NAFTA can provide, and the key to these efforts is the extension of unencumbered fast-track procedures.

There are great challenges ahead. The world is changing dramatically, as nations more toward democracy and free markets. The United States must continue to open new markets and lead in technological innovation, confident that America can and will prevail in this new and emerging world. By working together, we can negotiate good trade agreements that assure a strong and healthy America as we prepare to meet the challenges of the next century.

Sincerely,

GEORGE BUSH

"First step, North America"

Hanging in the U.S. Trade Representative's office is a snapshot of Carla Hills standing next to George Bush, brandishing an oversized crowbar. The photo is inscribed by the President: "I know you'll use this with finesse and strength." Praised by colleagues and adversaries for her tenacity as a negotiator, Hills has turned her attention away from the suspended GATT talks to concentrate on the Western Hemisphere: the proposed North American Free Trade Agreement and the Enterprise for the Americas Initiative. Hills spoke in Washington with LatinFinance's editor.

LF: As a U.S. negotiator you have long favored a multilateral approach to trade issues. Yet some free-trade advocates say the Enterprise for the Americas Initiative could lead to dozens of bilateral agreements branching out from Washington and friction among global trading blocs.

That's not the structure that we see for the Enterprise for the Americas. We see it as GATT-compliant. The word "bloc" is pejorative—it connotes an exclusionary approach. But regionalism doesn't have to be exclusive. It can be quite open. We don't oppose the European Community's common market, which is a further step beyond a free trade agreement. What we worry about is when it acts in an exclusionary way, as a fortress area, as in agriculture. But very often liberalization within a substantial region can push ahead multilateral talks, and we hope that will be the case here. We have no desire to look inward.

LF: Is the U.S. strategy to first negotiate individual bilateral framework agreements, as it did with Mexico, or would you prefer to deal with subregional groupings of countries?

I wouldn't say there is a preference. It makes sense to have a larger quantum of trade where that is possible. Sometimes it is not possible. Sometimes one country moves so far ahead of the pack that to make them wait creates problems. But a trade agreement with a tiny, tiny country really doesn't accomplish the objectives of creating more trade—and very often the tiny country already has in effect a one-way free trade agreement with the United States through our General System of Preferences.

One of our drives is to obtain a series of agreements under the Enterprise for the Americas Initiative between countries in Latin America and this country. Another goal is to try to get Latin American countries to lower their barriers to their neighbors—not only to have a bunch of spokes to the United States. I don't want to end up with just a lot of free trade agreements with the United States, because we will never get the kind of growth that would come if we reduced barriers among all countries of the Americas.

LF: Isn't that precisely the danger in pursuing five or more bilateral framework agreements at a time?

No, to the contrary. More agreements simply provide us with a mechanism for consulting on good trade policy. And one of the things that we will be talking about is the barriers not only with respect to bilateral trade, but to our hemispheric trade. The President made it quite clear that he is looking for a trade free zone in this hemisphere. It should not have barriers between Argentina and Brazil any more than between Argentina and the United States. The whole hemisphere would be without barriers. It's not a common market, but it is a trade free zone.

LF: It would not be a common market because there would be no free movement of labor, no moves towards monetary union?

There are many other things that distinguish a common market. There is a customs union. Look at the EC: there is a bureaucracy that runs a common market, with directors and a commission and a voting apparatus. Under the Treaty of Rome, trade and economic issues are not negotiated with the individual countries, but rather with the Commission. We are not contemplating such a dramatic change. We are contemplating free trade, a reduction of barriers, in the belief that maximizing trade will create growth. Our Latin neighbors have not experienced great growth in the '80s. We think we can correct that.

LF: Will the North American free trade area evolve into an EC-type market?

That is a much more extreme step. The first thing that we want to do is to deal with the FTA.

LF: Let's be visionaries: Could it happen? Should it?

We are already being visionary in talking about hemispheric free trade. If you are trying to get me to say that we have come to a resolution in this Administration to go for a common market, I can only say that we have not. We think that what we have undertaken with a free trade agreement is very ambitious, very visionary and part of the whole hemispheric effort. First step, North America.

LF: The U.S. Congress must decide by June whether to extend the Administration's authority to negotiate trade accords on a "fast track" basis—that is, without legislative revision. You have said that without fast-track authority, it would be impossible to negotiate a North American FTA. Why?

It would be impossible to negotiate any trade agreement with any kind of breadth. If Congress said, well, a reduction from 6% to 3% is intolerable, and you have to go back to your trading partner, they may not want to negotiate with you again. When you're talking about a comprehensive coverage of trade—goods, services, investment, intellectual property protection — a good dispute mechanism is far too complicated to have a trading partner's negotiators give you their bottom line, and then have to go all over it again. And we have a history of that.

LF: If you stay on the fast track, how long will the trilateral negotiations with Mexico and Canada take?

I think it is fully within the art of the possible to conclude the agreement across the board by the end of the year. But we don't have any ferocious deadline.

LF: What would you expect Carlos Salinas to point to on his side if this negotiation is concluded successfully? What market access would Mexico have then that it doesn't have now?

I wouldn't put words in his mouth, but he should also want to expand opportunities in goods and services. Even though Mexico might not have large service providers, it may in the future.

I would think that he would want to get good intellectual property protection. I know there are interests in Mexico that are not enthusiastic on that subject, but quite frankly it does encourage the creativity of those who are protected. It is also a magnet for foreign investment. We know that our entrepreneurs are choosing investment sites today that are offering intellectual property protection. We have agreements with Poland, Hungary and Czechoslovakia that give world-class protection. It is not realistic to suggest that high-technology companies would be pleased to go someplace else just because it is close by, without the protection of patents and trademarks and copyrights.

OVERVIEW

Enterprise for the Americas

LF: Aside from the regulatory and investment reforms that Mexico is expected to adopt, what kind of concessions can we anticipate from the U.S. side?

I regard this as a win-win negotiation, and "concessions" sounds like you lose. So often a country will say, if I give you protection of your intellectual property, what are you going to give me? What they are going to get as far as I'm concerned is a lot more investment, and a lot more energy by inventors of their own country.

LF: Mexican critics say their government is in a weak bargaining position, having unilaterally lowered tariffs and undertaken other reforms before going into the talks. They are afraid Mexico won't have the leverage to achieve significantly greater access to traditionally protected sectors of the U.S. market, such as citrus fruits, sugar, and textiles.

In fairness, I think Mexico has accomplished a great deal in a short time. But to suggest that they don't have any restrictions in place for bargaining is a laugh. The fact of the matter is that the Mexican market is much more restricted than the U.S. market. They still have import licensing. Their average tariff barriers are twice as high as ours. As for the United States, are you suggesting that we have protected industries that are going to be so recalcitrant as to oppose even a phased-in liberalization over ten years? I don't see that happening.

LF: Some proponents of a North American free trade group question the economic logic of a hemispheric trade zone. In much of South America, the EC is a larger trading partner than the United States.

That is a static analysis. Whether the twelve EC countries bought more from some Latin American countries than we did is not the principle issue, when we are as a single country their largest market, and they are very restrictive towards each other.

All we know is that Latin America's chances for growth are enhanced if it reduces its trade barriers. Latin American trade barriers are by world standards very, very high and their protection of intellectual property by world standards is quite low. That combination of factors means that Latin Americans are not getting the push that comes from trade.

Take Brazil, for example, with its Informatics law. As a result, small companies do not have access to the cheapest, most effective computers. The school population is not computer-literate. And that is a tremendous drain on the competitiveness of Brazil at a time that it is trying to throw off debt, bring down inflation, and stabilize its economy. It is an awful price to pay to protect a couple of domestic manufacturers that are not up to world-class standards.

That has happened in too many instances in Latin America, in my view. If that could change, people could be set free to achieve their own natural potential. That in turn would be a big advantage for us, because they are natural markets for our products. And whether they buy from us, or buy from a colleague Latin country which then buys from us, you generate an awful lot of economic enterprise.

LF: If all goes smoothly and the North American FTA is enacted by the beginning of 1993, how long would it take to extend the process to the rest of Latin America?

It depends on externalities over which we have no control. If the Salinas administration had not demonstrated a real willingness to open its market, we might not be having these discussions now. If politics change, and there is less of a dedication to removing restrictions, it could take longer. We are hoping to see dramatic reductions of restrictions and great hemispheric growth.

LF: Five years? Ten?

I don't think you can put a time limit on it. It really is a long term vision, and I think the President deserves a lot of credit for his faith in opening up markets so people can enjoy the benefits, the economic prosperity, that comes from expanded trade.

Pluses, Minuses of Free Trade With Mexico

It will enhance US trade and competitiveness

By Lloyd Bentsen

LATER this spring, the United States, Mexico, and Canada expect to begin negotiations to eliminate trade and investment barriers among our three countries.

Thanks to a 1988 agreement, US trade with Canada already is largely free. Now we have the opportunity to establish a more prosperous and secure economic relationship with our southern neighbor.

But let's not fool ourselves. These negotiations won't be easy and the specific terms negotiated will determine whether the agreement is a good one for US businesses and US workers.

I support moving ahead with negotiations because I believe a free-trade agreement can provide solid economic benefits to the US. In 1990, two-way trade with Mexico approached $60 billion, up $8 billion over the previous year and double the 1984 total.

Our exports to Mexico are growing far faster than our imports, reducing what was a $6 billion trade deficit in 1986 to just over $1 billion today. And these growing US sales to Mexico mean new jobs – 100,000 more just from last year's $4 billion increase in exports.

The time is also right to strike a favorable deal with Mexico. President Salinas continues to change the face of the Mexican economy, cutting inflation five-fold since 1988, selling unprofitable state-owned firms, eliminating red tape, opening new areas to foreign investment, and reducing many trade barriers.

Free-trade negotiations can address the important Mexican barriers that remain, including numerous auto trade restrictions and import licenses on many agricultural goods.

But we cannot be satisfied with just any agreement. Trade agreements create both winners and losers, and this one will be no exception.

We must be certain an agreement is fair to all US workers and industries, to all segments of our society. And we must not ignore other issues of real concern to many Americans, including cross-border pollution and other environmental problems.

The impact of an agreement on US manufacturing and agriculture is especially important. Mexico sees some of its greatest export opportunities in areas where the US already faces stiff import competition – such as textiles, steel, fruits and vegetables, and glassware.

With Mexican wages a fraction of US levels, many fear an agreement will do nothing except shift jobs south of the border.

We must pay attention to those who see peril, not promise, in an agreement. US barriers must be reduced gradually, not abruptly, in sensitive areas, and assistance must be provided to help workers and companies adjust.

At the same time, Mexico needs to do more to enforce environmental protection laws and protect the rights of workers. Without attention to these concerns, any agreement will face a dim future in Congress.

Properly negotiated, a free-trade agreement can keep and create good jobs in the US. In recent years, many US manufacturing jobs have been lost to lower-cost operations, especially in Pacific Rim countries. When firms move there, they often relocate *all* of their production.

In contrast, the *maquiladora* program, under which US firms have built plants just over the border, shows how production sharing with Mexico can create jobs in this country as well. Last year, *maquiladoras* bought over $9 billion in components and supplies from US companies. That certainly beats shifting production 10,000 miles away to Asia.

A free-trade agreement also can help us to compete globally in the 21st century. The European Community is creating a trading blox with a population of 325 million and an economy of almost $5 trillion, and Japan is strengthening its trade ties with its Pacific Rim neighbors.

The result is greater European and Asian export competitiveness. Free trade with Mexico and Canada can help us face that competition.

Free-trade negotiations will be difficult and may not achieve everything that either side desires. Given differences in the economies, challenges are considerable.

But these negotiations also carry great potential for a stronger economic relationship with our southern neighbor. That is an opportunity that holds great promise, one we cannot afford to ignore.

■ *Sen. Lloyd Bentsen (D) of Texas is chairman of the Senate Finance Committee.*

But impact on US jobs must be taken into account

By Don J. Pease

AN uneasy confrontation is developing in Washington's international-trade arena as lawmakers begin debating the merits of a Free Trade Agreement (FTA) involving Mexico, Canada, and the United States. Since the US already has an FTA with Canada, the debate really revolves around Mexico.

Few question the long-term macroeconomic benefits that will come from a North American FTA. The enthusiasm of those who are free to focus solely on the big picture is understandable.

JEFF DANZIGER · STAFF

But in Congress, where the voice of the people is heard, serious concerns about the regional, sectoral, and individual effects of the proposed agreement are being raised. President Bush and his trade advisers would do well to listen carefully.

Among the important considerations the administration has refused to address so far is the impact an FTA will have on America's working middle class.

For many manufacturing workers, particularly those in the heavy industries of the Northeast and Midwest, an FTA involving Mexico very likely will mean lower wages and fewer benefits. For some, it will mean a loss of jobs altogether.

Bush administration officials aren't going to advertise that fact. But they don't deny it. They just talk around it.

They say they don't believe that jobs will "tumble south" right away. They talk about a long phase-in period for any job-threatening provisions of the agreement. They say that in the long run the FTA will be good for the economy overall and will create new jobs.

And somewhere in all the happy talk the reality of an FTA's impact gets obscured. Congress can't let that happen.

US manufacturing workers have suffered a serious decline in real wages over the last decade. A study by the Economic Policy Institute shows that during the 1980s the average hourly real wages of American workers fell by 9.3 percent. An FTA negotiated under the narrow parameters set by the White House will almost certainly lead to future situations where workers are forced to accept wage and benefit cuts or see their jobs move south.

In our global economy, plant location decisions affecting American workers are frequently made in the faraway board rooms of multinational conglomerates by number-crunching strategic planners looking for the lowest costs – components of which are the lowest wages and the "friendliest" regulatory climate. Common sense tells us that US manufacturing workers, whose wages average $10.47 per hour, will lose out to Mexican workers, who average 57 cents an hour. America's more vigorous enforcement of environmental and health and safety regulations will further reduce US attractiveness to bottom-line-oriented decisionmakers when compared to Mexico's lax enforcement record.

These are simple facts of life. In view of them, the US government owes American workers an honest assessment of the costs as well as the benefits of an FTA. It owes American workers a carefully negotiated agreement which accounts for the disparities in environmental and labor-standard enforcement. And it owes American workers adjustment assistance when the realities of the FTA hit home.

Mexico, Canada, and the US are moving toward this agreement awfully fast. US officials want to start negotiations in June, finish them six months later, and get the agreement passed into law by early next year. By contrast, it took two years for Canada and the US to negotiate an FTA.

President Bush has asked Congress for an extension of his fast-track negotiation authority, which expires June 1. As written, the law authorizing the fast-track process applies to both bilateral negotiations like the FTA and multilateral negotiations like the recently revived GATT talks. Efforts are being made to find a way to delink the two processes.

If Congress can say no to an extension of fast-track authority for the FTA but yes for the GATT, it very well may do so. But, if the two issues cannot be separated, FTA opponents may have no choice but to reject extending the fast track altogether.

Sacrificing the GATT talks would be devastating to our standing in the world trading community. To avoid it, the Bush administration will have to quell congressional fears about the impact of an FTA with Mexico. Like it or not, that means slowing down the process and broadening the agenda.

■ *Rep. Don J. Pease (D) of Ohio is a member of the House Ways and Means Committee's Subcommittee on Trade.*

-264

Robert B. Zoellick

Trade Is Not a 'You Win, I Lose' Proposition

Some have asked whether the North American Free Trade Agreement, particularly our negotiation of a free trade agreement with Mexico, is motivated by foreign or by economic policy interests. My answer is yes, and yes.

Economic policy is and must become an increasingly critical component of the United States' foreign policy strategy. That is why this free trade agreement is so important: It is a rare strategic opportunity to secure, strengthen and develop our continental base economically and politically in a way that will promote America's foreign policy agenda, our economic strength and leadership and U.S. global influence.

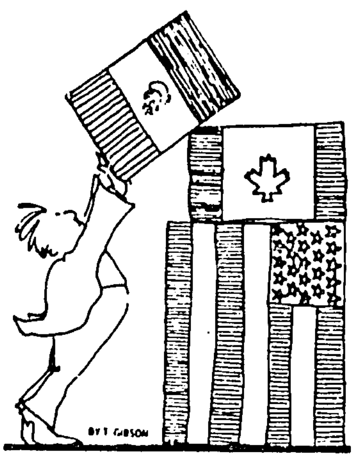
Our ability to seize this historic moment depends on Congress's willingness to extend our trade-negotiating authority so as to maintain the special congressional-executive partnership established 57 years ago in the wake of the Smoot-Hawley protectionist debacle. If Congress now decides to reverse course, to abandon the strategy that Franklin D. Roosevelt and Congress first set through the Reciprocal Trade Agreements Act of 1934, the United States will no longer be able to exert international economic leadership. There should be no mistake—the stakes are that high.

The North American FTA would increase sales opportunities for U.S. firms, improve their operating efficiency, increase real income in the United States, create jobs and spur growth in all three nations. Our neighbors' growth multiplies benefits for the United States. For each dollar of growth in Mexico, about 15 cents is spent on U.S. goods. As Mexico grows more, it will import more. Seventy cents of each Mexican-import dollar is spent on goods from the United States. This is an important point: Trade is not a "you win, I lose" proposition. By generating growth, trade multiplies the purchasing power of our trading partners.

Of course, Mexico's economy is relatively small compared to that of the United States. Its GNP, approximately $225 billion, is about the same as Florida's. Because Mexico's economy is only about 1/25th the size of the U.S. economy and its exports only amount to about 6 percent of U.S. imports, the scare stories of mass dislocations from reducing barriers simply are not credible.

Moreover, the record since 1986, when Mexico began a major opening of its economy, tells a very encouraging story. U.S. exports to Mexico have increased from $12.4 billion to $28.4 billion. Of this total, U.S. manufacturing exports increased from $10.4 billion to $24.0 billion, almost twice the rate of our overall growth in manufacturing exports during this period. Consumer goods exports tripled from $1 billion to $3 billion. Agricultural exports went from $1.1 billion to $2.5 billion, making Mexico our fourth largest customer in 1990.

Exports of corn and tripled. Exports of autos, auto parts and telecommunications equipment doubled. In fact, two highly sensitive sectors—steel and the textile, fiber and apparel industry—are now in surplus with Mexico.



"Seventy cents of each Mexican-import dollar is spent on goods from the United States."

Our bilateral trade deficit shrank from $4.9 billion in 1986 to $1.8 billion in 1990; if one excludes petroleum imports, the U.S. would have a $2.7 billion surplus with Mexico.

The FTA will create good jobs at good wages. Studies suggest it could create between 64,000 and 150,000 new U.S. jobs. Because our trade-weighted tariff for Mexican goods is only about 3 percent to 4 percent (45 percent of Mexico's goods already come in duty free), we can use the FTA to slash Mexico's higher barriers and lock in the new market openings. And it's useful to note for the record that past dire warnings about losses from reducing U.S. barriers turned out flat wrong: For example, after the Caribbean Basin Initiative opened our markets, we turned a $200 million deficit with these nations in 1986 into a $1.8 billion surplus last year. Jobs don't flee to places just because wages are lower. If they did, I imagine Haiti—which has the benefit of duty-free entry into the United States under CBI—would be the manufacturing center of the world.

The economic integration spurred by the FTA should make U.S. firms more competitive globally. Japanese firms have grown stronger by getting components from Asian sources. EC firms are doing the same with inputs from Southern Europe. Integrated operations that produce or assemble parts in Mexico can help our higher-wage workers in the same way. We even could expect a bonus, because Mexican workers will buy more from us. It would be extremely shortsighted to permit assembly or simple manufacturing jobs to shift to locations that strengthen export machines in Japan and Europe.

Worker readjustment can be addressed through a long transition period, safeguard provisions and the program under the 1988 Economic Dislocation and Worker Adjustment Assistance Act. EDWAA, funded at $527 million in 1991, will have served approximately 700,000 workers in its first three years, achieving a placement rate of about 66 percent.

If we send a signal to the Mexican people that we intend to reject their historic opening to North America—if we say trade agreements with the United States are fine for Israel, Canada and multilaterally, but not for Latins—I could see Mexico's return to autarky and protectionism. The choice faced by Congress is either yes or no—this decision cannot be put off without risking all we are building with Mexico and Latin America.

In 1933, FDR charted a new course with Mexico through his Good Neighbor Policy. About 30 years later, another new president, John F. Kennedy, called for an Alliance for Progress with Latin America. Now, another 30 years later, we have the opportunity to sustain and invigorate that vision. This generation, on both sides of the border, could integrate North America in a way that will build a foundation for stronger cooperation on diverse issues: economics, environment, energy, labor, narcotics, education and immigration—to name a few already on our common agenda.

If the Congress now rejects the approach of FDR and JFK by refusing to extend fast-track negotiating authority, it would signal a return to the days of 1930, to the logic that Congress should freely adjust and amend trade arrangements around the globe without consideration of the benefits of the package as a whole.

This reversal would take the United States out of the trade negotiating game. The other nations of the world will pin the blame on us for walking away from real bargaining. They will argue that they cannot offer their bottom-line positions if we are free to reopen agreements.

This would be a terrible time to signal to the rest of the world that the United States will abandon its leadership role in the field of international trade. Our exports are booming. The United States has just again demonstrated its capacity to lead the world politically and militarily. Some critics ask whether the United States can complement these achievements with international economic leadership. They want to know if the "new world order" will have a place for economics, and if not, they wonder if it can be meaningful.

The United States has a good answer. We are pursuing an ambitious agenda in the Uruguay Round, through the North American Free Trade Agreement and through the prospects for trade agreements under the Enterprise for the Americas Initiative. This is what is at stake if Congress fails to extend fast-track negotiating authority.

The writer is State Department counselor and undersecretary of state for economic affairs.

76

EDITORIAL/OPINION

Mexico: Social Concerns Count

By JOHN J. LaFALCE

In the "best of all possible worlds," a free trade agreement with Mexico would be easy to negotiate and bring prosperity and jobs to both sides of the border.

But in the real world, some companies pollute the environment and others gravitate to where health and safety regulations are least stringent. These are stark realities the Bush administration must accept as it prepares to negotiate a free trade agreement this year with Mexico.

Those of us in the U.S. Congress who insist that environmental, antitrust, labor and drug enforcement issues must be part of any trade negotiations with Mexico are not jumping blindly over a precipice, as some of our critics have maintained lately.

Rather, it is the administration that is blindly forging ahead, trying to place Mexican trade negotiations on a fast track so that Congress cannot amend whatever accord is reached. This effort continues despite pollution problems and the meager living conditions of Mexicans who work in so-called maquiladora plants. These are cross-border facilities, owned by U.S. companies, that bring finished products back into the United States.

Reports have surfaced lately of a hepatitis epidemic in Arizona and Texas caused by a lack of sewage facilities on the Mexican side of the border. Furniture-making plants that once were located in California now operate in Tijuana, Mexico, spewing toxic wastes free of California pollution regulations.

The United States and Mexico are at vastly different levels of economic development. Like most developing countries, Mexico lags far behind the United States in technology and productivity, but enjoys substantial advantages in labor and production costs. The average manufacturing wage in Mexico is currently $.57 an hour, compared with $10.47 an hour for American workers. And if fringe benefits are added into the wage computation, the differential is even larger.

Mexico does not have the means, nor has it exhibited the will, to put teeth into environmental protection, workplace safety and public health.

The proposed U.S.-Mexico-Canada free trade negotiations differ sharply from the negotiations the United States undertook to create the U.S.-Canada free trade agreement.

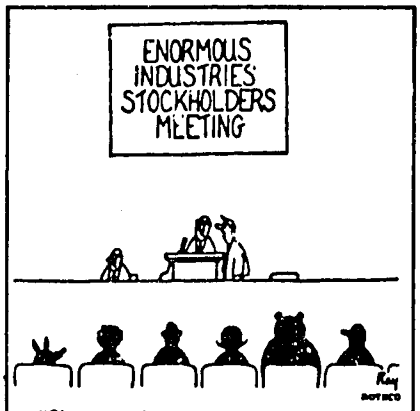
Canada is an industrialized nation with similar regulatory concern for worker safety and environment protection. Yet even with similar economies and the fact that almost three-quarters of bilateral trade between the two countries was already duty-free, negotiations for a free trade agreement with Canada took several years, necessitated a ten-year implementation schedule and prompted an intense political debate throughout Canada.

The proposed U.S.-Mexico free trade agreement is unprecedented in seeking to link an advanced industrial economy with a developing country whose size and proximity carries the potential to dislocate industries and workers on a massive scale.

Proponents of a free trade agreement say the United States must link its high-tech industries with low-cost labor if we are to compete internationally. I reject the idea that we must abandon U.S. labor with its workplace protections and environmental constraints. Rather, we need to use trade negotiations as a catalyst to raise the living standards of the Mexican people.

The maquiladora program has turned northern Mexico into a giant free trade zone. Mexican workers are living in shacks made of cardboard that is impregnated with polyvinyl chloride. They use water stored in drums cast off from the factories that once contained fluorocarbon solvent.

Is this fair competition for American workers? Should the United States be blithely promoting the export of American jobs to foreign soil so U.S. companies can provide discarded packaging for use as building materials for family dwellings?



"Sir, rumor has it that there are some environmentalists in the audience."

A simple expansion of Mexican economic activity in response to a free trade agreement is not likely to enhance the living standards of Mexican workers. Obviously, to attract the industry Mexican wages will have to remain low. Expanding the maquiladora concept throughout Mexico through the benefits of a free trade agreement will provide only marginal improvement in the living standards of the Mexican people while perpetuating the economic inequities that characterize Mexican life.

Mexico needs substantial domestic and foreign investment, but this investment is discouraged by perceived weakness in the Mexican economy and government. Eight years of debt crisis and devaluation have created a severe capital shortage that has forced the Mexican government to compete with Mexican business in seeking financing abroad.

There is also substantial capital flight as Mexicans of means continue to withdraw billions of dollars in capital assets from the economy for safer investments elsewhere. Between 1973 and 1987, an estimated $64 billion in Mexican capital was invested abroad by wealthy Mexicans seeking to protect capital assets from triple-digit inflation and possible devaluation of the overvalued Mexican peso.

This has significantly impeded economic growth not only by diverting capital needed for domestic investment but also by absorbing scarce foreign exchange to finance foreign investments that could have been used to finance imports needed for economic growth.

The key to economic growth for Mexico is persuading Mexicans to invest in their country's future. If resources pulled out of the country were repatriated, Mexico would have the capital it needs for long-term investment in resource development, business expansion and infrastructure improvement.

Without attention to these other problems, a free trade agreement with Mexico will merely transfer American capital and jobs to Mexico with little benefit to Mexican workers or to the U.S. economy.

We need trade discussions with Mexico, but discussions that go beyond just trade to labor conditions, environment, and the need to convince Mexicans that it is viable to invest in their own country.

John J. LaFalce is a Democratic congressman from New York.

368

THE WASHINGTON POST, April 16, 1991

No: The Biggest Export Will Be U.S. Jobs

Not Only That, Mexico's Problems—and Enormous Debt—Could Get Worse

By Jeff Faux

THE BUSH administration's proposed free trade agreement with Mexico would harm our long-term economic competitiveness and do severe damage to millions of Americans whose jobs would be shifted to Mexico as a result of the treaty. It would also prevent any meaningful effort to relieve Mexico of its major economic problem—debt.

But the public debate has been one-sided; the truth of this flawed proposal's downside is not getting out.

Supporters portray the issue as an old-time morality play. President Bush calls opponents of the congressional "fast-track" schedule "fear-mongers," and The Washington Post has editorialized that the proposal is favored by "disinterested economists" and opposed by those old villains—the special-interest protectionists. But it is not the economics profession that is working for the bill; it is the Mexican government, plus a group of multinational manufacturing and financial corporations.

Bush says a U.S.-Mexico Free Trade Agreement (FTA) would "provide more and better jobs for U.S. workers" because increased exports to Mexico will exceed U.S. job losses brought on by increased imports from Mexico.

But this overlooks the fact that Mexico's capacity as a consumer of U.S. goods is very small, while its capacity to produce with cheap labor goods now made in the United States is large. Mexico's economic output in 1989 was only 3.6 percent of U.S. output. Mexican wages average one-seventh of ours and are even lower in the Maquiladora free trade zone in northern Mexico.

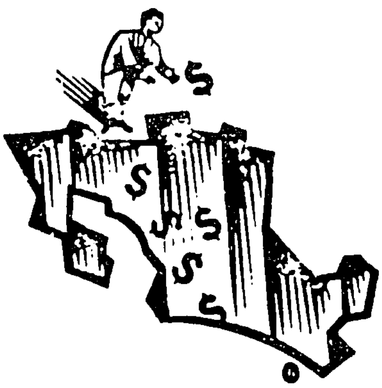
There won't be much improvement, either. A February report by the U.S. International Trade Commission, arguing for the FTA, admits that even under optimum circumstances, Mexican wages will not rise enough to close the gap significantly. Indeed, potential investors in Mexico were told at a recent conference sponsored by the U.S. and Mexican secretaries of commerce, that the wage gap will widen in coming years.

Most of the U.S. export gains to Mexico that can come from trade liberalization have already occurred. Drastic reductions in Mexican import barriers in the mid-1980s released the pent-up demand for American goods from Mexico's small middle class. Eliminating the last import restrictions will yield little further gain, due to extremely low income levels elsewhere in the Mexican population.

On the other hand, an FTA would have a much greater negative impact on the U.S. labor force than the administration admits. Numbers imbedded in the February trade commission report show declines in income for 73 percent of *all* U.S. workers!

The commission now says its own report is in error. But if anything, the commission understated possible U.S. job loss by refusing to calculate the potential effect of U.S. firms shifting production to Mexico. Yet, the large corporations are lobbying for FTA chiefly because it will eliminate Mexico's remaining restrictions on foreign investment in a way that cannot be unilaterally changed by any future hostile Mexican government. More than any other factor, U.S. firms are attracted by Mexico's labor force of almost 30 million willing to work for subsistence pay in unhealthy workplaces lacking environmental regulations. The protection of an international treaty for investments would give U.S. corporations confidence to expand from the Maquiladora zone to all of Mexico, thus lowering production costs while keeping U.S. market access.

Most of the lost U.S. jobs will occur among non-college workers (a majority of the U.S. labor force) whose real incomes fell dramatically in the 1980s. Hardest hit will be the least mobile and poorest workers. The apparel industry, for example, employs many disadvantaged minorities, immigrants and rural Americans for whom there will be few work alternatives when their jobs are lost to even cheaper labor in Mexico. In addition, Labor Department surveys show that U.S. workers dislocated by foreign imports in the 1980s have mostly found less skilled jobs at lower pay—if they were reemployed at all.



The lure of low wages is not limited to so-called low-wage U.S. industries. When the Maquiladora free trade zone was set up 20 years ago, the major activity was sewing garments. Today, apparel accounts for less than 10 percent of Maquiladora workers, almost 40 percent work in electronics and 20 percent in transportation equipment. Major employers include IBM, Hewlett-Packard, Wang and Westinghouse. But the Mexican worker has benefited little. Maquiladora wages are lower than the Mexican average, industrial pollution degrades the environment and educational and health services and physical infrastructure are abysmal. The Maquiladora experience also undercuts proponents' claim that the FTA will reduce illegal immigration. The desperate conditions of the Maquiladora sector have sent many migrants from southern Mexico and Central America further north.

Proponents say the Mexican government is committed to strengthening environmental and worker protection, but the promises of a transient administration alone cannot achieve such difficult goals. In the United States, such laws are made effective by strong institutions independent of government such as labor unions and environmental groups, and a genuine competitive political system—all non-existent in Mexico today.

Unlike the European Community, the United States lacks effective systems of retraining, job search help, unemployment compensation and redevelopment assistance for people and communities hurt by low wage competition. Tight local and federal budgets further fray already weakened safety nets. The administration's indifference to the fate of FTA victims is reflected in this year's proposed budget for trade adjustment assistance: It is zero.

Moreover, a free trade agreement demands more than a "one-time only" economic adjustment. The administration's FTA would subject increasing numbers of U.S. workers to continuous pressure to lower their wages, benefits and living standards to compete with Mexican labor.

Thus, the greatest danger of such an FTA may be that it will encourage U.S. firms to find low-wage solutions to the problem of global competitiveness. As the task force report on the U.S. economy chaired by former secretaries of labor Bill Brock and Ray Marshall recently concluded, we face an historic strategic choice in our response to the global marketplace.

One strategy—the "high-skills, high-wage" path—competes by efficiently producing high-quality goods for sale at high enough margins in the global marketplace to pay high wages and maintain U.S. living standards. This requires high private and public investment to continually upgrade the quality of our labor and production infrastructure. But with easy access to a large low-wage labor pool and minimal environmental regulation, U.S. managers are unlikely to take the more difficult "high-skills, high-wage" path.

These dangers do not concern this administration. Therefore, it is up to Congress to put U.S.-Mexico economic integration into a broader framework. The United States should help Mexico lower its debt burden, which forces austerity on her people, and build democratic institutions to protect labor and the environment. At home, the United States must create mechanisms to assure successful adjustment of U.S. workers, industries and communities.

None of this will take place, however, if Congress is stampeded along a fast-track to approve the administration's proposal. Only a rejection of fast-track will convince Washington and Mexico City to design an economic package that truly benefits both sides of the Rio Grande.

Jeff Faux is president of the Economic Policy Institute.

U.S.-Mexico Trade Pact: A Disaster Worthy of Stalin's Worst

The Wall Street Journal has trumpeted support for the U.S.-Mexico free-trade agreement. The paper touts the unconditional flow of goods and services across the Mexican border as a cure all for whatever social, economic and environmental problems now exist in either country.

But what is the basis for this argument? Essentially, it is this. If the tightly regulated economies of the Soviet Bloc and China produced vast degradation, then the opposite must also be true – free trade with Mexico will bring Heaven on Earth.

If this tortured reasoning is the best proponents can muster in favor of the

Counterpoint

By Lane Kirkland

agreement, then the Bush administration's "fast-track" strategy to prohibit amendments and limit debate makes perfect sense. Otherwise, the American people might learn the facts about the free-trade agreement and its disastrous potential for people on both sides of the border.

What, specifically, do the proponents have to fear from public debate?

For starters, we might get a full airing of what's going on with the *maquiladora* program, a miniature version of U.S.-Mexico free trade that currently enables U.S. firms to set up factories on the Mexican side of the border and export back to this country with minimal duty charges.

During the past decade, hundreds of U.S. companies, lured by Mexico's "comparative advantages" of rock-bottom wages and lack of effective government regulations and enforcement, have shut down factories in the states and relocated them in the *maquiladora* areas. While hundreds of thousands of American workers were losing their jobs to this dislocation, more than a half-million Mexicans working in *maquiladora* plants were joining the ranks of the most crudely exploited humans on the planet.

The result has been social and environmental conditions along the Mexican side of the border that rival any of the well-publicized disasters of the worst Stalinist regimes. But Journal editorialists do not have to take my word for it. They need only look at their own news pages to learn the facts about the *maquiladoras*.

Quoting from a Sept. 22, 1989, story: ". . . their very success is helping turn much of the border region into a sinkhole of abysmal living conditions and environmental degradation."

That article goes on to describe workers living in cardboard hovels with no running water or sanitation facilities, raw sewage and industrial toxins dumped into rivers that provide recreation and drinking water for local residents, and people huddling together for warmth at night.

Earlier this month, the Journal told the story of a promising 12-year-old student whose family's poverty has forced him to leave school to join his father and many of his contemporaries at a shoe factory making $34 a week. The article left no doubt child labor is the rule, not the exception.

Other news reports from the region tell of the rising hepatitis rate along rivers flowing from the *maquiladora* areas into the U.S. A study of one Texas border town showed that everyone living there had been exposed to the disease at least once by the time they were 20 years old.

Yet the *maquiladoras* continue to be lauded as a godsend to Mexican workers – a source of desperately needed jobs and economic development for an impoverished region.

After all, say the proponents of the free trade agreement, these jobs are better than no jobs at all.

But are they really? A few years ago, when Mexican wages were actually higher in dollar terms than they are today, an article in the pro-maquiladora Twin Plant News advised U.S. parent companies that they could "keep their minimum wage people at the minimum wage" by collecting donated clothing and blankets for their Mexican employees because "many of [their] houses are poorly heated, if heated at all, and warm clothing and blankets feel good on those cold nights."

And to keep their employees from going hungry, the magazine suggested: "How about a free kilo of tortillas each week or a few kilos of frijoles?"

If these jobs are so good for Mexican workers, then why do they need handouts to survive?

As for the prospect of American workers finding new jobs in industries that produce goods for the newly opened Mexican market – what do they propose we sell to people who earn $27 a week?

But these are the kinds of issues that proponents of the U.S.-Mexico free-trade agreement want to avoid. "Fast track" authority would help them do it by limiting the debate before Congress to one simple question: "Are you for free trade or against it?"

In this scenario, proponents are sure to argue the agreement is a necessary step for America to compete in an era when Europe is heading rapidly toward a single market. But the proposed "Yukon-to-Yucatan" common market has little in common with that of the European Community.

For instance, the European Common Market contains a Social Charter setting rights to social assistance, collective bargaining, vocational training and health and safety protections. The Europeans have also created a $66 billion Regional Development Fund to narrow the gap in per-capita income between rich and poor countries within the market – a gap that is only one-fifth as wide as the one between the U.S. and Mexico.

As currently described, the proposed U.S.-Mexico free-trade agreement would contain none of these social dimensions. And "fast track" consideration would prevent Congress from insisting that such provisions be included.

In this way, the insistence on the fast track consideration of the agreement speaks volumes about who this agreement is really intended to help.

Proponents of the agreement, the Journal included, have made it clear that any such conditions would render it worthless. They don't like the idea of large multinational corporations being forced by law to provide better than subsistence wages or having to contribute to a tax base to build sewers, roads, schools and other basic necessities of a decent and civil human society in the communities where they extract their profits.

Has our idolatry of the free and unregulated market really come to this?

The fact is that trade is good for workers on both sides of the border only when it is carried out side-by-side with minimum standards on wages, benefits, safety and environment. Without them, it merely serves as a vehicle for capital to locate where labor is cheap and government governs least.

The problems of poverty and economic development in both the U.S. and Mexico are too serious to be left solely to the interests of private capital. And the proposed free trade agreement between the two countries is far too serious a matter to be kept from the realm of public debate and left largely to these same interests.

We need a full airing of views so that the American people can decide for themselves whether this agreement is in their long-term interests. Undoubtedly, they'll see it for what it is – a golden opportunity for the rich to get richer at the expense of the working poor.

Mr. Kirkland is president of the AFL-CIO.

368

OPENING STATEMENT

BY
CHAIRMAN JOHN CONYERS, JR.

BEFORE THE
LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE

CONCERNING A HEARING ON
THE EFFICIENCY AND EFFECTIVENESS OF
U.S. ADVISORY AND ASSISTANCE EFFORTS IN PANAMA

Wednesday, April 17, 1991

The Subcommittee on Legislation and National Security will come to order.

We are continuing our oversight investigation of the effectiveness and efficiency of the U.S. advisory and assistance efforts in Panama. We are holding this hearing because I am concerned that an important opportunity is slipping away in Panama. What is being lost is the chance to give life to a sovereign, independent and democratic Panama.

This is perilous because of what it says about the success of U.S. foreign policy <u>after</u> an invasion. After the dust settled, national attention w⌐ned and the simmering conflicts in these nations continue to fester.

369

An invasion, like a war, creates an opportunity in its wake. To take advantage of that opportunity requires planning and foresight, two attributes that often get lost in the rush for quick-fix solutions.

In Panama the question is not just democracy but are we losing the opportunity to stop drug trafficking and money laundering, which was the major reason for military action. If the cause was just then, why has it been forgotten now?

Fifteen months ago, the U.S. swept into Panama to arrest former ally and dictator Noriega to install a democratic government, and to halt drug trafficking and money laundering. Today we know General Noriega resides in Federal prison awaiting trial. But what has become of democracy and drugs in Panama? And, what lessons can be learned from the experience in Panama?

I recently went to Panama to see where things stand. What I found was troubling.

Panama's democracy is guaranteed not by the people of Panama, but by U.S. soldiers. The irony is that even as the Panama Canal Treaties require the withdrawal of U.S. forces, there continues to be a dependence on those forces. Only four months ago, the new police force that is being organized and trained by the U.S. sought to overthrow Panama's elected government.

The tragedy is that in Panama, U.S. assistance efforts are not working. First, the U.S. is not moving swiftly to end this dependency by removing the command elements of the U.S. Southern Command. Second, neither the new government of Panama nor its U.S. advisors are facing up to the problems. There is an increasing crisis of legitimacy -- building a new police out of the remnants of Noriega's military may undermine the fledgling democracy. Just last week, the coalition government collapsed. In what could be called a "constitutional coup," the President of Panama removed the First Vice President from governmental power and purged all those associated with him. This comes at a time when the government's inefficiency, coupled with growing reports of corruption, are damaging the chances of its survival. There is a real potential for an explosion. Over 17,000 cases are backlogged in the criminal justice system -- not one case has been tried since the invasion.

371

Worst of all, as we learned in our meetings with officials, there is more money laundering and drug trafficking today than before the invasion. The Department of State has called the Panamanian record on drugs "spotty." There is a lack of the political will required to break the back of the sweet-heart deals between the money launderers and the banks.

The drug dealing dictator has been removed, but drug dealing entrepreneurs have now taken his place and the police are powerless to stop them.

Even the new agreement signed last week on money laundering is troubling. What should have been a signal of renewed cooperation in fighting drugs may only be of symbolic value. This agreement is essentially the same as the one the U.S. signed with the Bahamas in 1987, which we have since learned does not do the job. Until last week, the Department of State had sought a tougher treaty with Panama. For some reason, that position was abandoned and we agreed to accept what we know to be inadequate.

What is going on in Panama is not acceptable to American citizens or to Panamanians. After fighting off a drug-running dictator, no one wants to see the situation in Panama drift into anarchy or into a new, if different, type of dictatorship. This is not a case of U.S. policy wanting for resources. The Congress has provided almost a half a billion dollars for Panama this year.

What is lacking is leadership in Washington and in Panama City. Secretary of State Baker needs to be reminded that the crisis in Panama and the war to liberate were both proceeded by a failure to pay attention to situations that were then considered low priorities. The U.S. cannot afford to miss the opportunity to help the Panamanians build a new independent and democratic Panama. There may also be lessons to be learned in Panama that can relate directly to the situation in Kuwait. It is tragic that our stated objectives blur so quickly after our supposed victories in a costly war.

In Panama, a failure will also mean that more drugs will be finding their way onto American streets using Panama as a transit point. The military action in Panama was called Just Cause; U.S. policy toward Panama should support justice and democracy with an urgency that does not flinch from the cause.

Opening Statement

CONGRESSMAN FRANK HORTON

RANKING MINORITY MEMBER

April 17, 1991

Mr. Chairman, thank you for holding this hearing today on the status of United States assistance to Panama. As Panama is the third largest recipient of U.S. economic assistance after Israel and Egypt -- $420 million in direct grant assistance -- it is important that our programs are assessed, evaluated and, if needed, adjusted to the changing needs of this growing democracy.

A year and several months have passed since "Operation Just Cause" and the indictment of Manuel Noriega. The citizens of Panama have seen both the fruits and frustrations of trying to construct their democracy. On the positive side, political parties are now operating freely, foreign investors and deepsea fishermen are returning. Due to a boom in construction and retail, there was a 4% increase in Panama's gross national product last year. Retail stores and shops that had been looted during and after the invasion are now reopening creating new jobs and easing unemployment. There has also been very positive cooperation and progress in the area of money laundering and drug trafficking, as recently exemplified by last week's signing of the Mutual Legal Assistance Treaty.

However, while some things are looking up, there is reported frustration at the pace of economic and democratic reform. Rehousing the displaced families from the burned and ransacked El Chorrillo [chor-ee-o] district has been slow. Deadlines have come and gone, and still some of these families live in makeshift refugee camps awaiting their own accommodations. It is also reported that citizens and shopowners have armed themselves with guns while they wait for a successful conversion of Noriega's defense force into a civilian police force. The effectiveness of this new police force is then diminished as it relies on a judicial system that has yet to try one of the 17,000 court cases that have accumulated over the year.

After 21 years of military rule, one cannot expect Panama to transform into a smooth-running democracy overnight. However, this does not mean that we should be any less vigilant in our oversight of the efficiency and effectiveness of our economic assistance programs.

Thank you, Mr. Chairman. I look forward to the testimony of our witnesses.

Panel Maintains El Salvador Aid

R. MICHAEL JENKINS

El Salvador President Alfredo Cristiani lobbied in Washington for U.S. aid.

An attempt to restrict U.S. military aid to El Salvador was narrowly defeated by the Senate Foreign Relations Committee on June 12 as it completed work on a fiscal 1992-93 State Department authorization bill.

Christopher J. Dodd, D-Conn., had sought to hold back half of the $85 million in aid the administration has requested for El Salvador next year, similar to a limit imposed by Congress on 1991 aid.

The restriction was imposed last year to encourage both sides to end the nation's long-running civil war. It allows the administration to release the funds if it finds that leftist guerrillas are not negotiating in good faith with the government of Alfredo Cristiani.

Dodd said that failing to impose a similar limit on next year's aid might disrupt ongoing peace efforts. "What we're trying to do here is maintain the status quo," he said.

But opponents argued that a different message would be sent. They said a move by Congress now to restrict next year's aid would be a blow to Cristiani, who was in Washington during the week to lobby his cause in meetings with President Bush and congressional leaders.

Richard G. Lugar, R-Ind., said the Salvadoran president had made great strides in organizing his government and controlling the nation's military. "The belief that this money is going to a military run amok is simply untrue," Lugar said.

A tabling motion by Jesse Helms, R-N.C., to kill Dodd's amendment was approved, 10-9.

House leaders have agreed to defer action on the issue until September to give the two sides a chance to make progress in the peace talks. At the same time, members asked the administration not to release $42.5 million in fiscal 1991 military aid to Cristiani's government.

In January, Bush certified to Congress that the rebels, organized as the Farabundo Marti National Liberation Front (FMLN), had violated the conditions for withholding the aid after they shot down a U.S. military helicopter.

Bernard W. Aronson, assistant secretary of State for inter-American affairs, told reporters June 12 that the administration will probably begin the process of releasing the funds "in the near future." Aronson said that if the guerrillas "want the military aid not to flow, there's a very simple way to prevent it, and that's to enter into a cease-fire and end the war."

Controlling and Exporting Arms

The amendment was one of only a few controversial items taken up by the committee before it approved the bill, 18-0. The measure would authorize $5.9 billion in fiscal 1992 and $5.3 billion in fiscal 1993 for the State Department, the United States Information Agency and the Board for International Broadcasting.

The bill would create a broadcast network, similar to Radio Free Europe, to promote democracy in China. It also would authorize $130 million in fiscal 1992 and $85 million in fiscal 1993 to complete the U.S. Embassy in Moscow, a project long mired in disputes. *(Story, p. 1602)*

The legislation includes language to prohibit selling conventional arms to the Middle East until 60 days after the president reports to Congress on the threat to allies in the region and the willingness of supplier nations to hold a Mideast arms control conference.

But the committee also approved, 11-5, an amendment by Dodd to create a $1 billion loan guarantee program for U.S. companies selling military goods to NATO countries, Japan, Israel, Australia and New Zealand.

A similar proposal by the administration has run into strong opposition, especially in the House. Critics say the guarantees would encourage arms proliferation abroad at a time when the United States is scaling back its defense budget and seeking international arms controls. *(Weekly Report, p. 735)*

"It seems to me there's an inconsistency here," said Sen. Paul S. Sarbanes, D-Md.

But Dodd said the guarantees are needed to help domestic military contractors compete with subsidized foreign firms. John Kerry, D-Mass., argued that continued U.S. involvement in the international arms market would mean "furthering of our clout" when it came to seeking multilateral arms control agreements.

The committee also agreed, 12-1, to an amendment expressing the sense of Congress that the U.S. trade embargo against Vietnam and Cambodia should be lifted. Kerry and Frank H. Murkowski, R-Alaska, said the embargo hurts U.S. firms and has prevented Americans from resolving prisoner-of-war and missing-in-action cases left over from the Vietnam War. "We need access," Murkowski said.

The administration says the embargo is needed to pressure the two countries to cooperate in those and other efforts. *(Background, Weekly Report, p. 924)*

The committee also approved a $44 million fiscal 1992 authorization for the Arms Control and Disarmament Agency. Committee Chairman Claiborne Pell, D-R.I., had sought to link the State Department and arms control bills to foreign aid legislation approved a day earlier, but the committee failed to do so. Kerry, whose Subcommittee on Terrorism, Narcotics and International Operations drafted the State Department bill, expressed concern about its fate on the floor if attached to the far more controversial foreign aid measure.

—Pamela Fessler

THE LOS ANGELES TIMES, June 27, 1991

Don't Knock Colombia for Dealing With the Devil

■ Drug war: The cocaine king's surrender buys the government a peaceful interlude; ending the trade requires action in the U.S.

By MATHEA FALCO

Before Americans rush to condemn Colombia's President César Gaviria Trujillo—as U.S. drug czar Bob Martinez seems to be doing—for making a deal with Medellin drug lord Pablo Escobar, they should at least suspend judgment until all the details of the arrangement become known.

Escobar, who surrendered to Colombian authorities last Wednesday, is in a jail near Medellin designed and presumably paid for by him. Friends and family have free access and his security is assured as much by his own bodyguards as by the police.

This follows years of violence where Escobar and the Medellin cartel amassed billions of dollars and were responsible for killing thousands of Colombians. In the past decade, violent deaths in Colombia have exceeded 20,000, with 18,000 in Medellin alone, according to Colombian human-rights procurator Jaime Cordoba Triviño. The slain include Cabinet ministers, Supreme Court justices, law-enforcement officials and prominent journalists.

Against this background, it helps to remember that 90% of Colombia's estimated $2 billion to $3 billion in cocaine exports is consumed in the United States. Without the American market, the Colombian drug trade, and the violence and huge profits associated with it, would never have grown to its current size. Yet American assistance to Colombia to combat the cocaine traffic amounted to only $85 million last year, while Washington has largely ignored Bogota's requests for lower U.S. tariffs on its principal legal exports—coffee (worth as much as $2 billion a year) and cut flowers (up to $200 million a year).

Gaviria, elected in 1990 after three of the presidential candidates, including front-runner Luis Carlos Galan, were assassinated by drug lords, faced an impossible choice: either preside over a deepening cycle of violence and corruption with no end in sight, or try to reach some form of accommodation with the leading drug traffickers. Americans should at least understand Gaviria's reasoning for seeking a negotiated accommodation, even if it is still premature to condone the agreement.

It is one measure of the Colombian government's effectiveness in pursuing the war against the drug cartel that leaders like Escobar have come to feel they need government protection. Moreover, much of the recent anti-government terrorism was organized by the self-styled "extraditables," the top drug lords who faced extradition to the United States under the terms of a 1980 treaty between the two countries.

As a candidate, Gaviria announced that he favored repeal of the treaty if the principal drug traffickers would turn themselves in. The Parliament has just repealed the extradition treaty, which never had popular support. Although two dozen Colombians were sent to the United States for trial under the terms of the treaty, only three have been extradited since late 1989 when the United States seized Manuel Noriega in Panama and forced him to stand trial in Miami—a move widely condemned in Colombia and much of the rest of Latin America.

> **'Gaviria . . . faced an impossible choice: either preside over a deepening cycle of violence and corruption with no end in sight, or try to reach some form of accommodation.'**

Any final judgment of the success and fairness of the Garviria-Escobar pact will depend mainly on two factors:

—Will the Medellin cartel close down even if this means allowing them to transfer much of their illicit gains into legitimate business operations and being spared heavy jail terms? Heavy fines on Escobar and his associates would at least reduce their financial benefits from the arrangement.

—After dealing with Escobar, will Gaviria move to force the Cali cartel, Colombia's second-largest drug ring, and lesser traffickers to accept similar terms? Unless virtually all of the Colombian drug operations are put out of business, the Escobar arrest will have little effect on cocaine prices in the United States.

Although such actions would not signal a victory against the Colombian drug cartels, they might provide a basis for compromise preferable to prolonging the murderous status quo indefinitely.

Neither the Colombian government nor the traffickers were likely to prevail militarily anytime soon. Above all, neither the United States nor other drug-consuming nations has been willing to provide any of Colombia's democratically elected governments with enough resources or promises of significant reduction in cocaine demand to tip the balance in favor of Colombia's efforts.

Looking to the future, America's interest might be better served by dramatically curtailing Colombian cocaine traffic, rather than by continuing to insist, fruitlessly, that the drug lords simply be brought to justice.

It may be that the Colombian government, rather than pursuing indefinitely a murderous and unwinnable war, has found an imperfect but justifiable way out of a desperate dilemma for which it is only partially to blame.

Mathea Falco, a lawyer in New York City, was assistant secretary of state for international narcotics matters from 1977 to 1981.

377

VIOLETA CHAMORRO

A future linked to support

MANAGUA, Nicaragua

The war has stopped. Nicaragua is at peace and is promoting peace in the region. The size of our army and officer corps has been reduced by 60 percent, from 86,000 to 27,000. And recently we arrested seven Nicaraguans for their role in illegally transferring arms to the Salvadoran rebels.

After 50 years of being ruled by the Somoza family and 11 years under the Sandinistas, there is no longer any censorship in Nicaragua. There is freedom of the press and freedom of travel for Nicaraguans. Amnesty has helped heal the wounds of war and foster reconciliation. These accomplishments of my first year in office provide, I believe, the basis for taking on the immense task of reconstruction that now faces us.

At the moment, Nicaragua is one of the poorest nations in the world. On top of that, my government has inherited billions of dollars in debt from the previous Sandinista administration. Our disgrace is that its mismanagement has made us a bankrupt nation.

I have accepted these debts because I believe there is no other way to reconstruct Nicaragua economically. Who will invest here or lend to us unless we get rid of these debts? And how will we have enough economic strength to guarantee our democracy without such loans and investments?

In foreign policy, this means we want to work with any friendly countries that support the reconstruction of Nicaragua. The most pressing issue now is the $365 million in arrears we owe to the World Bank and the International Development Bank (IDB). This is crucial because we cannot obtain any further loans for development until those overdue loan payments are cleared.

Everything else depends on this first step. That is why I was very happy with my visit to Washington last week. Not only did President Bush pledge a sizable contribution toward making those loan payments — probably around $75 million — but he also agreed to use his influence with the Japanese and others to garner more assistance. And just this week, Spain, knowing the difficulties of transition to democracy, pledged $70 million to help remove our foreign debt.

The U.S. support, in particular, will be critical for us at a special meeting of World Bank and IDB donors that will convene in Paris May 15-17 to find a way to eliminate our back debts. I've placed all my hopes on that meeting, after which we may expect to see new lending — not just to the Nicaraguan government, but to private enterprise as well.

For now, we have no money. Without new loans we can do nothing. As we say in Nicaragua, which has a drenched winter and a baking hot summer, without the rains you can't plow the land.

My government has proved its economic responsibility to potential lenders. Since it was initiated on March 3, our economic stabilization program — one of the harshest in Latin America — has already eliminated hyperinflation. We devalued the cordoba by 400 percent, prohibited the Central Bank from printing new money and committed ourselves to filling the fiscal gap in our budget with external support. Inflation has dropped from 50 percent in March to 6 percent at the end of April.

Beyond the immediate debt and stabilization issues, our approach to reconstruction is characterized by very different attitudes and orientations compared to previous governments. With respect to aid donations, I insist on accountability — both to the Nicaraguan people and to the donor.

In the past, money flowed into Nicaragua from the United States or from Europe, but the people wondered where it went. Or, if they received some benefit, they didn't know who it came from.

Now, for instance, the U.S. Agency for International Development has given us a donation for the specific purpose of revamping school textbooks, from preschool to high school. Not only will the aid go accountably for the purpose it was given, but I have let people know in my speeches: "Thanks to AID, we've been able to change our schoolbooks."

The privatization of the Nicaraguan economy and the return of confiscated property are also high on the agenda of my administration. During the Sandinista government, about 50 percent of the economy became state-owned — including the large coffee, cattle and cotton industries, such as Agromax. Our intention is to return these firms to private hands.

In the next couple of weeks, I will introduce legislation in the National Assembly authorizing privatization. However, as we agreed with the Sandinistas during the election last year, land which was given to the peasants under land reform, and which they now occupy, will remain theirs.

Finally, while we don't want to abandon the idea of the nation, or national culture, we must accept the fact that small Central American countries are not economically viable units on their own. Their internal markets are too small.

That is why we have taken the lead in reviving the Central American Common Market and are seeking free-trade agreements with Mexico and Venezuela. Within the Central American Common Market, we are hoping to eliminate tariffs altogether on trade among Central Americans and to reduce tariffs on imports to the region to only 20 percent by next year.

Like all of Central America, Nicaragua must orient its economy toward exports, especially as the new North American free-trade zone takes shape. Once we rehabilitate our traditional exports, such as coffee, cotton and cattle, then we will need to diversify, including the development of industries that can process our traditional products here in Nicaragua.

During my first year as president, we have tried to erase the errors of the previous government in Nicaragua so that we can begin shaping a true democracy with a clean slate. We have been serious and responsible in this endeavor, and I think the world recognizes that we have changed.

My visit to Washington last week shows that we now have good relations with the United States. King Juan Carlos of Spain just visited Managua last week. My tour of Europe last month convinced me that Europeans, too, see a new Nicaragua. With that kind of support, and with the new atmosphere of peace at home, I am confident we will be able to "plow the land" once again in my country.

Violeta Barrios de Chamorro is president of Nicaragua. This month marks the first anniversary of her presidency. © 1991, New Perspectives Quarterly. Distributed by Los Angeles Times Syndicate.

275

31